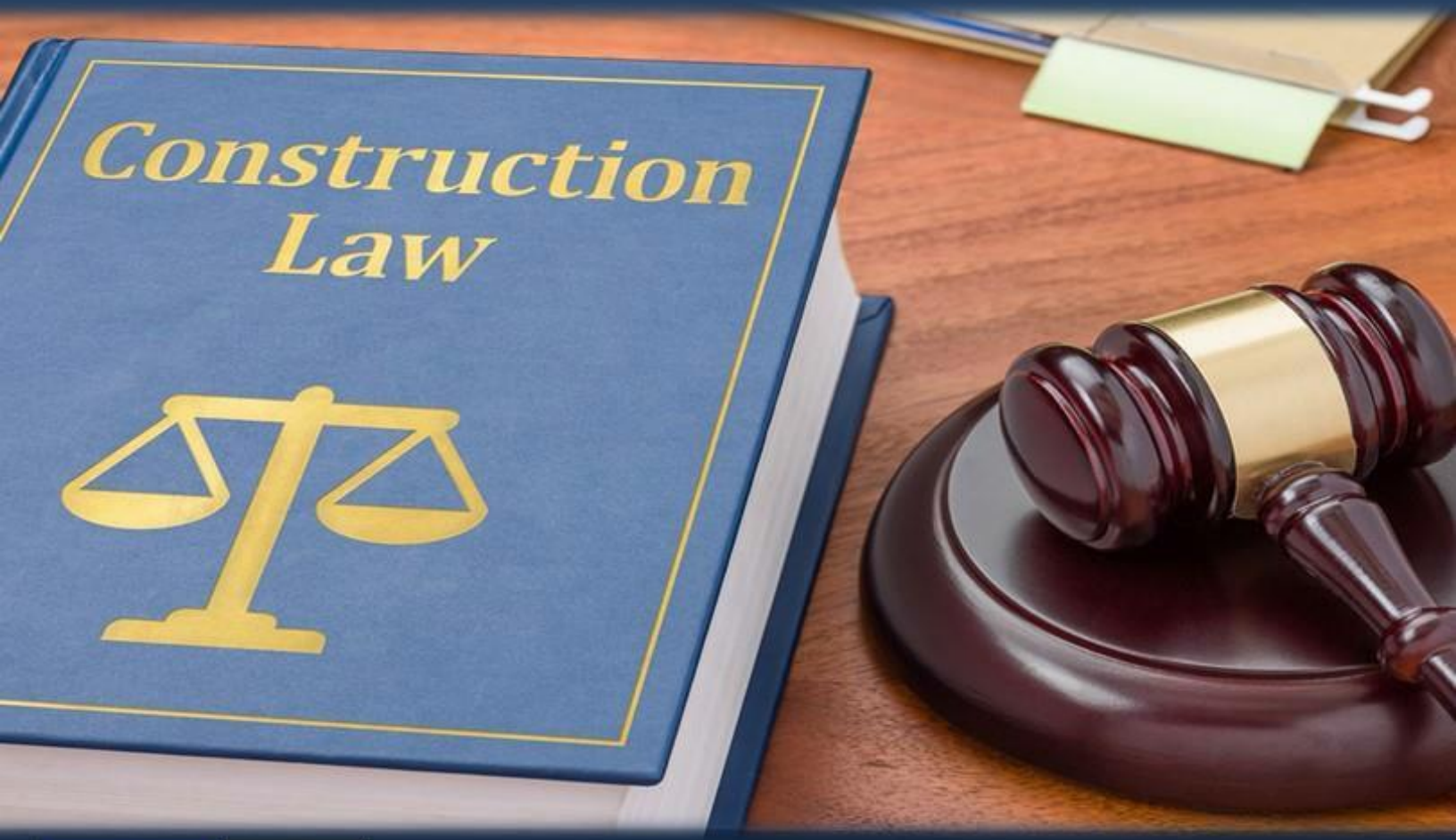
THE BENEFITS OF

Alternative Dispute Resolution

for

Resolving Construction Disputes



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DISPUTE RESOLUTION SECTION

April 2011

"Disputes arise across a broad spectrum of relationships and substantive areas of the law. Alternatives to litigation may best serve client needs for resolving many of these disputes. The NYSBA Dispute Resolution Section has prepared a series of White Papers to set forth some of the special advantages of mediation and arbitration in the various contexts in which disputes commonly arise."

Edna Sussman, Chair, NYSBA Dispute Resolution Section
David Singer, Chair, White Paper Subcommittee

THE BENEFITS OF ALTERNATVE DISPUTE RESOLUTION FOR RESOLVING CONSTRUCTION DISPUTES

By John Rusk, Walter Breakell, Esq., Amy K. Eckman, Esq.

"Traditional litigation is a mistake that must be corrected. For some disputes trials will be the only means, but for many claims trial by adversarial contest must in time go the way of the ancient trial by battle... Our system is too costly, too painful, too destructive, too inefficient for really civilized people." Chief Justice Warren E. Burger of the U.S. Supreme Court

Any litigator will attest that litigation has become a lengthy and expensive proposition. It is a stressful process that destroys relationships. As some disputes will inevitably arise, lawyers seeking to best serve their clients must consider forms of alternative dispute resolution ("ADR" or "dispute resolution") which can avoid much of the delay, expense and disruption of traditional litigation. Mediation and arbitration, both of which are responsive to party needs in a way that is not possible in a court proceeding, are two of the most frequently utilized forms of dispute resolution.

THE BENEFITS OF ALTERNATIVE DISPUTE RESOLUTION FOR RESOLVING CONSTRUCTION DISPUTES

The construction industry involves coordination of many different parties with different contractual relationships, interests, and time frames for performance. Owners, contractors, construction managers, subcontractors, material suppliers, design professionals all must coordinate to achieve the final goal, but along the way disputes can easily arise. Arbitration and mediation can be effective means of resolving disputes expeditiously and cost-effectively.

Mediation and arbitration are no longer *alternate* dispute resolution mechanisms but have become common in the resolution of commercial and non-commercial disputes between and among business entities and/or individuals. Mediation and arbitration are routinely incorporated into construction contracts as the method of choice for resolving disputes that may arise in the future. They are also routinely used after problems arise and the parties are seeking an appropriate means to resolve their disputes.

This white paper provides an overview of the benefits of mediation and arbitration generally and then addresses a number of issues specific to the construction industry.

I. Mediation

> ***"Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often areal loser -- in fees, and expenses, and waste of Time." Abraham Lincoln***

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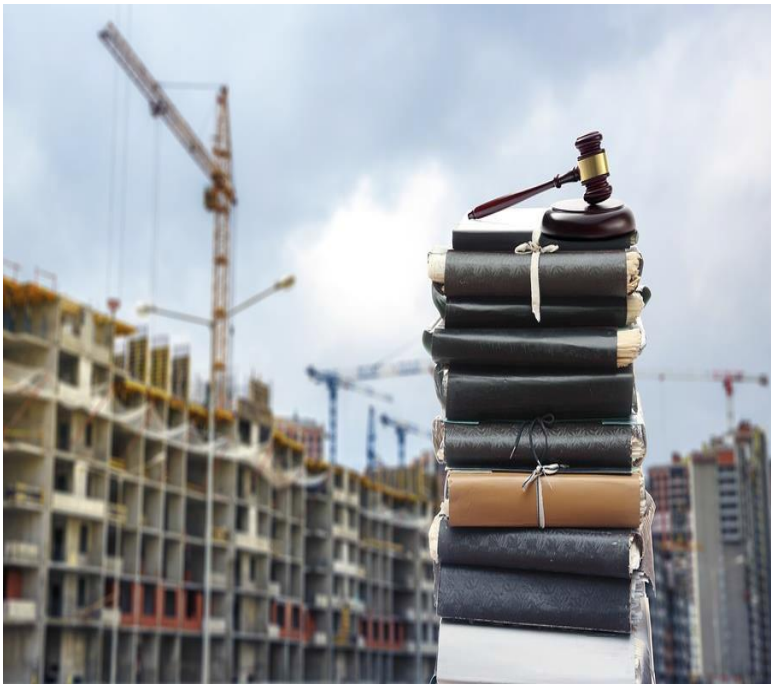

Mediation is the process in which parties engage a neutral third person to work with them to facilitate the resolution of a dispute. The growth of mediation over the past fifteen years has been exponential, a tribute to the success of the process. User satisfaction is high as parties retain control and tailor their own solution in a less confrontational setting that preserves relationships and results in a win/win instead of a win/lose. While not every case can be settled, an effort to mediate is appropriate in virtually any subject matter and any area of the law. The advantages of mediation include the following:

1. ***Mediation Works.*** Statistics have shown that mediation is a highly effective mechanism for resolving disputes. The rate of success through mediation is very high. For example, the mediation office of the U.S. District Court for the Southern District of New York reports that over 90 percent of its cases settle in mediation. Most cases in mediation settle long before the traditional "courthouse steps" at a significant saving of cost and time for the parties.

2. ***Control by the Parties.*** Each dispute is unique, and the parties have the opportunity to design their own unique approach and structure for each mediation. They can select a mediator of their choice who has the experience and knowledge they require, and, with the help of the experienced mediator, plan how the mediation should proceed and decide what approaches make sense during the mediation itself.

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3. ***The Mediator plays a crucial role***. The mediator's goal is to help the parties settle their differences in a manner that meets their needs, and is preferable to the litigation alternative. An experienced mediator can serve as a sounding board, help identify and frame the relevant interests and issues of the parties, help the parties test their case and quantify the risk/reward of pursuing the matter, if asked provide a helpful and objective analysis of the merits to each of the parties, foster and even suggest creative solutions, and identify and assist in solving impediments to settlement. This is often accomplished by meeting with parties separately, as well as in a group, so that participants can speak with total candor during the mediation process. The mediator can also provide the persistence that is often necessary to help parties reach a resolution.

4. ***Opportunity to Listen and be Heard.*** Parties to mediation have the opportunity to air their views and positions directly, in the presence of their adversaries. The process can thus provide a catharsis for the parties that can engender a willingness to resolve differences between them. Moreover, since they are heard in the presence of a neutral authority figure, the parties often feel that they have had "their day in court."

5. ***Mediation Helps In Complicated Cases***. When the facts and/or legal issues are particularly complicated, it can be difficult to sort them out through direct negotiations, or during trial. In mediation, in contrast, there is an opportunity to break down the facts and issues into smaller components, enabling the parties to separate the matters that they agree upon and those that they do not yet agree upon. The mediator can be indispensable to this process by separating, organizing, simplifying and addressing relevant issues.

6. ***Mediation Can Save An Existing Relationship.*** The litigation process can be very stressful, time consuming, costly and often personally painful. At the end of litigation, the parties are often unable to continue or restart any relationship. In contrast, in mediation disputes -- such as those between an employer and employee or partners in a business -- can be resolved in manner that saves a business or personal relationship that; ultimately, the parties would prefer to save.

7. ***Expeditious Resolution.*** The mediation can take place at any time. Since mediation can be conducted at the earliest stages of a dispute, the parties avoid the potentially enormous distraction from and disruption of one's business and the upset in one's personal life that commonly results from protracted litigation.

8. ***Reduced Cost.*** By resolving disputes earlier rather than later the parties can save tremendous sums in attorney's fees, court costs and related expenses.

9. ***Lessens the Emotional Burden.*** Since mediation can be conducted sooner, more quickly, less expensively and in a less adversarial manner, there typically is much less of an emotional burden on the individuals involved than proceeding in a burdensome and stressful trial. Furthermore, proceeding through trial may involve publicly reliving a particularly unpleasant experience or exposing an unfavorable business action which gave rise to the dispute. This is avoided in mediation.

10. Confidential Process and Result. Mediation is conducted in private -- only the mediator, the parties and their representatives participate. The mediator is generally bound not to divulge any information disclosed in the mediation. Confidentiality agreements are often entered into to reinforce the confidentiality of the mediation. Moreover, the parties may agree to keep their dispute and the nature of the settlement confidential when the matter is resolved.

11. ***Avoiding the Uncertainty of a Litigated Outcome.*** Resolution during mediation avoids the inherently uncertain outcome of litigation and enables the parties to control the outcome. Recent studies have confirmed the wisdom of mediated solutions as the predictive abilities of parties and their counsel are unclear at best. Attorney advocates may suffer from "advocacy bias" -- they come to believe in and overvalue the strength of their client's case.

> In an analysis of 2,054 cases that went to trial from 2002 to 2005, plaintiffs realized smaller recoveries than the settlement offered in 61% of cases. While defendants made the wrong decision by proceeding to trial far less often -- in 24% of cases -- they suffered a greater cost -- an average of $1.1 million -- when they did make the wrong decision. [1]

A mediator without any stake in the outcome or advocacy bias can be an effective "agent of reality" in helping the parties be realistic as to their likely litigation or arbitration alternative."

12. ***There are no "winners" or "losers."*** In mediation, the mediator has no authority to make or impose any determination on the parties. Any resolution through mediation is solely voluntary and at the discretion of the parties.

13. ***Parties Retain Their Options***. Since resolution during mediation is completely voluntary, the option to proceed thereafter to trial or arbitration is not lost in the event the mediation is not successful in resolving all matters.

14. ***The pro se litigant.*** Mediation can be very helpful when a party does not have an attorney and is therefore representing him/herself *pro se*. Court litigation can be very difficult for the *pro se* litigant who is unable to navigate the complexities of the court process and trial. With the downturn in the economy, studies showed that fewer parties are represented by counsel and that lack of representation negatively impacted the *pro se* litigant's case.[2] Dealing with a *pro se* litigant in court can also create difficult challenges for the party that is represented by counsel. However, in mediation, the parties can more easily participate in the process and benefit from the involvement of an experienced mediator.

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[1] Randall Kiser, Beyond Right and Wrong: The Power of Effective Decision Making for Attorneys and Clients, (Springer Science + Business Media LLC New York publ.) (2010)

[2] Report on the Survey of Judges on the Impact of the Economic Downturn on Representation in the Courts (Preliminary), ABA Coalition for Justice, July 12, 2010, available at http://new.abanet.org/JusticeCenter/PublicDocuments/CoalitionforJusticeSurveyReport.pdf

15. ***More creative and long-lasting solutions.*** Parties develop and create their own solutions to issues addressed in mediation and may enter into innovative, creative solutions tailored to their own particular interests rather than being limited by the remedies available in court or arbitration.[3] Because the parties are involved in crafting their own solutions, the solutions reached are more likely to be satisfying, long-lasting ones, adhered to by the parties.

II. Arbitration

> ***"Choice - the opportunity to tailor procedures to business goals and priorities- is the fundamental advantage of arbitration over litigation."***[4]

Arbitration is the process in which parties engage a neutral arbitrator or panel of three arbitrators to conduct an evidentiary hearing and render an award in connection with a dispute that has arisen between them. As arbitration is a matter of agreement between the parties, either pre-dispute in a contract as is generally the case or post dispute when a difference arises, the process can be tailored to meet the needs of the parties. With the ability to design the process and the best practices that have developed, arbitration offers many advantages including the following:

1. ***Speed and Efficiency***. Arbitration can be a far more expedited process than court litigation. Arbitrations can be commenced and concluded within months, and often in less than a year. Leading dispute resolution providers report that the median time from the filing of the demand to the award was 8 months in domestic cases and 12 month in international cases compared to a median length for civil jury trials in the U.S. District Court for the Southern District of New York of 28.4 months and through appeals in the Second Circuit many months longer.[5]

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[3] Irene C. Warshauer, *Creative Mediated Solutions*, 2 New York Dispute Resolution Lawyer n.2, p. 59-60 (Fall 2009).

[4] Thomas J. Stipanowich*, Arbitration and Choice: Taking Charge of the "New Litigation*.* 7 De Paul Bus.&Comm. L.J. 3 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1372291

[5] *Judicial Business of the United States Courts 2009* Table C-5, available at http://www.uscourts.gov/Viewer.aspx?doc=/uscourts/Statistics/FederalJudicialCaseloadStatistics/2009/tables/C05Mar09.pdf

2. ***Less Expensive.*** The arbitration process can result in substantial savings of attorney's fees, court costs and related expenses because the arbitration process generally does not include time consuming and expensive discovery that is common in courts in the United States (such as taking multiple depositions and very extensive e-discovery). Time consuming and expensive motion practice is also much less common.

3. ***More Control and Flexibility.*** In cases where arbitration is required by contract, the parties can prescribe various preferences to suit their needs, such as the number of arbitrators hearing the case, the location of the arbitration and scope of discovery. Once the arbitration is commenced, a party seeking a more streamlined and less expensive process will be better able to achieve that goal than in court where the applicable procedural and evidentiary rules govern. The parties will also have input in scheduling the hearing at a time that is convenient.

4. ***Qualified Neutral Decision Makers.*** The parties can select arbitrators with expertise and experience in the relevant subject matter or that meet other criteria that they desire. Arbitration avoids a trial where the subject matter may not be within the knowledge or experience of the judge or jury.

5. ***Arbitration is a Private Process***. Arbitrations are conducted in private. Only the arbitrators, the parties, counsel and witnesses attend the arbitration. Confidentiality of the arbitration proceedings, including sensitive testimony and documents, can be agreed to by the parties. In contrast, court proceedings are generally open to the public. In the generally less adversarial context of a private arbitration, ongoing relationships suffer less damage.

6. ***Arbitration provides Finality.*** In court proceedings, parties have the right to appeal the decision of a judge or the verdict of a jury. In contrast, the grounds for court review of an arbitration award are very limited. The award of an arbitrator is final and binding on the parties.

7. ***Special considerations for international arbitrations.*** Party selection of arbitrators ensures that a neutral decision maker rather than the home court of one party decides the case, and allows the parties to select an arbitrator with cross cultural expertise and understanding of the different relevant legal traditions. Of crucial importance also is the enforceability of arbitration awards under the New York Convention, in contrast to the much more difficult enforcement of court judgments across borders.

III. <u>Application of Mediation and Arbitration to Construction Disputes</u>

1. Benefits of the Industry Expert.

Most cases would settle if the parties shared a uniform understanding of the facts at hand. They don't settle because they don't share the same view of the facts, or even agree on the facts themselves. Their opinions of the dispute also diverge. Arbitration and Mediation offer unique opportunities to the disputants to develop an understanding of the facts of the case through a knowledgeable neutral. For the most part, arbitrators and mediators practicing in construction are either construction attorneys or "construction professionals." Construction professionals are typically either architects, engineers or contractors. Sometimes referred to as "dirty shoe" construction professionals, their understanding of construction means and methods are often advantageous to the settlement of the matter. The use of this construction expertise varies depending upon whether the matter is being resolved in arbitration or mediation.

In arbitration, the experienced construction neutral requires much less "setting the stage" for the context of the dispute. He or she will understand substantive case law in the area, for instance case law regarding change orders, betterment, "quantum meruit" claims and other specialties of construction law. These concepts will not be "new" to the arbitrator so while time may be spent on describing the application of these laws to the particular case, the arbitrator will not need to be introduced to the concepts.

An experienced construction arbitrator will also have the ability to understand complex construction disputes on a technical level. Construction disputes are usually resolved on the facts and the contract. In cases that haven't settled, there is often a disagreement on the facts and the contract. Was there a material delay by the engineer in approving shop drawings? Were the shop drawings complete? Do the disputed Change Orders actually represent work outside the scope of the contract? Were proper procedures followed during drilling? Does the contract promise payment for unanticipated sub-surface site conditions or not? Experienced arbitrators frequently commiserate that attorneys inexperienced in arbitration often spend their time proving the failings of character or ethics in the participants, while neglecting to address that which every arbitrator cares about, the facts and the contract. Construction cases do not deserve to be settled on emotion, but rather on a matrix of complex facts and contractual responsibilities.

Arbitrators, adjudicating both the facts and law, are charged with evaluating the veracity of testimony, as well as the application of law. Because construction cases may have multiple claims for amounts due, 30 change orders, a liquidated damage cross claim as well as a hundred bills from a completion contractor, arbitrators are frequently handy with a spreadsheet as they organize this complex data. Frequently, there is no clear single culprit in a construction dispute, but rather a series of competing claims and cross claims which must be carefully teased apart and then decisions rendered on each.

Together and in close consultation with their industry knowledgeable clients, counsel and the parties can choose their arbitrator, taking into consideration the unique areas of expertise helpful to understanding the particular issues. For example, it is possible to select an arbitrator for specific knowledge regarding caissons, underpinning, veneer, wood flooring, and hundreds of other specialties. An Arbitrator/Mediator with expertise in the disputed area will be able to quickly cut to the heart of the case. Because of the quasi-judicial powers granted to the arbitrator under the arbitration rules in the parties' contract, the arbitrator can pursue the truth to its reasonable conclusion.

While it may make attorneys uncomfortable, arbitrators commonly ask questions of witnesses independently in an effort to understand the technical realities of the jobsite. Developers and owners, architects, engineers, designers, contractors and subcontractors anticipate a rational decision based on the facts of the case and the applicable law. It is for this reason that a majority of construction disputes are resolved through arbitration and mediation rather than through litigation.

As a construction mediator, this insider's knowledge of construction makes it possible to identify and organize critical information quickly to help the parties understand the cause of the dispute and then to focus on its resolution. Most construction mediators are also working arbitrators and will have the evaluative skills to give reasonable forecasts of the future of the dispute if the matter fails to settle. Industry professionals, particularly, may be very helpful in exploring the facts of the case; often succeeding in bringing an understanding to what happened that wasn't available before. A competent mediator will be able to facilitate communication between the parties and their job site personnel and drill down the facts, documents and law in a manner that frequently discovers the root cause of the dispute during the mediation. This "ah ha" moment is part of the satisfaction experienced in the practice of mediation.

In each of its niches, construction cases can involve a number of contractors, subcontractors, material suppliers and design professionals. Mediation with a knowledgeable industry professional can not only resolve the dispute, but resolve the dispute with a consensus regarding the cause of the dispute that allows the parties to accept responsibility for their respective obligations.

This can lead to a resolution of the conflict which helps maintain relationships and allows companies to work together again.

2. Misconceptions of mediation/arbitration in construction Disputes

Attorneys inexperienced in arbitration continue to suspect that engaging in arbitration and mediation can be a delaying tactic. With reference to binding arbitration, it is feared that the result will be a "split the baby" outcome based on equity and not the law. It is feared that the restricted ability to challenge the decision through judicial review that a legally erroneous award will result in an injustice to their client.

Realistically, construction law is a specialized field. While there are competent construction law firms throughout the country, not all disputants have at their disposal a firm that specializes in construction law. While firms that practice construction law will almost certainly include attorneys who also serve as arbitrators and mediators, firms in related fields such as real estate which are more common may not have attorneys on their staff experienced in arbitration. Arbitration and mediation have particular rules and procedures. Attorneys representing their clients in a construction dispute, who are not completely familiar and comfortable with these rules, may be at a disadvantage when disputes are to be resolved in mediation or arbitration.

According to an American Arbitration Association study,[6] the median time for arbitrations to reach resolution for cases $75,000 to $500,000 is 10 months. According to a US District Court's Report the median time for all cases, (not broken down to $75,000 to $500,000), the median time is 23.3 months. Claims that arbitration is a delaying tactic are without merit. Likewise, the claim that mediation is a delaying tactic belies the fact that according to the same US District study[7], only 1% of cases ever go to trial. Most cases settle.

[6]Timeline in Cases Awarded in 2010 American Arbitration Association

[7]U.S. District Courts report —Median Time Intervals From Filing to Disposition of Civil Cases Terminated, by District and Method of Disposition, During the 12-Month Period Ending March 31, 2010

In addressing the widely held belief that arbitration frequently "splits the baby," a 2007 study by the AAA[8] revealed that only 7% of the studied cases were awarded in the midrange (41-60%) of their filed range with 4% of their counterclaims filed in the midrange. A 2001 study[9] yielded similar results with 9% of claims "split" or divided near the halfway mark and less than 4.5% of counterclaims. More recent informal surveys appear to confirm similar results.

It is absolutely true that arbitrations are rarely overturned by the courts. This reality frequently results in the expeditious satisfaction of an arbitration award or judgment arising out of arbitration.

3. Mediation in the Construction Industry

Mediation in the construction industry is widely utilized for simple reasons. It is the safest and most expedient way to put the parties back to work and to resolve construction disputes without destroying critical business relationships. Mediation in construction is frequently fact intensive and includes pre-mediation statements that include documentary evidence, photographs and legal arguments providing clear glimpses into the future of the dispute at trial. During construction mediations, there are frequently both fact and expert witnesses, key exhibits and discussion of points of law. So armed, the parties are typically able to resolve their dispute based on critical information unavailable at the inception or development of the dispute. These mediations are typically carried out with principals, representatives, witnesses and a mediator. Many construction disputes are settled in a single day's mediation, many others continue further negotiation using phone and email communication until such progress has been made that it is beneficial to bring the parties together to accomplish the final outcome.

Mediator skill is essential in resolving construction disputes. Mediators frequently use a variety of tools to resolve disputes. Construction mediation is often begun with careful facilitation and even the release of pent-up emotions that have stymied previous settlement efforts. Construction mediators will then often work through a fact intensive joint discussion of the case which has some similarity to an arbitration or court proceeding, and mediators often resolve the case through diplomacy and an evaluation of the case.

[8]Splitting the Baby, a New AAA Study March 9, 2007 http://www.adr.org/sp.asp?id=32004

[9] Arbitrators Do Not "Split-the-Baby": Empirical Evidence from International Business Arbitrations Stephanie E. Keer and Richard W. Naimark June 15, 2001

Construction mediators typically have extensive experience in arbitration and construction law and frequently also have experience in litigation. It is not uncommon for construction mediators to delve deeply into the facts of the case to settle, while other mediators may work the numbers in more of a facilitated negotiation. Attorneys and their clients have the opportunity to choose a neutral from this continuum that best fits their resolution strategy and the nature of their dispute.

It should be noted, however, that many experienced mediators are adept at adjusting their styles between evaluative, facilitative and transformative and one benefit of mediation is that parties and counsel can discuss the type of mediation they need up front. This is particularly of concern when evaluations are involved. Having an evaluative mediator when the parties did not expect one can derail mediation. It's a distinct advantage to use the pre-mediation discussions to talk with the mediator about the past experiences in mediation and expectations in mediation and expectations for the one at hand.

4. Arbitration in the Construction Industry

Arbitration continues to be heavily used in the construction industry as a means to resolve complex construction disputes swiftly and fairly. It is not uncommon in arbitration to have dozens of separate claims and counterclaims, all with separate issues of law, fact, and testimony. In litigation where only 1% of all claims (not just construction) make it to trial[10], there is little to stop a party from being unreasonable in their settlement position knowing full well that a third party decision maker won't be making a decision any time soon. In arbitration, approximately 36% and 39% of construction and real estate cases filed respectively reach an arbitral decision[11]; parties who feel the other side is being irrational will be able to swiftly test their theory. A case with 50 separate claims and the supporting evidence and argument to support it is beyond the reasonable capabilities of the court system. It begs for an industry expert who already understands the law, is familiar with construction and is experienced in organizing complex disputes to an orderly conclusion.

[10] U.S. District Courts report —Median Time Intervals From Filing to Disposition of Civil Cases Terminated, by District and Method of Disposition, During the 12-Month Period Ending March 31, 2010
[11] AAA statistics.

For years, the default dispute resolution method for the American Institute of Architects (AIA) was arbitration but this changed in 2007 with the AIA's revised 2007 edition of their standard documents. Without affirmative action by the drafter of the documents, the default method of dispute resolution is now litigation (followed mediation according to the AAA rules)[12].

Arbitration at the AAA is common in construction disputes and the AAA has separate Construction Industry rules.[13] This includes a "Fast Track" procedure for cases where no claim or counterclaim is more than $75,000.[14] This procedure promises the hearing will be closed within 45 days of the preliminary telephone conference with an award 14 days later and there is no discovery; parties may only exchange documents presented at the hearing. Both the time and the discovery limitations are sometimes modified, however under AAA Fast Track Construction Rule F-12 there must now be a written memorialization of the reasons for any time extension. The sole arbitrator is also paid at a reduced rate for a one day hearing.

Cases between $75,000 and $1,000,000 follow the "Regular Track" procedures which, in the interests of speed and justice, allow under AAA Construction Rule R-24 for some limited document production and identification of witnesses, with the arbitrator being authorized to resolve discovery disputes and to allow additional discovery in exceptional cases. These cases are typically also heard by a sole arbitrator. Cases over a $1,000,000 are considered Large Complex Cases (LCC), are generally heard by a panel of three arbitrators and follow the LCC rules which allow under Rule L-5 for depositions in limited cases in the discretion of the arbitrators.

Arbitrators are typically charged with making decisions on multiple claims and counterclaims. Evidence typically comes in through individual witness testimony and exhibits which the arbitrators must use to decide each of the claims. Expert witnesses are often used in larger cases and it is not unusual for experts for both sides to appear at the hearing together so that each may hear the other and then may be led in a discussion of the matter by the arbitration panel.

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[12]AIA Standard form of Agreement between Architect and Contractor for a project of a limited scope A-107 Article 21 and General Conditions for the Contract for Construction A-201 Article 15

[13]Construction Industry Arbitration Rules and Mediation Procedures American Arbitration Association October 1, 2009 http://www.adr.org/sp.asp?id=22004#fast

Site visits are not uncommon, nor are mock-ups of particular technical issues. Because of the technical issues at hand, arbitrators often ask questions during the hearings to better understand the details. As arbitrations are rarely overturned by the courts, most arbitrators feel a great pressure to get it right. As the matter previously failed to settle, there are usually unresolved issues of fact, law or the legitimacy of testimony which must be decided by the arbitrators on the way to their decision.

Awards are typically standard, non-reasoned awards, except in complex cases where under AAA Rule L-6 the arbitrators are to issue a reasoned award unless the parties agree otherwise. Awards are broken down to award specific amounts for each claim made by each side. The claim and counterclaim are then netted out against each other for a final award amount.

5. Arbitration and Mediation Hybrids in the construction Industry

There are also certain hybrid processes such as Med/Arb (a process generally in which the Mediator becomes the Arbitrator if the Mediation fails), Arb/Med (a process in which generally the Arbitrator in a case mediates the case at some point during the case, and Medaloa (a process in which the Mediator in a case that fails to settle than makes a binding choice between the two last best offers of the parties)

All of these methods have been experimented with in construction disputes but are not widely prevalent. In the case of Med/Arb, many feel that the advantages experienced through time and monetary savings, (a single process with a single dispute resolution professional) may outweigh the challenges presented to the core advantages of mediation – namely a neutral that isn't deciding the case and therefore can be told certain unfortunate truths in confidence. Many feel that Med/Arb procedure undermines the mediator's abilities resulting from the resultant lack of candor thus condemning the mediation to failure. The dispute then moves to Arbitration saddled with a mediator who's been subject to ex parte communication and disclosures of confidential information that may compromise his/her neutrality.

Arb/Med has the advantages of providing the parties with a mediated solution that is less risky and has the potential of drawing the parties back together in ongoing business relationships, but at a greater cost than simple mediation. It can also put incredible pressure on the mediation as many arbitrators feel that once they've become mediators and spoken to the parties individually and expressed their thoughts on the case, they are no longer able to continue the arbitration and the time expense of the arbitration must be started again with a new Arbitrator if the mediation fails, putting potentially undue hardship on the party with less deep pockets.

Another hybrid dispute resolution procedure is one where the arbitrator hears all the evidence and writes the award, but rather than publishing it to the parties, the award is kept under seal during which time the parties engage in one final mediation to settle the case themselves, having now heard all the evidence. Mediation under this process, in application to construction disputes, may result in a final outcome several weeks after the last arbitration hearing. This hybrid provides the parties a last chance opportunity to control their own fate before an award is issued. If the parties are able to settle the case on their own after the evidentiary hearing but before publication of the award, then the sealed award is usually destroyed, and no one will ever know what the outcome would have been.

Medaloa gives mediators a place to go after a failed mediation, but a mediator who must decide as an arbitrator must have a far greater command of the facts than a mediator who is there to facilitate agreement. The devil is frequently in the details and while the parties know the details, mediation is more time and cost efficient than arbitration because the mediator does not need to know all.

Mediations sometimes don't settle and when they don't, often the mediator and one of the parties are in agreement on the reasonableness of a settlement offer, and one of the parties doesn't agree. The party who walks away does so because he feels that for whatever reason, the other side and the mediator failed to grasp his point and wants to now prepare more fully and present his case to an arbitrator or a judge whom he believes will understand. Med/Arb and Medaloa takes away this second chance. Without it, each side must prepare for mediation with full discovery, witness preparation, etc. etc. Or risk losing its case when it lands before an uneducated decision maker. In Arb/Med, the parties must use full discovery and witness preparations again, go through the trial or arbitration, and then resort to the "cost efficient method of mediation." Many believe that economic waste alone, aside from other more esoteric issues of ex parte communication, disclosure, etc. is the reason for limited use of these hybrids in construction.

The AAA Construction Industry Arbitration Rules address the possibility of a mediation that occurs after arbitration has been commenced. Rule 10 of these Rules states:

> "(a) At any stage of the proceedings, the parties may agree to conduct a mediation conference under the AAA Construction Industry Mediation Procedures in order to facilitate settlement. Unless requested by all parties, the mediator shall not be an arbitrator appointed to the case. Should the parties jointly request that the arbitrator serve as a mediator, the arbitrator's consent to do so is also required.

(b) If the case is initially filed for arbitration and the parties subsequently agree to mediate, unless the parties agree otherwise, or in the absence of party agreement, by the decision of the arbitrator, the arbitration process shall not be stayed while the mediation is pending."

Also, Under AAA Construction LCC Rule L-3(d), absent agreement of the parties, the arbitrator shall not have served as the mediator in the mediation phase of the instant proceeding.

6. Standard Form Contracts in the Construction Industry

Because of the multiple parties and relationships involved in a construction project, successful completion of a project requires numerous entities to work cooperatively to achieve a defined goal within a set time frame and within a specified budget. While the majority of construction projects achieve these goals successfully, the industry is rife with the potential for conflict due to the technical complexity of the endeavor and the many parties with differing interests and personalities who need to work as a team.

Therefore, a number of the major trade organizations in the industry have collaborated on drafting certain form contracts that are intended to work together in defining the rights and responsibilities of the various parties involved in a construction project.

There are two major sets of standard form contract documents utilized in the construction industry, both of which issued revisions in 2007: those published by the American Institute of Architects (the "AIA"), and those developed by a consortium of 33 leading construction industry associations with members from many stakeholders in the design and the construction industry, including the Associated General Contractors of America (the "AGC"), called the ConsensusDOCS ("DOCS" being an acronym for designers, owners, contractors, and sureties).

AIA documents, in various forms, have been used extensively over the past century, but now there are two document schemes for the industry to choose from.

Dispute resolution procedures are located in Article 15 of the AIA A201-2007 General Conditions Document and Article 12 of the ConsensusDOCS 200 General Conditions Document. While there are similarities between the two document schemes, there are also differences concerning dispute resolution procedures, outlined below:

AIA A201 General Conditions 2007 Dispute Resolution Procedure:

AIA Document A201–2007 is adopted by reference in owner/architect, owner/contractor, and contractor/subcontractor agreements in the Conventional (A201) family of documents; thus, it is often called the "keystone" document. This document, A201–2007 replaces AIA Document A201–1997, which expired May 31, 2009, although there are still many construction disputes as yet unresolved that are based on the earlier documents.

Under the earlier AIA documents, dispute resolution was placed in Article 4, relating to duties of the architect, who was to be the first entity the parties should look to in the event of a dispute. However, under the 2007 AIA A201 document, dispute resolution has been moved to a new Article 15, regulating "Claims." Under this new section, the parties can elect to have all "claims" decided upon by an initial Decision Maker, commonly referred to as a "neutral." This takes the architect out of the sometimes awkward position of having to resolve initial disputes while being paid by the owner, which could lead to a suspicion of bias. The Architect remains the Initial Decision Maker if the parties do not identify a different Initial Decision Maker. If a party does not agree with the decision of the Initial Decision Maker, the party may demand mediation and then dispute resolution in the forum provided under the contract.

Regarding mediation under the AIA A201-2007, the parties, not the Architect (or Initial Decision Maker) control when parties can demand mediation**.** Under the 1997 A201, the Architect could state that the Architect's decision would be final and binding if neither party demanded mediation within 30 days of the decision. Under the 2007 A201, within 30 days after the Architect's decision, either the Owner or Contractor can attempt to make the Architect's decision final and binding by serving the other with a notice that the Architect's decision will be final and binding if the other party does not file a demand for mediation within 60 days after the initial decision.

Another significant change to the dispute resolution procedures in the 2007 AIA document is to allow greater up front flexibility by the parties in determining whether to go to litigation, mediation or arbitration. The new documents allow for selection of ADR forum as a specific election to be made by checking the appropriate box on the form, whether to choose "arbitration," "litigation," or "other." If no box is checked, the default is *litigation*, and not *arbitration*. If the parties choose binding arbitration, the parties may also choose their own provider of arbitration services.

Even in the event the parties, either consciously or simply by failure to make a choice, end up "defaulted" into litigation, the parties can always agree after execution of the contract or when the dispute arises to submit their disputes to arbitration. And, if the parties choose to arbitrate their disputes, the default selection for the arbitration forum remains the American Arbitration Association (the "AAA.") Of course, the parties may agree otherwise in their contract.

The A201-1997 expressly *prevented* a party from joining the Architect as a party in any dispute between the Owner and the Contractor. Many owners objected to these special protections afforded to the Architect. To address these concerns, the A201-2007 allows the Architect, or any other party "whose presence is required if complete relief is to be accorded in arbitration," to be joined in any dispute between the Owner and the Contractor that involves a "common question of fact or law."

Joinder and Consolidation

Because a construction project involves significant interaction among many different parties, it is important to discuss consolidation and joinder in this context.

The 2007 AIA A201 document, in contrast to previous AIA documents, on the topic of consolidation and joinder, now provides as follows:

> "§ 15.4.4 CONSOLIDATION OR JOINDER
>
> § 15.4.4.1 Either party, at its sole discretion, may consolidate an arbitration conducted under this Agreement with any other arbitration to which it is a party provided that (1) the arbitration agreement governing the other arbitration permits consolidation, (2) the arbitrations to be consolidated substantially involve common questions of law or fact, and (3) the arbitrations employ materially similar procedural rules and methods for selecting arbitrator(s).
>
> § 15.4.4.2 Either party, at its sole discretion, may include by joinder persons or entities substantially involved in a common question of law or fact whose presence is required if complete relief is to be accorded in arbitration, provided that the party sought to be joined consents in writing to such joinder. Consent to arbitration involving an additional person or entity shall not constitute consent to arbitration of any claim, dispute or other matter in question not described in the written consent.

> § 15.4.4.3 The Owner and Contractor grant to any person or entity made a party to an arbitration conducted under this Section 15.4, whether by joinder or consolidation, the same rights of joinder and consolidation as the Owner and Contractor under this Agreement."

The AAA Construction Division Rules have a unique procedure (not found in the Commercial Rules), under Rule 7, allowing for a separate arbitrator, one who is not the arbitrator on any of the pending cases, to decide issues relating to consolidation of related arbitrations or joinder of parties. The purpose of this independent consolidation/joinder arbitrator is to avoid any conflict of interest an arbitrator already appointed to a case might have.

As a general proposition, and under the AIA provisions, a person who is not party to an arbitration agreement may not be joined in the arbitration without the party's written consent. However there are some exceptions to this:

In 1995 the Second Circuit Court of Appeals set forth the circumstances, in which a nonsignatory may be joined to arbitration, stating:

> "Arbitration is contractual by nature...It does not follow, however, that under the [Federal Arbitration] Act an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision. This court has made clear that a non-signatory party may be bound to an arbitration agreement if so dictated by the ordinary principles of contract and agency." Thomson-CSF, S.A. v American Arbitration Assoc. and Evans & Sutherland Computer Corp., 63 F.3d 773, 766 (1995).

The court identified five principles under which a non-signatory can be bound by an arbitration agreement: Estoppel, Incorporation by Reference, Assumption, Agency, Veil Piercing/Alter Ego. Id.

Likewise, in Meyer v WMCO-GP L.L.C., 211 S.W.3d 302, 305 (Tex. 2006), the Texas Supreme Court concisely explained the doctrine of estoppel and held that any person (including a non-signatory) claiming a benefit from a contract containing an arbitration agreement is equitably estopped from refusing to arbitrate.

As a point of interest, the ConsensusDOCS 200 and 240 explicitly require joinder of all necessary parties:

> "The Owner and the Architect/Engineer agree that all parties necessary to resolve a claim shall be parties to the same dispute resolution procedure. Appropriate provisions shall be included in all other contracts relating to the Project to provide for the joinder or consolidation of such dispute resolution procedures.[15]

Without delving into a complete analysis of this topic in this white paper, suffice it to say that there are appropriate circumstances where a non-signatory may be joined in arbitration notwithstanding his or her failure to have entered into an agreement to arbitrate. This is particularly significant in the context of a construction case where there may be multiple parties whose presence may be required in arbitration in order to achieve an expedient and fair resolution.

ConsensusDOCS and Dispute Resolution

The ConsensusDOCS now include more than 90 contract agreements and forms that address all major project delivery methods, and publish the industry's first standard integrated project delivery (IPD) agreement and Building Information Modeling (BIM) document.

According to Brian Perlberg, Executive Director and Senior Counsel to ConsensusDOCS:

> "Unlike the American Institute of Architects (AIA) standard documents, which, not coincidentally, make the architect the pivotal party of all construction contracts, the ConsensusDOCS require direct party communications and emphasize dispute avoidance. The contracts attempt to build positive relations to resolve problems before they become intractable, rather than force the architect into the middle of the ring as the third-person. In addition, the owner determines if they want to pay a design professional to serve as an 'impartial' decision maker and administrative manager The ConsensusDOCS drafters see an owner not simply as a check-payer, but rather a potentially actively engaged participant, who has the most to gain or lose in the success of a completed project.[16]

[15] ConsensusDOCS 200 § 12.6, ConsensusDOCS 240, Section 9.6

[16] *Construction Litigation Reporter*Volume 30, Number 1, 2009

Article 12 of the ConsensusDOCS 200 deals with Dispute Resolution. In contrast to AIA Document A201, the ConsensusDOCS does not employ an Initial Decision Maker, but focuses on direct discussions between the Contractor and the Owner. ConsensusDOCS requires the contractor and owner, or their respective representatives, to engage in good faith direct discussions. If the parties cannot resolve the dispute within five (5) days, then the parties' senior executives must meet within five (5) days to attempt to resolve the issue. If the matter remains unresolved after fifteen (15) days from the date of the first discussion, then the parties must submit the dispute to "mitigation" or mediation, depending on their selection in the contract.

In mitigation, the parties submit the dispute to either a Project Neutral or a Dispute Review Board. After a dispute is referred to the Project Neutral/Dispute Review Board, it issues nonbinding findings within five (5) business days. If the Project Neutral/Dispute Review Board fails to issue nonbinding findings or if the matter remains unresolved after issuance of the findings, then the parties move on to either binding arbitration or litigation. It is noteworthy that Section 12.3 of ConsensusDOC 200 allows for the mitigation nonbinding finding being able to be introduced as evidence at a subsequent binding adjudication of the matter[17].

If the parties are unable to resolve the dispute through direct discussions and have not selected a dispute mitigation procedure, then the dispute is submitted to mediation within thirty (30) business days of the matter first being discussed and must conclude within forty-five (45) days of the matter first being discussed. The mediation should use the current Construction Industry Mediation Rules of the AAA, or the parties may mutually agree to select another set of mediation rules[18]. Should mediation be unsuccessful, then the parties may pursue arbitration or litigation. If arbitration is selected, the AAA rules in effect at the time of the proceedings are used as the procedure for the arbitration.

One important distinction between the AIA and ConsensusDOCS on the topic of arbitration or litigation is worth mentioning: referring to both arbitration and litigation, the ConsensusDOCS 200, Section 12.5.1 states that "(t)he costs of any binding dispute resolution processes shall be borne by the non-prevailing Party, as determined by the adjudicator of the dispute." "Costs" are not expressly defined, but it appears that this provision requires that the loser pay the winner's attorney's fees.

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17 ConsensusDOCS 200 Section 12.3

18 ConsensusDOCS 200 Section 12.4

19 ConsensusDOCS 200:

§6†.9 BINDING DI"PUTE 'E"OLUTION If the matter is unresolved after submission of the matter to a mitigation procedure or to mediation, the Parties shall submit the matter to the binding dispute resolution procedure designated herein. (Designate only one:) Arbitration using the current Construction Arbitration Rules of the American

7. Preserving mechanics' lien rights in arbitration

The ability to file a Mechanics lien as security for unpaid labor and material utilized on a project is a security mechanism which is unique to the construction industry.

In New York the courts have held that an arbitrator's jurisdiction to adjudicate disputes does not extend to granting of a Mechanics Lien foreclosure relief. However an Arbitrator's factual and legal award on the underlying facts upon which the Mechanics Lien is premised, may be found determinative of the facts and law in a Mechanic Lien Foreclosure Action thus providing for an opportunity to apply for Summary Judgment.

There have also been efforts to issue a Demand to Foreclose a Lien in Supreme Court under the Lien Law in order to preclude a Lienors' ability to utilize the contractual arbitration clause for adjudication of the underlying dispute. New York Courts have allowed Lienors to commence a Lien Foreclosure proceeding as demanded but then institute a stay of proceedings until the arbitration proceedings have been concluded.

8. Expanded Role for Arbitration under 2010 Revised Prompt Pay Act in New York

On September 8, 2009, New York Gov. David Paterson signed into law amendments to the state's Prompt Payment Act (the "Prompt Pay Act") intended to create broader enforcement mechanisms for the benefit of contractors, subcontractors, suppliers and laborers. N.Y. Gen. Bus. Law § 756-a (Consol. 2010) Among other things, the revised Act broadened its applicability by reducing the minimum cost threshold for applicability from an aggregate value of $250,000 to $100,000, and it also changed certain size requirements for applicable construction contracts.

With reference to arbitration, the amendments allow a contractor, subcontractor or supplier to use arbitration as a permissive remedy for nonpayment. Where an owner, contractor or subcontractor does not make a timely payment, the aggrieved contractor, subcontractor or supplier can resort to binding arbitration to resolve the payment dispute. The nonpaying party can be required to participate in

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Arbitration Association or the Parties may mutually agree to select another set of arbitration rules. The administration of the arbitration shall be as mutually agreed by the Parties.

__Litigation in either the state or federal court having jurisdiction of the matter in the location of the Project.

§12.5.1 The costs of any binding dispute resolution procedures shall be borne by the non-prevailing Party, as determined by the adjudicator of the dispute."

binding arbitration under the auspices of the AAA. First, the aggrieved party must provide written notice of nonpayment and attempt to resolve the matter. If a resolution is not reached by the parties within 15 days, the contractor, subcontractor or supplier has the option of mandating expedited and binding arbitration. NY General Business Law Section 756-b (3(c) et seq.

The parties may not contract to opt out of the arbitration requirement. A provision in the parties' contract providing that arbitration is unavailable to one or both parties is void and unenforceable under NY GBL Section 757(3). Thus, a nonpaying party can now be required by statute to participate in binding arbitration under the auspices of the American Arbitration Association, even though its construction contract does not contain an arbitration provision.

9. New York Arbitration Law, CPLR Article 75

In New York, Article 75 of the Civil Practice Law and Rules governs arbitration, and the New York practitioner should review this statute when involved in arbitrations in that jurisdiction. There are certain procedural limitations contained in Article 75, for example, NY CPLR Sec.7503(c), which states "An application to stay arbitration must be made by the party served within twenty days after service upon him of the notice or demand, or he shall be so precluded." The practitioner is advised to thoroughly review CPLR Article 75 whenever involved in an applicable proceeding in New York, as there are a number of technical requirements regarding form of service, etc. that should be considered.

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