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DIRECTOR'S CORNER

JAMS GEC Group Celebrates its Second Anniversary

By PHILIP L. BRUNER, ESQ. ***Director, JAMS Global Engineering & Construction Group***

JAMS Global Engineering & Construction Group was founded on January 1, 2008. In its first 24 months, GEC has mediated or arbitrated engineering and construction cases with alleged claims and other disputes aggregating in the billions of dollars. Those claims and disputes arose on major projects both within and outside of North America, and involved numerous types of projects – power plants, ethanol plants, government court houses, justice centers, hotels, airports, oil refineries, offshore oil rigs, mill facilities and the like. Their subject matter invoked everything from scope of work, delay and disruption issues to wrongful contract terminations, liens and demands on surety performance bonds. GEC panel members were invited to provide neutral dispute resolution services because they have been recognized as among the finest and most accomplished construction law experts and dispute resolution neutrals in North America and Europe. To those who invited us to serve, we say thank you. ■

Cultural Sensitivities in International Construction Arbitration

By ROY S. MITCHELL, ESQ.

The author has often been asked how lawyers from one country can handle construction contract issues in a wide variety of foreign jurisdictions. The three key answers, of course, are that: 1) contract lawyers are particularly fortunate in that the three primary legal systems throughout the world – Common Law, Civil Code and Islamic Law countries – all have as a common denominator the sanctity of contract; different names are applied to the different approaches used in the various

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legal systems, and some significant exceptions exist, but the underlying concepts are generally quite similar; 2) construction lawyers are further fortunate in that the vast majority of major international construction contracts during the past forty years have been awarded on standard form contract terms, primarily a variation of the ubiquitous FIDIC family of contracts; and 3) dispute resolution on construction contracts has typically been via international arbitration, which tends to yield more or less consistent results, as opposed to civil lawsuits which would have involved the local court systems of many of the 193 national jurisdictions throughout the world.

However, it would be a grave mistake for international construction lawyers to believe that the above advantages translate into a uniform approach to international construction arbitration, which overrides the significant cultural differences that exist in various regions and countries throughout the world. They do not, and the international construction lawyer who fails to recognize these cultural differences will not only encounter unfortunate surprises, he or she may in fact lose cases that were otherwise winnable. It is the purpose of this paper to briefly discuss a few of the cultural differences which may create traps for the unwary in international construction arbitration.

Starting in the United States and working eastward, and with apologies to George Bernard Shaw, American litigators and British barristers are divided by a common language. Perhaps the most shocking thing to an American is that members of the various British Inns of Court are not considered to be partners with each other, but rather a series of individual barristers supported by a common infrastructure. Thus, it is not uncommon to see one of the Panel of Arbitrators coming from the same Inn as opposing counsel. Countless court challenges to this system, not only in the U.K. but also in France and elsewhere, alleging bias or the appearance of bias such as to disqualify the Panel member from serving have been unavailing.

In addition, British barristers, whether serving as advocates or Panel members, tend to be more formalistic and somewhat less liberal in their approaches to arbitration than their American counterparts. The concept of constructive acceleration, for example, although widely argued and accepted in the United States for more than forty years, still has not been blessed by any court rulings in the U.K. The closest approach occurred when a Panel ruling allowing this concept was challenged on a variety of other issues and the Court decided that case on those issues without commenting either favorably or unfavorably on the Panel's ruling accepting a constructive acceleration argument.

Similarly, British barristers tend to expect, and to follow, a more structured approach to causation evidence in their cases. As an example, in October 2002, the Society of Construction Law in the U.K. issued a Delay and Disruption Protocol providing "useful guidance on some of the common issues that arise on construction contracts." This is widely accepted as the leading thinking in time extension analyses, and failure to be aware of this document in the critical areas of delay and disruption claims can result in a British Panel Chairman or member being

British barristers, whether serving as advocates or Panel members, tend to be more formalistic and somewhat less liberal in their approaches to arbitration than their American counterparts.

[In] the Middle East in countries in which Islamic law is the norm, the most difficult concept for a western attorney to grasp is the extent to which religion is the overriding consideration even in secular matters.

highly critical of a parties' approach to proving its case. On the concept of constructive acceleration mentioned above, paragraph 1.18.5 of the Protocol states that:

> *"Where a Contractor accelerates of its own accord, it is not entitled to compensation. If it accelerates as a result of not receiving an EOT that it considers to be due to it, it is not recommended that a claim for so-called constructive acceleration (emphasis in original) be made. Instead, prior to any acceleration measures, steps should be taken by either party to have the dispute or difference about entitlement to EOT resolved in accordance with the dispute resolution procedures applicable to the contract."*

Finally, there are significant differences between the U.S. and the U.K. as to how expert witnesses are allowed to present their testimony. In America, experts are rather typically thought of as hired guns for the side that employed them and it is not unusual for them to virtually become advocates for their side. In the U.K. that is not allowed. Experts there are considered primarily to be for the benefit of the Panel to explain how technical matters are handled, and under many circumstances are prohibited even from stating conclusions that might be considered adversarial. Indeed, in the U.K. experts are effectively officers of the court or tribunal and are required to make a statement to that effect, e.g.:

> *Duty & Statement of Proof – Due to the nature of my assignment I have an overriding duty to the Court or formal body that has proper jurisdiction over this dispute. I confirm that insofar as the facts stated in my report are within my own knowledge I have made clear which they are and I believe them to be true, and that the opinions I have expressed represent my true and complete professional opinion.*

As one continues the journey from west to east around the globe, the author has found that there is a transition from relative liberalism, i.e., allowing contractors to recover for claims on far broader theories, to greater and greater conservatism, i.e., not allowing contractor recovery unless there is a specific clause in the contract explicitly allowing it. There is likewise an ever growing discomfort with the typical reliance of American litigators on wide ranging discovery, heavy reliance on oral testimony and extensive use of cross examination as a means of ascertaining the truth.

Continental Europe consists entirely of Civil Code countries and here the legal systems and culture change from the adversarial approach utilized in Common Law jurisdictions to an inquisitorial approach. Written submissions rather than oral testimony are relied upon heavily, cross examination is acceptable to a far lesser degree, and discovery in the American sense is virtually unknown. Written direct testimony, rather than oral, is the norm. The Panel can be expected to take a far more active role in questioning witnesses, hearing dialogue between the Panel and counsel with limited participation by witnesses also can be expected, and the use of experts selected by the Panel becomes common.

Detailed written statements of claim rather than bare bones pleadings are utilized, and direct testimony is almost always submitted in writing. Perhaps the most jarring to a Common Law litigator is the extent to

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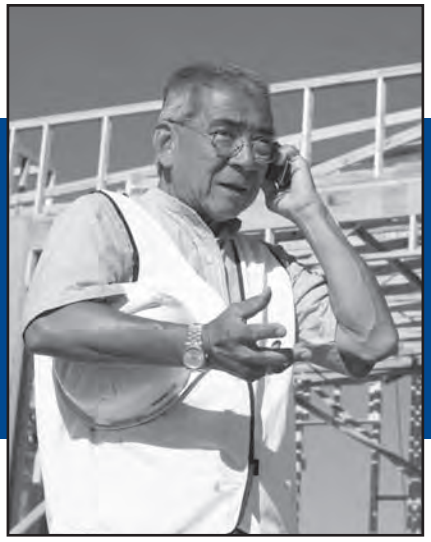
which Panel members and counsel dialogue take the place of oral testimony. Representations by counsel rather than testimony by a witness are used extensively. To the extent that oral testimony is utilized, the Panel often asks questions of the witness before counsel is allowed to do so. Equally surprising is that any documentary discovery desired must be by specific designation of the document sought. American style fishing expeditions are totally unacceptable. Another cultural difference is that the Panel will often require expert witnesses of the parties to be available simultaneously for questioning, the so-called confrontation approach, rather than separately being presented within each party's case. As is obvious from the above limited examples, an American litigator commencing arbitration without awareness of these differences will be severely disadvantaged.



Continuing eastward to countries in the Middle East in which Islamic law is the norm, the most difficult concept for a western attorney to grasp is the extent to which religion is the overriding consideration even in secular matters. This can be true even in those countries which also have a Civil Code or a Civil Procedure that provide for arbitration, as is now rather normal, since Sharia'h concepts may trump such codes in ways unexpected by a western litigator. There is also somewhat of a distrust of fully western Tribunals, which are not considered sufficiently appreciative of local circumstances and conditions, plus the historical residuum of ill feelings remaining from having been taken advantage of by western countries during both colonial and more recent periods. This is aggravated by the fact that many of the Middle Eastern countries are monarchies and that most of the major projects are undertaken by government agencies or other entities with heavy government involvement. They are simply not used to having their authority questioned or to disputes against government entities in their countries. In support of their position, they cite ICC and other statistics during the past 30 to 40 years which document that 1) these entities are almost always the Respondents in most international arbitrations in this part of the world, and 2) Claimants have won an overwhelming number of these arbitrations.

> [In] Asia, the primary cultural difference is the well known aversion to confrontation and the desire to reach a mutual agreement unless it is absolutely impossible to do so. Thus, westernized arbitration concepts are not as culturally acceptable as Mediation or Conciliation.

Unfortunately, this perceived disadvantage is often attempted to be overcome by nominating a local person to be a Panel member but the two remaining members, including the Chairman, are Europeans or, to a lesser extent, Americans. The local nominees may have little or no experience in international arbitration and may be selected with an expectation that they will serve in some manner partial to the Respondent's position. Such a person is likely to be marginalized by the two remaining Panel members and thus be unable to become an effective Panel member. A more sophisticated response has been the recent growth of arbitration centers within this area that are increasingly being named in construction contracts rather than utilizing ICC or other western centers and rules.

Another cultural difference is a tendency in some countries in the Middle East to distinguish between official contracts or documents which they consider binding on them to "unofficial" contracts or documents which they do not. This is a foreign concept to most western Tribunals and most often works to the detriment of the Respondent. The author experienced this problem in an UNCITRAL arbitration between a European Claimant and Middle Eastern Respondent in which the General Counsel of the Respondent insisted in testifying that the various "unofficial" letters bearing his signature in

which he admitted Claimant's position to be valid should have no bearing on the case because his official letters denied this. This destroyed the credibility of both the witness and the argument in the eyes of the British and French arbitrators on the Panel and the Respondent lost the case.

Finally, some of the more conservative Middle Eastern countries such as Saudi Arabia have the concept that employees of a party cannot testify because their testimony would inherently not be credible and thus, that such testimony should come only from others. Some may also entertain the concept that Muslim witnesses or entities are inherently more credible than non-Muslims. These ideas can completely derail a western litigator who is unaware of these cultural considerations.

Moving now to Asia, the primary cultural difference is the well known aversion to confrontation and the desire to reach a mutual agreement unless it is absolutely impossible to do so. Thus, westernized arbitration concepts are not as culturally acceptable as mediation or conciliation. This, coupled with an emphasis on technical matters to the exclusion of contractual terms, often creates difficulties. In one arbitration, for example, the Claimant went to great lengths to explain the technical difficulties of the problem and ignored the timeliness and contract administration requirements of the contract. Because this was a delay claim involving liquidated damages, the western Arbitrator hearing the case did not feel he was getting answers to various questions asked. Even more telling was a situation in which, under the local rules, dispute resolution started as conciliation but then shifted to arbitration if the conciliation failed. During the latter process, the Panel expressed its strong aversion to any type of cross examination and made it clear that to continue to do so would result in an award to the other side. An American litigator crosses such boundaries at his or her own risk.

Many other examples from the author's experience could be provided but space prohibits doing so, and this paper is intended only to be a generalized discussion of these issues. There are many excellent sources for more detailed information on this subject to which the reader is directed. The primary point, however, is that Arbitrators, like counsel and the parties involved, tend to follow methods and procedures with which they are familiar, and American litigators who are not aware of this predilection do a disservice to themselves and their clients. ■

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ADR and the Reluctant Surety

By BRUCE REYNOLDS and SHARON VOGEL

In the turbulent economic environment of the current recession, surety claims are on the increase as contractor insolvencies rise. More defaulted contract means that, although most such troubled projects will be completed without disputes as to liability between surety and obligee, a certain proportion of surety claims will be denied, resulting in significant disputes. Traditionally, such circumstances have triggered a significant upsurge in litigation and reported decisions in regards to surety bond claims. Will that be the case over the coming years, or will the surety community avail itself of the ADR mechanisms that have taken hold in the market since the last significant recession? Historically, sureties have displayed a reluctance to participate in certain ADR processes, particularly arbitration; however, public policy considerations militating in favor of such processes may influence the courts to compel all parties to a construction dispute, including sureties, to participate in ADR.

Clearly, participation in mediation

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in relation to the potential resolution of litigation in respect of bond claims is a less contentious issue for sureties than participation in arbitration, given the non-binding nature of the process and the potential advantages of mediation from a surety's perspective. Surety disputes generally involve numerous parties and many documents, such that an early mediation can be cost effective if it results in a settlement of the litigation. Perhaps most importantly, participating in mediation allows the parties to select an expert construction mediator with experience in addressing the issues in dispute. As well, participating in a mediation allows the parties to disclose facts on a without prejudice basis and the mediated settlement is private. Furthermore, given that mediation is conciliatory in nature, mediation may assist in preserving business relationships and, if proving unsuccessful, can simply be brought to an end unilaterally inasmuch as it is non-binding.

Where the proverbial rubber hits the road in relation to a surety's participation in ADR is with respect to whether or not a surety is bound to participate in a mandatory arbitration under the bonded construction contract between the principal and the obligee. In this regard, almost all performance bonds and labor and material payment bonds contain language which incorporate by reference the contract(s) between the obligee (owner) and the principal (contractor). Given the mandatory arbitration provisions that are now prevalent in construction contracts, the issue squarely arises as to whether or not a surety will be compelled to submit to arbitration where the underlying construction contract contains a mandatory arbitration clause. Canada and the United States have adopted different approaches. In Canada, the Courts have not forced sureties to participate in an arbitration between an obligee and a principal, although in practical terms, if a surety does not participate, there is a risk that a companion bond action will be stayed and/or that the surety will be bound by the findings in the arbitration. For example, in the frequently cited Alberta Queen's Bench decision in *Kvaerner Enviropower Inc. v. Tanar Industries Ltd.* [1994] 9 W.W.R. 228 (Alta.) the Court addressed an application for a stay of an action and a referral to arbitration in a case involving a surety. The application was brought by Kvaerner Enviropower Inc. ("Kvaerner") which had agreed to construct a wood burning facility in Whitecourt, Alberta. Kvaerner had entered into a subcontract with Tanar Industries Ltd. ("Tanar") to provide labor and materials for mechanical erection and piping. Tanar had obtained a performance bond and a labor and material payment bond from Sovereign General Insurance Company ("Sovereign"). Tanar failed to pay some of its subcontractors and suppliers on the project. Sovereign paid claims under the labor and material payment bond and obtained assignments of all of the rights of the subcontractors and suppliers, including their lien rights. Kvaerner sought to stay the lien actions and refer the matter to arbitration based on the mandatory arbitration provision in the subcontract between Tanar and Kvaerner.

> *"Given the mandatory arbitration provisions that are now prevalent in construction contracts, the issue squarely arises as to whether or not a surety will be compelled to submit to arbitration where the underlying construction contract contains a mandatory arbitration clause."*

After a careful review of the relevant provisions of the construction contract, the Court concluded that Kvaerner and Tanar had agreed by contract to submit "any controversy" between them to arbitration and that the issues presented constituted "controversies," as they were "differences arising out of commercial, legal relationships, and in the context of the contract at bar." However, with respect to Sovereign's participation in the arbitration, the Court accepted the argument that "Sovereign has not agreed to arbitrate its differences with Kvaerner and therefore ought not be compelled to arbitrate those differences." The Court found that the incorporation by reference provision in the bond could not be interpreted as an agreement to submit issues between Kvaerner and Sovereign to arbitration. The Court therefore refused Kvaerner's application for an order referring differences between it and Sovereign to arbitration. The Court did state that the incorporation by reference language in the performance bond

"may mean, and indeed probably does mean, that an arbitration award on issues between Kvaerner and Tanar will bind Sovereign **as to the amounts found by the arbitrators**." [emphasis added] The Court also stayed Sovereign's lien action until the resolution of the arbitration on the basis that the surety's lien claims were included in Tanar's lien and that security for the one was security for the others.

The Alberta Court of Appeal dismissed the appeals of both parties, including Sovereign's appeal of the stay. The Court noted that the arbitration was to take place within a reasonable timeframe and that Sovereign was at liberty, if there was any delay or new problem, to apply to lift or vary the terms of the stay. The Court of Appeal stated that it "did not understand that the learned chambers judge has said Sovereign is in any way bound by the results of the arbitration." This comment is interesting in light of the chambers judge's comments about Sovereign being bound by the "amounts found by the arbitrators."

Subsequently, the Nova Scotia Supreme Court followed Kvaerner in its decision in *Meridian Construction Inc., Re.* (2006), 16 C.B.R. (5th) 219, 240 N.S.R. (2d) 236,763 A.P.R. 236. The facts of Meridian involved an application by Shannex Inc. ("Shannex") pursuant to Section 69.4 of the Bankruptcy and Insolvency Act ("BIA") to lift a stay of proceedings in relation to a bankrupt corporation, Meridian Contracting Inc. ("Meridian") with respect to an ongoing arbitration between Shannex and Meridian. St. Paul Guarantee Insurance Company ("St. Paul"), which had been called upon under various bonds issued on Meridian projects, was aware of the arbitration between Shannex and Meridian and was funding Meridian's legal costs. However, St. Paul denied that it had participated in the arbitration.

The arbitration had been underway when an Order was made placing Meridian into bankruptcy. The Court concluded that there was no compelling reason to exercise its discretion to lift the automatic stay of proceedings against Meridian, noting that Shannex was still free to pursue its claim against St. Paul in a companion performance bond action. In support of the conclusion that the arbitration award would not be binding on the surety in any event, the Court pointed out that an arbitration award only binds the parties to the arbitration agreement pursuant to which it is made. The Court also stated that there was no evidence before it that, apart from funding legal counsel, St. Paul had directed the conduct of the arbitration and that "using the arbitration as a 'platform' for the claim against St. Paul is a precarious strategy." Allowing the arbitration to proceed would raise the potential for inconsistent findings in the arbitration and performance bond actions.

Conversely, a trend has developed in U.S. caselaw over the last 25 years supporting the proposition that a surety is committed to arbitration by incorporation in its performance bond of a contract containing a binding arbitration clause.

In the 1966 decision of *Transamerica Insurance Co. v. Yonkers Contracting Company, Inc.* 49 Misc. 2d 512; 267 N.Y.S.2d 669; (1966) N.Y. Dist. LEXIS 2333 the successor to a surety on a performance bond obtained by a subcontractor was successful in seeking to stay an arbitration demanded by the general contractor between the contractor and predecessor surety. The Court found that the successor surety was not a party to the original arbitration clause contained in the subcontract and evidenced no intention to be included as a party thereto. The incorporation by reference in the performance bond of the bonded subcontract was not found to be sufficient to require the surety to submit to arbitration. At that time, the prevailing line of cases led to the conclusion that arbitration could not be judicially mandated, unless by clear and unequivocal language the parties involved had agreed thereto and an arbitration agreement would not be extended by construction or by implication.

Similarly, in 1981, the United States District Court for the Southern district of Ohio Eastern Division in *Windowmaster Corp. v. B.G. Danis Company* 511 F. Supp. 157; 1981 U.S. Dist. LEXIS 12958; 23 Ohio Op. 3d 83 found that a surety was not bound by an agreement to arbitrate entered into between its principal and a third party because the surety was not a party to the contract. There the Court referred to the general principle of law that parties cannot be required to submit to arbitration any dispute which they have not agreed to so submit.

However, the 1984 decision in *Exchange Mutual Insurance Company v. Haskell* (1984), 742 F.2d 274 marked the beginning of a new trend. In this case, the U.S. Court of Appeals for the Sixth Circuit compelled a surety to submit to arbitration. The case concerned an agreement to build a shopping center. Haskell Company ("Haskell") was the prime contractor

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and subcontracted a portion of the work to Rogersville Co. ("Rogersville"), which agreed to install the parking lot for the shopping centre. Rogersville obtained a performance bond through Exchange Mutual Insurance Company ("Exchange Mutual"). A dispute arose and Haskell made a claim under the performance bond. Haskell initiated arbitration proceedings against Exchange Mutual. Exchange Mutual obtained an order to restrain arbitration. The U.S. District Court subsequently dissolved the temporary restraining order and ordered the action to proceed to arbitration. The Court of Appeals agreed with the District Court. There, the Court found that although Exchange Mutual was not a signatory to the primary construction contract, the Rogersville performance bond incorporated by reference the terms of the underlying subcontract, and the subcontract, in turn, incorporated by reference the terms of the general contract, which imposed an obligation to submit all unresolved disputes to arbitration. The Court rejected Exchange Mutual's argument that it was not a signatory to the general contract which contained the arbitration clause.

A review of subsequent U.S. decisions indicates that the eleventh, sixth, fifth, third, second and first circuits of the U.S. Courts of Appeal and several District Courts have required sureties to arbitrate. Federal policy in the U.S. favors arbitration and requires a liberal construction of arbitration clauses (See *Harford Fire Insurance Company v. Latona Trucking, Inc.* 984 F. Supp 95; 1997 U.S. Dist. LEXIS 15375, *Commercial Union Insurance Company v. Gilbane Building Company* 992 F.2d 386; 1993 U.S. App. LEXIS 10909, and *Lee Hoffman v. Fidelity and Deposit Company of Maryland* 734 F. Supp. 192; 1990 U.S. Dist. LEXIS 4133).

Interestingly, in the 1996 case of *Aetna Casualty and Surety Company v. L'Energia* 1996 U.S. Dist. LEXIS 5732, the United States District Court for the District of Massachusetts accepted the proposition set out in Exchange Mutual that a surety, by incorporating an underlying contract containing an arbitration clause into a surety bond, has approved the arbitration clause, such that the surety must also have agreed to arbitrate its own disputes pursuant to the procedures of the arbitration clause. However, the implementation of this principle was considered problematic in this case, as both the surety and the principal wished to "take a seat at the arbitration table, or at least wished to have a say about how the seating should be done." The District Court held that under the current law, the surety presumably could be compelled to participate in some arbitration, but the Court was not convinced that it could compel the surety to participate in the filed arbitration, which was a consolidated arbitration under the AAA regarding two classes of claims, although it did stay the litigation.

> *"Canada and the United States have adopted different approaches.... [I]n contrast to the Canadian experience, it appears that American courts have developed a willingness to compel a surety's participation in arbitration based on the public policy favoring arbitration."*

For a surety, there may be advantages to participating in arbitration, for example where maintaining privacy over the ultimate ruling is important. In the U.S., a surety may favor arbitration in document intensive and factually complicated cases where an arbitrator with construction experience may be better suited to serve as a decision maker than a judge or jury who have no experience in the area. In *Buck Run Baptist Church Inc. v. Cumberland Surety Ins. Co. Inc.* 983 S.W.2d (KY. 1998) the surety actually compelled the obligee, Buck Run Baptist Church ("Buck Run"), to arbitrate under the contractual provisions between Buck Run and its general contractor. Buck Run argued that the dispute was not subject to arbitration because the performance bond was an insurance contract, rendering any dispute arising thereunder exempt from arbitration pursuant to the law of Kentucky. The performance bond clearly and specifically incorporated by reference the construction contract. The surety had stepped into the shoes of its principal and became the contractor on the job. The surety was successful in compelling Buck Run to arbitrate, as the Court held that the insurance contract exemption to arbitration did not apply.

Thus, in contrast to the Canadian experience, it appears that American courts have developed a willingness

to compel a surety's participation in arbitration based on the public policy favoring arbitration.

Given the increasing use of ADR in the current economic climate, it is likely that sureties, like other participants in the construction industry, will participate more frequently in ADR. To date, one of the most interesting issues that has arisen in this context is whether or not a surety can be compelled to arbitrate in a situation where the underlying construction contract contains an arbitration clause. In litigating this issue, much will depend on the wording of the bond and the bonded contract as well as the surrounding circumstances, but to date, the American and Canadian courts have taken significantly different approaches to this issue, with American courts showing a much greater willingness to compel sureties to arbitrate. ■

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GEC Neutrals Resolve An Array of Construction Disputes

In his Director's Column in this issue, Phil Bruner states that, since JAMS Global Engineering & Construction Group was founded 24 months ago, it has arbitrated or mediated engineering and construction cases with alleged claims aggregating in the billions of dollars.

The following represents some of the larger and more complex projects and claims which JAMS GEC neutrals have recently been helping to resolve:

- **Doug Oles, Harvey Kirsh** and **John Hinchey** arbitrated a $16 million claim of a contractor against an owner for the quantification of a termination for convenience provision in a contract for the construction of a cement mill facility in West Virginia
- **Philip Bruner** conducted an arbitration of claims aggregating $125 million arising out of the delayed completion and termination of a construction contract for the conversion of an historic Manhattan warehouse into luxury condominium units
- **Zee Claiborne, Harvey Kirsh** and **Barry Grove** arbitrated a $12 million claim of a subcontractor against a contractor relating to the fabrication and erection of structural steel racking and process equipment arising out of the construction of a gas oil hydrocracker unit for an oil refinery near Salt Lake City, Utah
- **Kenneth Gibbs** and **George Calkins** were members of an arbitration panel which was constituted to deal with a dispute between an owner, a contractor and a surety for $20 million in damages for delay, scope changes, termination and breach of contract issues arising out of the construction of a hotel in San Diego, CA
- **John Hinchey, Roy Mitchell** and **Philip Bruner** arbitrated breach of contract claims and counterclaims aggregating $30 million relating to the construction of an ethanol distillation plant in Ohio
- **Kenneth Gibbs** acted as mediator with respect to multi-party claims aggregating $35 million for delays and defective work arising out of the construction of a water treatment plant in Austin, Texas
- **Roy Mitchell** arbitrated a ship construction dispute involving issues of delays and additional costs between a prime contractor and a subcontractor under a multimillion dollar U. S. Government contract
- **Philip Bruner** and **Kenneth Gibbs** were members of an arbitration panel relating to a multi-party dispute between an owner, a contractor, a surety and subcontractors for claims aggregating $120 million for deficiencies, scope of work and breach of contract issues arising out of the construction of a courthouse in Las Vegas, Nevada

Designing a Cost-Effective Construction Arbitration

BY ZELA "ZEE" G. CLAIBORNE, ESQ.

Construction attorneys and their clients were among the first to adopt arbitration as an efficient and economical alternative to court trials. Discovery was sharply limited, the arbitrators were to issue an award no more than 30 days after the close of hearings, and finality was assured since there was no lengthy appeal. Since the 1980s, arbitration has grown in popularity and many types of businesses have been using it with increasing frequency to resolve disputes. But as arbitration has evolved, many have expressed a concern that arbitration has become increasingly cumbersome and uneconomical – just like the trials it was meant to replace.

After selecting an arbitrator or arbitration panel, counsel can begin to work with the arbitrators and opposing counsel to design a process that suits the case. Of course, arbitration is adversarial and the parties will not agree on the merits. Nevertheless, working together – even partnering – to design a suitable process is mutually advantageous. Such cooperation will save all parties time and money, while assuring that there is a full and fair hearing. A good time to open this discussion with opposing counsel is sometime before the preliminary conference when counsel and the arbitrators meet for the first time, in person or on the phone, to discuss plans for the case.

The flexibility of the process is one of arbitration's main benefits. Nonetheless, even experienced construction counsel sometimes fail to take advantage of the fact that the process can be tailored to fit the particular case.

The following are suggestions for working with arbitrators toward a fair and efficient process. All notes on the Rules refer to the new *JAMS Engineering and Construction Arbitration Rules & Procedures* effective July 15, 2009.

PREPARE A CLEAR STATEMENT OF CLAIMS

At time of filing or very early in the process, and certainly before the preliminary conference, it is important to file a statement of the case, including background facts and outlining all claims. While the damages calculations for most construction claims will not be final until the experts complete their work, the numbers can be brought up to date later. At the preliminary conference, it is a good idea to set a date for amending the claims and counterclaims to specify and quantify damages.

Lengthy litigation-style formulaic pleadings are neither required nor helpful. Claims, answering statements and counterclaims should be stated in a straightforward and concise manner to avoid confusion and wasted time at the outset of the case. What is important is that opposing counsel and the arbitration panel are clear on the claims being made so that it is possible to shape the process to the dispute at hand.

START DESIGNING THE PROCESS AT THE PRELIMINARY CONFERENCE

There is a long list of items to be discussed at the Preliminary Conference. For example, this is the time to agree on the hearing dates and location, to set a time for submitting a discovery plan, and to schedule dates for exchanging witness lists and arbitration exhibits, pre-hearing briefing, and so forth. Some of these arrangements are particularly important in laying the foundation for fair and efficient hearings. See Rule 16. The Preliminary Conference is a good time to begin a collaboration with

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the arbitrators to design an effective process.

First, set hearing dates and stick to the schedule. Arbitration hearings are best held on consecutive days. It may make sense to schedule an extra day or two just in case the hearings take more time than expected. Also, continuances can be extremely expensive. There is a huge cost involved in preparing for hearings and then having to re-mobilize at a date months later. Especially when there are three arbitrators, it may be difficult to reschedule hearings since the calendars of the arbitration panel as well as those of the parties, counsel, and witnesses must be considered. Furthermore, most experienced arbitrators will charge a fee for time reserved and unused, especially if the hearings are continued or cancelled at the last minute. Save money and time for your client by going forward on schedule.

Second, agree to limit motion practice. Motions in limine and dispositive motions can be wasteful at arbitration, especially if there has been little discovery. One of the grounds for vacating an arbitration award is the arbitrators' refusal to hear relevant evidence. See FAA 10 (a) (3). Arbitrators will be concerned about preparing an award that ultimately will be confirmed and their rulings will be influenced by an interest in protecting the final award. Further, arbitrators often are reluctant to grant dispositive motions since there is no appeal in arbitration unless the parties have agreed in writing in advance to utilize the Optional Arbitration Appeal Procedure pursuant to Rule 34.

Third, consider whether the hearings should be bifurcated into liability and damages phases, for example, or otherwise set to move forward in phases. The attorneys may want to confer with the arbitrators to reach agreements on the order of proof so that the hearings move forward smoothly.

For example, in a complex case involving claims of breach of contract and fraud arising out of construction of a high tech facility, claimants and respondents agreed to divide the hearings into phases. They handled each discreet issue completely before moving to the next phase, rather than adhering to the usual order where claimants present their entire case and respondents' case follows. In addition to the various claims, there were later phases to deal with claims for attorneys' fees and costs as well as punitive damages.

Fourth, familiarize yourself with Rule 6 (e) which allows for consolidation of arbitrations with common issues of fact or law. Construction disputes often involve multiple parties and arise out of the same project so consolidation may save time and money.

Finally, if there are witnesses who may be unavailable, discuss how to preserve their testimony, or make plans to have them testify via video. Most arbitrators will be flexible in making these arrangements in order to assist counsel in presenting the case efficiently.

In all of these matters, the arbitrators are empowered to make the necessary rulings if counsel cannot reach agreement. Rule 11.

LIMIT DISCOVERY

As arbitration has been treated more like litigation, there has been more discovery in construction cases. Discovery is the most expensive part of any arbitration, especially now that so much of it involves electronically stored information. The key here is that discovery should be proportional to the dispute's complexity. Obviously, counsel will do more discovery for a bet-the-company, complex dispute than for a case involving a simple breach of contract.

Here again, it is in the parties' interest for all counsel to work with the arbitrators to rein in costs. Establishing a reasonable discovery plan may be the best way to avoid unnecessary expense. Clients no doubt will appreciate this effort.

In the early days of arbitration, discovery was limited to exchanging documents and witness information. Traditionally in arbitration, there is a broad exchange of all relevant and non-privileged documents. Counsel can work together to agree on electronic discovery limits to try to avoid the enormous costs involved. Also, at a certain time, both sides will be required to identify the witnesses expected to testify.

For expert witnesses, it is important to establish a procedure for exchanging biographies and reports. Although counsel sometimes request an opportunity to issue interrogatories and requests for admission, those types of discovery are not favored in arbitration since they can be time consuming and expensive, and often fail to elicit significant information.

In a complex, high-dollar case, taking some depositions actually may save time during the arbitration hearings. Experienced arbitrators know that listening to an attorney examine a witness extensively at the hearings, an exercise that is similar

See "Designing" on Page 12

Designing a Cost-Effective Construction Arbitration continued from Page 11

to a deposition, can be a poor use of hearing time.

Talk with opposing counsel and agree on a limited number of depositions that are also limited in duration. If agreement is not possible, an experienced arbitrator can hear the arguments of both sides and then make a ruling on the number of depositions to be allowed. Sometimes in a large case, for example, an arbitrator may allow five depositions for each side, each deposition not to exceed seven hours. Or perhaps that arbitrator will rule that each side may have forty hours of deposition time to be used as desired.

Again, the discovery process should be designed to fit the case. Arbitrators will make the necessary rulings to avoid gamesmanship or a scorched-earth approach. Typically, arbitration rules empower an arbitrator to manage discovery. See Rule 17(d).

AGREE ON LIMITED TIME FOR THE HEARINGS

If possible, it is a good idea to agree on a number of hearing days and an amount of time allotted to each party. The "chess clock" approach to hearing time is one of the best ways to ensure that hearing time and cost will not exceed the time necessary for a full and fair hearing. Usually, if there are two parties, they agree to split the time, with each side being allowed a specific number of hours to put on its case and conduct cross examination.

This approach worked well in a multi-million dollar construction dispute between a developer and a general contractor, involving claims of cost overruns and delays caused by deficiencies in the architectural and structural drawings, among other things. In this case, the time scheduled for trial was three to four months. After many delays in obtaining a courtroom, counsel agreed on an arbitration schedule of six weeks, with the time evenly divided between the parties. The limited time allotted led to an efficient and effective presentation of evidence from both parties.

The chess clock approach has the benefit of forcing everyone to use the hearing time in a disciplined way. Counsel with limited time tend to focus on those witnesses and documents most important to the case. The approach has the added benefit of assuring that the arbitrators will hear a clear and concise presentation of claims and defenses. Limited time also assures that hearing time will not be wasted in rambling and confusing cross examinations. The attorneys are forced to be brief, clear and to-the-point on cross.

There are many other approaches to encouraging efficient use of hearing time. Sometimes counsel will agree to present percipient or expert direct testimony in written declarations with an opportunity for a live cross examination. Also, by agreement, all documents can be admitted without formalities if no objections to documents on the exhibit list have been raised in advance of the hearings. Demonstrative exhibits are worth considering, too, since they can help arbitrators get up to speed quickly on the chronology of events, the relationships of various entities or on damages theories.

AVOID UNNECESSARY OBJECTIONS

Since strict conformity to the rules of evidence is not required in arbitration, raising numerous objections is not useful. It may be important to object to hearsay in order to alert the panel to it, but that objection will only go to the weight to be given to that evidence and will not preclude it. Save objections for important matters and avoid slowing the hearings with repeated interruptions. Rule 22 (d).

AVOID RESTRICTIVE ARBITRATION PROVISIONS

Most construction arbitrations take place pursuant to an arbitration provision in the parties' contract. Often a construction contract will call for a three-step process with negotiations among representatives of each company followed by mediation and, finally, by arbitration. Some arbitration provisions are general, calling for arbitration of "all disputes arising under this agreement." Others are more specific and set a time frame for completing the hearings and the award's issuance, discovery limits, applicable rules of evidence, etc. These requirements are agreed upon at the time of contracting, but

often the dispute arises long after the contract's execution, and is not the type of dispute anticipated during negotiations. For that reason, the arbitration provision's restrictions may not be suitable to the dispute at hand. The better practice is to use a broad form arbitration provision and agree on specific process details after a dispute arises.

In a dispute involving hospital construction, the contract specified that discovery was to be completed and the hearings were to proceed within 90 days of the arbitrators' selection. At the preliminary hearing, both sides agreed that the time frame specified was too short and both stipulated to an additional two months so that they could be prepared for efficient hearings. Counsel agreed that they needed extra time to exchange documents, many of which were in electronic form, and to take a few key depositions. This stipulation allowed the attorneys to be prepared so that the hearings could go forward smoothly and avoid further delay.

In another case involving a dispute arising out of the renovation of a small commercial building, the arbitration provision provided for an expedited process with only a half day of hearings for each side. When a dispute actually arose, one side claimed damages exceeding a million dollars and both sides raised time-consuming issues. In this case, it was necessary to schedule additional hearing days so that each side could make a full presentation of its case.

Sometimes, too, the arbitration provision limits discovery unreasonably. For instance, although the provision may specify that no depositions can be taken, sometimes a brief deposition of a key witness will save hours of hearing time because counsel can be well prepared in advance for efficient witness examination.

Stipulations to modify the process specified in an arbitration agreement can help match the procedure to the dispute and benefit all parties. Since arbitration is contractual, counsel and the parties are free to work with the arbitrators to stipulate to any changes they believe are appropriate to fit the case.

SELECT DECISIVE ARBITRATORS

None of these techniques for making arbitration economical will work unless the arbitrators are experienced, decisive and willing to make the necessary rulings. Good arbitrators actively manage a case expeditiously, both during the discovery phase and during the hearings.

If problems arise during discovery, arbitrators should be available to make decisions promptly as needed through emails or conference calls – not *ex parte*, of course – and often on shortened notice. Usually one arbitrator will be designated to make decisions on routine discovery issues, with the others weighing in on more important matters. In a recent contract dispute involving two construction companies doing business on different sides of the country, it was necessary to confer by phone with the attorneys weekly in order to resolve discovery disputes and keep the case on track for prompt hearings. By contrast, other cases move forward to hearing with few or no disputes.

During the hearings, arbitrators should be ready to move the case along, making rulings as needed in accordance with the rules selected by the parties. Active arbitrators assist in avoiding gamesmanship and deal effectively with cumulative evidence, helping the parties avoid unnecessary hearing time. See Rule 22 (d).

Review the biographies of the proposed arbitrators, including examples of cases they have handled in the past. Ask for references. Particularly in large cases, it is customary to interview potential arbitrators – not *ex parte* but jointly with opposing counsel. During these interviews, arbitrators should not be asked about issues in the case but rather about their experience, style and managerial skills.

The flexibility of the arbitration process, including the ability of the attorneys and the parties to work with the arbitrators to tailor arbitration to fit a particular case, can be an enormous benefit to all participants. Using these suggestions and designing others to streamline a case will lead to a just, speedy and cost-effective resolution and to greater client satisfaction with the process, win or lose. ■

Notices & Calendar of Events

UPCOMING EVENTS

MAY 13-14, 2010: 17th Annual West Coast Casualty Construction Defect Seminar

Disneyland Hotel and Resort • Anaheim, CA • **http://www.westcoastcasualty.com**

JAMS is a sponsor of this event, the largest seminar of its kind worldwide focusing on all of the elements of the prosecution, defense, coverage and technologies of construction defect claims and litigation from a national perspective. JAMS neutrals **HON. JONATHAN CANNON (RET.), RICHARD CHERNICK, ESQ., ROSS W. FEINBERG, ESQ., KENNETH C. GIBBS, ESQ., GERALD A. KURLAND, ESQ., HON. ROBERT E. MAY (RET.),** and **HON. STEPHEN J. SUNDVOLD (RET.)** will speak on a wide range of issues.

MAY 27-30, 2010: "Comparative Construction Law – Different Strokes"

13th Annual Conference of the Canadian College of Construction Lawyers

Westin Nova Scotian • Halifax, Nova Scotia • **http://www.cccl.org/**

JAMS GEC neutrals **HARVEY J. KIRSH, ESQ.** and **PHILIP L. BRUNER, ESQ.** will discuss "International Construction Dispute Resolution." **JOHN W. HINCHEY, ESQ.** and **HH HUMPHREY LLOYD, Q.C.** of JAMS will address "Comparative Construction Law Topics."

RECENT HONORS

On April 26, 2010, the **CARL M. SAPERS ETHICS IN PRACTICE** fund was established at the Harvard Graduate School of Design. The Dean of the School of Design announced that over $100,000 had been raised "to build upon Professor Sapers' leadership in the field of architectural ethics and practice [by] advancing knowledge in the field of architectural ethics in practice, including research, publications, and lecture support for faculty, scholars, and students at the GSD and in collaboration with related institutions." Mr. Sapers is an Adjunct Professor of Studies in Professional Practice in Architecture at the school and a JAMS GEC neutral.

RECENT ARTICLES AND SPEAKING ENGAGEMENTS

- **HON. CLIFFORD L. MEACHAM (RET.)**, JAMS, is co-author of a Chapter on subcontractor's rights in the Illinois Institute of Continuing Legal Education publication on Mechanic's Lien law issued in February 2010.
- **JUDGE MEACHAM** also participated in a panel discussion of mortgage foreclosure issues on ABC local news in Chicago on March 23, 2010.
- At the 12th Annual Conference of the American Bar Association, Section of Dispute Resolution on April 9, 2010 in San Francisco, JAMS neutrals **JOHN W. HINCHEY, ESQ.**, **MICHAEL J. TIMPANE, ESQ.** and **HON. CURTIS VON KANN (RET.)** served as moderators and panelists on a variety of topics.
- **JUDGE VON KANN** also spoke on "The Award" at a College of Commercial Arbitrators program in Hartford, CN, entitled "Managing Your First Arbitration" on April 22, 2010.
- **HARVEY J. KIRSH, ESQ.**, JAMS, was a panelist at the May 6, 2010 program "Practical and Creative Approaches to Construction ADR," sponsored by the Construction Law Section of the Ontario Bar Association. His topic was "Best Practices in the Arbitration of Construction Disputes."
- **MR. KIRSH** is also an Editor of "The Construction Glossary," a new publication of the ABA Forum on the Construction Industry. The book is scheduled to be launched at the Forum's 2010 Fall Meeting in Miami, Florida on September 2-3, 2010. Leading construction attorneys across the United States, including fellow GEC neutral **JOHN HINCHEY,** contributed to the large compilation of annotated glossary terms.

For more information or copies of these articles, please contact jherrera@jamsadr.com.

Please join us for a live MCLE video webcast –

Top 10 Cost-Effective Ways to Resolve Construction Disputes

Wed., June 16, 2010 • Noon to 3:15 pm EDT (9 am to 12:15 pm PDT)

Rapid resolution of construction claims and disputes is a construction industry imperative. This program explores the nuances of construction's "top ten" ADR options. You will get a clear understanding of what's available, which option to select in any situation, what limitations affect each option (and why each can fail), and how best to utilize each option to achieve an early and cost-effective settlement.

1. Partnering/project "meet and greet"
2. Structured negotiations
3. Project neutral
4. Initial decision maker
5. Expert determinations
6. Dispute review board
7. Adjudication
8. Mediation
9. Advisory "mini-trial"
10. Binding arbitration

The distinguished faculty are all members of the **JAMS Global Engineering & Construction Group** and include some of North America's top construction ADR neutrals:

- Planning Chair **Philip L. Bruner, Esq.,** Director, JAMS Global Engineering & Construction Group, Chicago, IL
- **Zela "Zee" G. Claiborne, Esq.,** JAMS neutral, San Francisco, CA
- **John W. Hinchey, Esq.,** JAMS neutral and Senior Partner, King & Spalding, Atlanta, GA
- **Harvey J. Kirsh, Esq.,** JAMS neutral and Co-Chair, Construction and Infrastucture Group, Osler, Hoskin & Harcourt LLP, Toronto
- **Thomas J. Stipanowich, Esq.,** JAMS neutral and Professor of Law, Academic Director, Straus Institute for Dispute Resolution, Pepperdine University School of Law, Malibu, CA

Registration: www.ali-aba.org/VCR0616 or 800-CLE-NEWS. This interactive seminar will give you the opportunity to submit your questions to the speakers before and/or during the program. All registrants will receive a set of downloadable course materials and free access to the archived online program later. Tuition is $299.

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