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Success in Claim Resolution and Mediation: The Insurance Component

By **DEBORAH S. BALLATI, ESQ.**

The Fall 2010 *JAMS Global Construction Solutions* newsletter contained two excellent articles about why construction mediations often fail and suggested some valuable tips for improving the chances of success. The first article, written by Douglas S. Oles, titled "Ten Common Reasons for Failure in a Mediation," focused on lack of preparation, lack of funding, failure to involve decision makers and lack of access to key information as some of the main reasons why mediations fail. The second article, by Paul M. Lurie, "Using Failure Analysis to Design Successful Mediations," posited that a lack of understanding of the mediation process by participants, lawyers and poorly trained mediators is often the culprit in failed mediations; Mr. Lurie suggested that the use of a process similar to engineering failure analysis fo-

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The Future of Construction Arbitration

By **PHILIP L. BRUNER, ESQ.**

Director, JAMS Global Engineering & Construction Group

Informal arbitral and mediative dispute resolution processes are older than recorded history.[1] Aristotle is said to have advised his students 2500 years ago: "[I]t is equitable…to prefer arbitration to the law court, for the arbitrator keeps equity in view whereas the [judge] looks only to the law, and the reason why arbitrators were appointed was that equity might prevail."[2] This view has prevailed throughout the ages. By the Elizabethan era, arbitration was well established in England's *Lex Mercatoria*. An English merchant, who wrote a treatise on the Law Merchant in the early 1600s for the benefit of "all statesmen, judges, magistrates, temporal and civil lawyers, mint-men, merchants, mariners and all others negotiating in all places of the world," described the arbitration process as follows:

> *"[The] ordinary course to end the questions and controversies arising between merchants is by way of* ***Arbitrement****, when both parties do make choice of honest*

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cusing on why mediations fail could assist participants in avoiding failure in the future. This article is intended to supplement those two fine articles with some thoughts regarding another crucial component of many successful construction mediations, namely, the presence of adequate, applicable insurance to fund the resolution.

Both the Oles and the Lurie articles noted the importance of having key knowledgeable participants present at the mediation, ready to fully participate in achieving resolution. In light of the central role insurance funds often play in resolving construction and other cases, the participation of informed insurance carriers—or at least the funding they control—at the mediation can be as important to resolution as the skills of the mediator or the commitment and preparedness of the participants in reaching an agreement to resolve the case. Unfortunately, there often is too little attention paid to the importance of insurance from the outset of a project, during construction and into the claim resolution process; this lack of attention can result in complicating, and sometimes prohibiting, the resolution of claims when they arise. Below are suggestions to avoid this result.

Defining Insurance Requirements

The process of ensuring that appropriate and accessible insurance will be available starts at the inception of the project. If construction contracts are not drafted to include appropriate insurance requirements, the right insurance may not be secured or available in sufficient amounts to fund resolution when a claim arises. Too often, especially in cases where the participants are not using standard form agreements issued by such organizations as the American Institute of Architects or the Association of General Contractors, lawyers, risk managers and others involved in contract drafting simply incorporate into their current contract the same standard, sometimes outdated, insurance requirements they included in earlier contracts without thinking about the particular needs of the project in question, the risks inherent in that project or the changes in the insurance marketplace that may have occurred since those old requirements were drafted; this routine adoption of old requirements sometimes results in the participants missing coverages or limits that might be available at a reasonable price for the current project that were not available, or not appropriate, at the time the earlier contract was executed. Thus, the first suggestion of this article is to review and draft the provisions dealing with insurance and the insurance requirements in construction contracts as carefully as you review and draft the definitions of scope and work and the indemnification provisions in those contracts; don't just rely on prior language, assuming it is appropriate. The assistance of risk managers, insurance brokers or coverage counsel can be invaluable in this process; a few hours of time for this review by knowledgeable professionals before the contracts are finalized may add significant funds to the defense and resolution of claims.

Even when the two sides in a dispute have radically different views of the facts and the law applicable to a claim... those dueling parties may come to understand with the right guidance that they are, or should be, strongly aligned on matters of insurance.

Confirming Available Insurance at Project Inception

Next, written contract requirements are only as good as the follow-through undertaken to enforce them. It does no good for owners, contractors and subcontractors to include in their contracts sufficient and carefully crafted insurance requirements, including the requirement that certificates of insurance

and, in some cases, insurance policies themselves be exchanged at the outset of the project if there is no follow-through to make sure those requirements have been satisfied in full. It is far simpler to get evidence that the insurance requirements have been met at the front end of the project, before a dispute arises, than it is afterwards. More importantly, rectifying the failure to get insurance after a claim has arisen is useless with respect to that claim; in most cases, insurance placed after a claim has arisen will not provide any protection for that claim. Moreover, the existence of the claim may further limit what insurance can be purchased for future claims.

Structuring the Claim to Maximize Insurance

Another pitfall for the unwary that can make securing insurance for claim resolution more difficult is the failure to think through how best to draft and present available claims to trigger coverage. While a claim for the damage caused by negligent design of a project system or failure to use appropriately skilled and experienced personnel should easily be covered under standard professional liability or general liability insurance policies, claims including allegations of gross negligence, fraud or intentional misrepresentation based on the same underlying facts will raise red flags for the insurance carriers and complicate the ability to get coverage for the claims in question. Counseling parties and lawyers to tone down the rhetoric in the claim is the best way to avoid invalidating coverage that might otherwise be available.

Moreover, thinking through the types of insurance that particular parties might have for certain claims can aid the resolution of claims immensely. Understanding what insurance was required to be provided by the various participants in the project is a good starting point for this analysis. While the facts will obviously drive the scope and nature of the claims that can be presented, insurance considerations should drive, or at least be considered in, their shape and presentation.

Even when the two sides in a dispute have radically different views of the facts and the law applicable to a claim, as is often the case, those dueling parties may come to understand with the right guidance that they are, or should be, strongly aligned on matters of insurance. The most skilled construction practitioners provide that guidance to their clients; the most skilled mediators can fill the void and provide the guidance even when the practitioners do not if they are aware of the potential for maximizing insurance coverage by doing so.

Marshaling All Available Insurance

Once a claim arises, the participants in the claim process should be willing to exchange insurance information readily. If they are not, however, many states, including California, permit the discovery of insurance as part of the litigation process. Reminding participants early in the claim process that the scope and limits of their insurance will ultimately be discoverable may ease the process of getting that information even without a lawsuit. Matters of privilege related to communications between insureds and their insurance companies must also be considered; the laws in the various states differ on these issues.

Making sure before you get to the mediation that all appropriate insurance carriers have been tendered to, and have responded, is often essential to resolution. Skilled mediators typically question the participants in the preliminary stages of planning the mediation on what insurance is available, the status of tenders and the carriers' positions on coverage. Some ask if coverage counsel is involved for one or more of the parties and, if they are, will urge them to be present at, or at least available during, the mediation. All of these steps are good practice.

Reservations of Rights and Coverage Disputes

Sadly, it is rare, though not unheard of, for insurance carriers to accept the defense of a construction participant against a claim without a reservation of rights on some basis. Reservation letters tend, like some insurance requirements included in construction contracts, to be drafted without real consideration of the available facts and issues at the time of the tender. Thus, as framed by the reservation of rights letter, a carrier's position may appear to be an impediment to resolution.

It is important, however, for the parties, and especially the mediator, to understand whether coverage disputes are genuine or serious, or merely the standard starting point for discussion. For example, the most frequent defenses to coverage that carriers offer in construction cases are the so-called work performed and product exclusions in the standard comprehensive liability ("CGL") policies, and the faulty design and faulty workmanship in builder's risk policies. Understanding the nuances in these exclusions, and the many ways to argue around them, depending on the facts, is important. Insurance carriers routinely assert these exclusions far more broadly than the facts justify.

It is also crucial for the parties and the mediator to understand whether the asserted coverage dispute is being used as a basis to argue for a

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lower settlement value for the case. To the extent that the mediator, the participants and their lawyers lack the expertise to evaluate this issue, securing the involvement of independent coverage counsel may be useful to resolution.

Taking the Insurance Claim in Settlement

In a case where an insurance carrier is particularly intransigent, the option of a party settling a claim by taking an assignment of the insured's rights against that carrier may present itself during mediation. The ability to agree to such a settlement where the carrier has denied coverage can be an important negotiating tool. Even the realistic threat of a settlement with a covenant not to execute an assignment of rights can help move an intransigent insurer to contribute meaningfully to a final settlement. In order to take advantage of these levers, however, those who might do so, or those who might offer them, must be in a position by the time the situation presents itself to know how to effectuate and use these potentialities. Anticipating the need for this information long before the situation arises is crucial, as the pitfalls for structuring an assignment are many and vary by state.

The Impact of an Adverse Economy on Insurance

In recent years, we have seen more and more companies involved in construction go into bankruptcy or become insolvent. This reality increases the need to maximize the carrier's contributions to settlement, and the risks for the carrier of failing to contribute similarly increase. The possibility that the carrier's refusal to settle will later be found to have caused the insured's bankruptcy exposes the insurer to large compensatory and punitive damage awards. That prospect, in turn, will often cause carriers to tread far more carefully in taking coverage positions, and mediators and the parties can use these potential risks to assist in fashioning a settlement funded by the carriers.

Conclusions

Requiring, confirming and triggering all applicable and appropriate insurance can be key to successful resolution of a construction claim. Mediators and construction practitioners who know enough about insurance issues to aid in getting that insurance on the table will add great value to the resolution of claims. ■

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Good Faith in the Negotiation, Performance and Enforcement of Construction Contracts

By STEVEN G.M. STEIN, ESQ., and MELISSA R. PAVELY, ESQ.

Although the concept of "good faith" can be traced back to Greek and Roman times,[1] it was largely absent from jurisprudence in the United States until the second half of the 19th century.[2] In 1893, the New York Court of Appeals announced that courts should infer that contracting parties contemplated good faith in the performance of their contracts.[3] In 1903, the New York Court of Appeals said with respect to requirements contracts, "The obligation of good faith and fair dealing towards each other is implied in every contract of this character."[4] The 1933 case of *Kirk La Shelle Company v. Paul Armstrong Company* is credited with setting forth the current framework of the doctrine.[5] The Court ruled that "in any contract there is an implied covenant that neither party shall do anything which shall have the effect of destroying or injuring the rights of the other party, to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing."[6]

The implied covenant of good faith was incorporated into the Uniform Commercial Code (UCC), which was first promulgated in 1951, and states, "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."[7] The Restatement (Second) of Contracts, published in final form in 1982, provides, "Every

contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[8]

There is no generally accepted definition of good faith. The UCC originally defined good faith in Article 1 as "honesty in fact in the conduct or transaction concerned," but applied a special definition to merchants in Article 2, including both "honesty in fact" and the observance of "reasonable commercial standards."[9] Honesty in fact is considered the subjective standard of good faith, and observance of reasonable commercial standards is considered the objective standard.[10] In 2001, after significant criticism, the UCC Article 1 definition was expanded to include objective good faith.[11] Comment "d" to Section 205 of the Restatement provides that good faith is violated "even though the actor believes his conduct to be justified" and that "bad faith may be overt or may consist of inaction."[12] Common law cases diverge on whether or not ill motive is an element of breach of good faith.[13]

Good faith "has been defined variously as requiring reasonableness or fair conduct, reasonable standards of fair dealing, decency as well as fairness and reasonableness, fairness, and community standards of fairness, decency and reasonableness."[14] Robert Summers famously argued that good faith is not susceptible to this sort of definitional approach, and instead should be the subject of an "excluder analysis" by which good faith simply rules out a wide variety of forms of bad faith.[15] Commentators have even suggested that good faith cannot have an absolute meaning, or that Justice Stewart's obscenity test of "I will know it when I see it" should be used.[16] There is no consensus about whether the lack of a clear definition is problematic.[17]

Although there is little agreement about how good faith should be defined, and even less about how it should be applied to construction contracts, or other contracts,[18] it has become part of the statutory commercial law of every state, and accepted as part of the common law in most states.[19] As Judge Posner put it, the cases regarding good faith "are cryptic as to its meaning though emphatic about its existence."[20] This article discusses United States law on good faith, and the different approaches taken, specifically focusing on the negotiation of construction contracts.

Good Faith in Negotiation

In the United States, it is widely believed that there is no duty of good faith in the *negotiation* of a construction contract.[21] Both the Restatement and the UCC impose obligations of good faith only in the performance and enforcement of contracts.[22] During the 19th Century, the doctrine of caveat emptor, or "let the buyer beware," became entrenched in American jurisprudence.[23] Courts reason that in a business transaction, such as a construction contract, both sides negotiate for the best deal, and self-interest does not constitute bad faith.[24]

The lack of a general good faith requirement in negotiations of construction contracts in the United States is in sharp contrast to many civil law countries. German law recognizes a doctrine called *culpa in contrahendo*, in which parties are under a duty to deal with each other in good faith during the negotiation stage, because a relationship of trust and confidence comes into existence as soon as they enter negotiations.[25] Each party is bound to disclose matters that are relevant to the other's decision, if he knows the other party is unable to discover that information for himself.[26]

A party is also liable for negligently creating the expectation that a contract will be forthcoming when he knows, or should know, that the expectation cannot be realized.[27] The doctrine of *culpa in contrahendo* has also affected Austrian and Swiss law.[28] Similarly, the Italian Codice Civile also provides that parties in the process of negotiations and formation of a contract must act in good faith.[29]

Some commentators have rejected the general belief that there is no duty of good faith in contract negotiations in the United States, through an analysis of concepts such as mistake and misrepresentation.[30] Nicola Palmieri, an Italian lawyer, relays his experience in negotiating with American attorneys: "Wall Street lawyers of world fame, echoed by their clients, told me that good faith disclosures during negotiations are not required in the world of sophisticated businessmen during negotiations in the United States…. During contract negotiations, neither good faith dealing nor good faith disclosures was required, and everyone was free to take advantage of the ignorance or misperceptions of another, no matter how unfair or unethical, except in the context of a special relationship where the parties repose trust and confidence in each other."[31] Palmieri argues that this approach is "out of touch with today's reality of law."[32]

Perhaps the most important aspect of a duty of good faith in construction contract negotiations is the question of what, if anything, parties are required to disclose to each other while bargaining. Parties who knowingly misrepresent material facts during negotiations may be subject to fraud actions, if the other party reasonably relies on those misrepresentations.[33] Traditionally, in the United States, however, there is

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no liability for silence unless there is a duty to speak.[34] Thus, parties to construction contract negotiations are generally not liable for failing to disclose information the other parties may find useful.[35]

Palmieri has identified seven exceptions to this rule, which he argues have almost subsumed the rule of nondisclosure.[36] One party may not actively conceal facts from the other party by use of some trick or artifice intended to prevent discovery of or inquiry into such facts. If a party has learned that a material representation is no longer true, it must be corrected. If a party chooses to speak in response to questions, the response must be complete and full, not partial or ambiguous. A party who owes a confidential or fiduciary duty has an obligation to divulge all material facts within his knowledge. When one of the parties is aware that he has access to superior material information concerning the transaction, and that the other party is acting under a mistaken belief as to that information, there is a general duty to disclose. Broad disclosures are required in the formation of insurance contracts. Finally, there are statutes that require disclosures in certain circumstances.[37]

The Restatement also provides that in certain of these circumstances, non-disclosure of a fact is equivalent to an assertion that the fact does not exist.[38] Interestingly, the Restatement says that where a party "knows that disclosure of the fact would correct a mistake of the other party as to a basic assumption on which that party is making the contract *and if non-disclosure of the fact amounts to a failure to act in good faith* and in accordance with reasonable standards of fair dealing," the failure to disclose constitutes a misrepresentation.[39] Thus, even though the duty of good faith is generally considered to be an implied provision of a construction contract,[40] it may sometimes be applied before a contract is entered into. Several courts have referred to good faith as the standard to determine when disclosures are required.[41]

Even where there is a duty to speak, courts have been reluctant to impose liability if the plaintiff could have discovered the facts through a reasonable investigation.[42] However, some courts have moved away from this traditional rule. For example, the Nevada Supreme Court held that a party has no duty to investigate unless he has "information which would serve as a danger signal and a red light to any normal person of his intelligence and experience."[43] In the securities context, in which disclosures are required by statute, the Seventh Circuit has said, "Once the duty to disclose exists, and lying or nondisclosure is condemned as an intentional tort, it no longer matters whether the buyer conducts an investigation well or at all."[44]

Parties who fail to make required disclosures during construction contract negotiations may find themselves liable for fraudulent inducement once the contract has been entered into. Some courts have held that a specific integration clause in a contract can exculpate a party from such a claim by negating the element of reliance.[45] In rejecting this argument with respect to a general integration clause in an adhesion contract, the Colorado Supreme Court stated, "The policy of encouraging honesty and candor in contract negotiations, which policy is reflected in the recognition of an implied covenant of good faith and fair dealing, supports this result. The implied covenant of good faith and fair dealing would virtually be eliminated if a contracting party could escape liability for negligent conduct simply by inserting a general integration clause into the agreement."[46] Thus, in some circumstances, courts will extend the general duty of good faith to contract negotiations, at least in rhetoric.

Nonetheless, American courts have remained reluctant to impose a general duty of disclosure in construction contract negotiations. The Seventh Circuit has emphasized that not every failure to disclose information that would cause the other party to reassess the deal is actionable, stating, "A general duty of disclosure would turn every bargaining relationship into a fiduciary one. There would no longer be such a thing as arms'-length bargaining, and enterprise and commerce would be impeded. The seller who deals at arms'-length is entitled to 'take advantage' of the buyer at least to the extent of exploiting information and expertise that the seller expended substantial resources of time and money on obtaining—otherwise what incentive would there be to incur such costs?"[47]

In addition to the requirements of good faith disclosures, some courts allow parties to construction contracts to impose greater obligations on themselves by entering into agreements to negotiate in good faith. Early contract law rejected this idea, finding, "An agreement to enter into an agreement upon terms to be afterwards settled between the parties is a contradiction in terms. It is absurd to say that a man enters into an agreement till the terms of that agreement are settled."[48] The Minnesota Supreme Court held that an agreement to negotiate was nothing more than an agreement to agree, stating, "An agreement to enter into negotiations, and agree upon the terms of a contract, if they can, cannot be made the basis of a cause of action. There would be no way by which the court could

determine what sort of contract the negotiations would result in; no rule by which the court could ascertain whether any, or, if so, what damages might follow a refusal to enter into such future contract."[49] Texas appellate courts have continued to reject such contracts, finding that "the words 'good faith effort' or 'best effort' are not talismanic; their presence in an agreement does not automatically mean that the provision which contains them is enforceable."[50]

Other courts have distinguished between unenforceable "agreements to agree" and enforceable "agreements to negotiate." A California appellate court recently stated, "A contract to negotiate the terms of an agreement is not, in form or substance, an 'agreement to agree.' If, despite their good faith efforts, the parties fail to reach ultimate agreement on the terms in issue the contract to negotiate is deemed performed and the parties are discharged from their obligations… A party will be liable only if a failure to reach ultimate agreement resulted from a breach of that party's obligation to negotiate or to negotiate in good faith."[51] The Court found "no reason why in principle the parties could not enter into a valid, enforceable contract to negotiate the terms" of an agreement.[52] Similarly, the Southern District of New York found that an agreement to use best efforts to reach an agreement was enforceable, and that it "does not require that the agreement sought be achieved, but does require that the parties work to achieve it actively and in good faith."[53] Several other courts have found the same.[54] Thus even where there is no general requirement that parties to a construction contract negotiate in good faith, they can voluntarily accept such a requirement by entering into an agreement to do so.

Conclusion

Although courts in the U.S. generally agree that there is a covenant of good faith implied in every construction contract, they do not agree about what that duty entails or when or how it should be applied. They disagree about what the term "good faith" means, whether it should have any impact in arm's-length transactions and whether it can be used to limit or contradict the express terms of a contract. Its application has been limited in the pre-contractual phase of negotiation, but the underlying rationale is often present, if tempered by the strong American tradition of caveat emptor. ■

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> *men to end their causes, which is voluntary and in their own power, and therefore called* ***Arbitrium*** *or of free will, whence the name Arbitrator is derived and these men (by some called Good men) give their judgments by awards, according to Equity and Conscience, observing the Custom of Merchants …having only care that right may take place according to the truth, and that the difference may be ended with brevity and expedition…."*[3]

From this early English custom devolved the practice of arbitration among American businessmen well before the American Revolution.[4]

Arbitration was the dispute resolution method preferred by the American construction industry from the 19th through late 20th centuries. The 1888 "Uniform Contract"—the first national building contract sponsored jointly by the American Institute of Architects (AIA) and the National Association of Builders—provided for ultimate resolution of disputes by a Board of Arbitration comprised of three persons, one each selected by the parties and the third selected by the two appointed arbitrators.[5] The construction industry's long love affair with arbitration arose out of five key facts: (1) Construction is technologically complex and comprises a host of specialized applied design sciences, such as architecture and engineering (and its variants: civil, electrical, mechanical structural, geotechnical and others; materials sciences governing extraction, formulation and manufacture of building materials; and management sciences addressing the building process); (2) Construction is unique in that it usually takes place in an uncontrolled environment, is built to a unique design, on a unique site, by a unique aggregation of business entities operating without economies of scale, in which productivity is affected by weather, geology, local labor skills and availability, local building codes, and site accessibility; (3) As a consequence of construction's complexity, American law governing construction necessarily has become more complex and unique[6] to the point that some in the judiciary describe construction law as a "separate breed of animal"[7] and as including both the "law of the courts" and "the law of the shop"; (4) Because of construction's technological and legal complexity and uniqueness, legal proof of causation and damage necessarily relies heavily upon opinion testimony of experts—a fact of life that can be frustrating to judges and mesmerizing to jurors; and (5) Construction for generations has been the largest segment of the production sector of the United States economy. Arbitrator expertise, in particular, was regarded for generations as critical to resolution of disputes arising out of such a complex and unique industry.

Notwithstanding its centuries-old preference for arbitration, the U.S construction industry by 2007 had lost confidence in arbitration as its preferred method for resolving domestic[8] disputes. In 2007 standard industry contract documents of both the AIA and contractor organizations abandoned mandatory arbitration as the preferred dispute resolution method in favor of early intervention "rapid resolution" methods such as structured negotiation and mediation, with courtroom litigation rather than arbitration as the "default option." The cause of this action was perceived to be the "judicialization" of the arbitration process, characterized by arbitrators lacking arbitration management skills, over-lawyering, unlimited pre-hearing discovery, extensive motion practice, liberal substantive and procedural "due process," unnecessary hearing delay and time-consuming post-award disputes over judicial confirmation or vacation of binding awards.[9] Parties, lawyers, providers and arbitrators all share responsibility for the construction industry's loss of confidence in arbitration. Under the leadership of the College of Commercial Arbitrators, protocol initiatives have been suggested by which to "right the ship."[10]

At the heart of industry dissatisfaction with the modern arbitration process is the loss of confidence in arbitrator expertise that has commended arbitration through the ages. This loss of confidence is due to (1) inadequate arbitrator management of the arbitration process, resulting in a loss of confidence in arbitration's historic hallmarks of *efficiency and cost-effectiveness,* and (2) inadequate arbitration selection procedures, resulting in loss of confidence in arbitration's second historic hallmark of *critical arbitrator expertise,* where providers list or parties select arbitrators not sufficiently expert in the *construction law issues and practical factual matters in dispute and in arbitration hearing management.* Such loss of confidence leads parties to conclude that arbitration is no better than courtroom litigation. To address these fundamental issues is the critical future need.

Parties who continue to prefer arbitration know how to assure its efficiency, cost-effectiveness and expertise. Issues critical to parties' effective use of arbitration are (1) planning pre-contract for conflict management; (2) drafting of a well-thought-out arbitration agreement; (3) selecting appropriate arbitration

What is the future of construction arbitration? It will survive and eventually return to its preferred position.

rules;[11] (4) selecting arbitrators expert in both construction law and arbitration management; (5) requiring parties to present early detailed claims and defenses to reduce the need for discovery; (6) limiting document and deposition discovery to the issues;[12] (7) presenting dispositive pre-hearing motions; (8) promoting joinder of third parties; (9) encouraging effective arbitrator hearing control; (10) defining remedy limitations and parameters; (11) requiring a reasoned award; and (12) providing for appellate arbitrator review where there is a concern about a limited scope of judicial review.[13]

What is the future of construction arbitration? It will survive and eventually return to its preferred position. The lessons of the recent past tell us what is needed for arbitration to retain dominance over litigation as the construction industry's preferred binding dispute resolution method. *Arbitrator expertise* remains the single most important factor that commends the use of arbitration over litigation. Parties must seek out and retain the best and most competent arbitrators, in lieu of relying simply on provider strike lists and public advertisements. Expert arbitrators can do much to restore arbitration's long-standing reputation as the most efficient, cost-effective and fair binding dispute resolution method. The advice offered to the U.S. legal profession in 1985 by U.S. Supreme Court Chief Justice Warren E. Burger is no less relevant today:

> *"My overview of the work of the courts from a dozen years on the Court of Appeals [for the D.C. Circuit] and now sixteen in my present position, added to twenty years of private practice, has given me some new perspectives on the problems of arbitration. One thing an appellate judge learns very quickly is that a large part of all litigation in the courts is an exercise in futility and frustration. A large proportion of civil disputes in the courts could be disposed of more satisfactorily in some other way…. My own experience persuades me that in terms of cost, time and human wear and tear, arbitration is vastly better than conventional litigation for many kinds of cases. In mentioning these factors, I intend no disparagement of the skills and broad experience of judges. I emphasize this because to find precisely the judge whose talents and experience fit a particular case of great complexity is a fortuitous circumstance. This can be made more likely if two intelligent litigants agree to pick their own private triers of the issues. This is not at all to bypass the lawyers; they are key factors in this process. The acceptance of this concept has been far too slow in the United States."*[14] ■

Mr. Bruner is a JAMS arbitrator, mediator and project neutral based in Chicago. Email him at pbruner@jamsadr.com or view his Engineering & Construction bio online.

1. Earl S. Wolaver, *The Historical Background of Commercial Arbitration,* 83 U. Pa. L. Rev. 133 (1934) (noting that patriarchal tribunals offered perhaps the earliest ADR processes).
2. Kaja Harter-Uibopuu, *Ancient Greek Approaches Toward Alternative Dispute Resolution,* 19 Willamette J. Int'l & Disp. Resol. 48, 58 (2002).
3. Gerard Malynes, *The Ancient Law-Merchant,* 447 (1622).
4. Bruce H. Mann, *The Formalization of Informal Law Arbitration before the American Revolution,* 59 NYU L. Rev. 443 (June 1984).
5. The American Institute of Architects, Form 19642-PL, *The Uniform Contract,* Art. XIII (1905).
6. Philip L. Bruner, *The Historical Emergence of Construction Law,* 34 Wm. Mitchell L. Rev. 1 (2007).
7. Paul Hardeman, Inc. v. Ark. Power & Light Co., 380 F. Supp. 298, 317 (E. D. Ark. 1974). ("Construction contracts are a separate breed of animal; and, even if not completely sui generis, still…[the] law must be stated in principles reflecting underlying economic and industry realities. Therefore it is not safe to broadly generalize.").
8. Arbitration still is preferred for resolution of international disputes in lieu of litigation in local courts in the country where a project is located.
9. Thomas J. Stipanowich, *Arbitration and Choice: Taking charge of the "New Litigation,"* 7 DePaul Bus. & Comm. L. J. 401 (2009).
10. The College of Commercial Arbitrators, *Protocols for Expeditious, Cost-Effective commercial Arbitration* (2010). See also Zee Claiborne, *Designing a Cost-Effective Construction Arbitration*, 3 JAMS Global Construction Solutions 10 (Spring 2010).
11. *JAMS Construction Arbitration Rules* and *JAMS Expedited Construction Arbitration Rules*. See also Jesse B. Grove III, *New Rules for Expedited Construction Arbitration in the United States*, 24 Int'l Constr. L. Rev. 136 (Spring 2007).
12. *JAMS Recommended Arbitration Discovery Protocols* (2009); *2010 Revised IBA Rules of Evidence for International Arbitration*, and Nathan O'Malley, *An Annotated Commentary on the 2010 Revised IBA Rules of Evidence for International Arbitration,* 27 Int'l Constr. L. Rev. 461 (October 2010).
13. *JAMS Optional Arbitration Appeal Procedure* (June 2003).
14. Warren E. Burger, Chief Justice of the U.S. Supreme Court, *Remarks before the American Arbitration Association and the Minnesota State Bar Association: Using Arbitration to Achieve Justice* (August 21, 1985), published in 40 Arb. J. 3, 6 (1985).

Arbitration & Settlement

By HARVEY J. KIRSH, ESQ.

"Conflict is normal; we reach accommodation as wisdom may teach us that it does not pay to fight."
— Judge Learned Hand

It is curious that the drafters of the ICC (International Chamber of Commerce) Rules of Arbitration chose to refer to arbitration as a method for the *"settlement,"* rather than the *"resolution,"* of disputes. For example, Article 1(1) of the ICC Rules provides that "(t)*he function of the* [International Court of Arbitration] *is to provide for the* ***settlement by arbitration*** *of business disputes of an international character in accordance with the Rules of Arbitration of the International Chamber of Commerce.*" Article 1(2), however, concedes that the Court *"does not itself settle disputes."*

In point of fact, an informal survey of the ICC Rules, as well as the arbitration rules of some of the other major institutional ADR service providers, does not disclose any rule, procedure, protocol or mandate that directly imposes an obligatory process on the disputing parties to attempt to settle their underlying dispute or claim. For example, although the AAA (American Arbitration Association) Construction Industry Arbitration Rules; the JAMS Engineering and Construction Arbitration Rules and Procedures; the LCIA (London Court of International Arbitration) Arbitration Rules; the CIDRA (Chicago International Dispute Resolution Association) Arbitration Rules; and even the recently revised UNCITRAL Arbitration Rules all contemplate the implementation of a negotiated settlement by the issuance of a Consent Award, those arbitration rules, for the most part, do not purport to shepherd the parties through any mandatory process of settlement discussion or negotiation.

By way of contrast, the Federal Rules of Civil Procedure, which generally govern the practice and procedure for litigation in the U.S. federal courts, provide that one of the express purposes of a pre-trial conference is *"facilitating settlement"* (Rule 16(a)(5)). Furthermore, Rule 26(f) requires the parties to confer before any scheduling conference, and that, in so conferring, they must consider *"the possibilities for promptly settling or resolving the case."* And Rule 68 also promotes settlement by laying out a protocol whereby a defendant would serve a plaintiff with a settlement offer *"to allow judgment on specified terms,"* which, if not accepted by the plaintiff, could lead to costs sanctions if the defendant does better at trial.

Despite these generally contrasting approaches between arbitration and litigation with respect to settlement directives, the distinction is not entirely black and white. For example:

- The JAMS Engineering and Construction Arbitration Rules and Procedures (July 15, 2009) provide that the "(p)*arties may agree, at any stage of the Arbitration process, to submit the case to JAMS for mediation"* (Rule 28(a)); and "(t)*he Parties may invite the arbitrator to recommend another JAMS neutral to assist them in reaching settlement*" (Rule 28(b)). Furthermore, in 2009, JAMS instituted a new "Mediator-in-Reserve" policy for international arbitrations, which contemplates the appointment of a mediator who would be available to the parties to assist in settlement negotiations in the event that, at any time during the course of the arbitration proceedings, the parties all agree to enlist the mediator's assistance. The arbitrators in the proceeding would not have any knowledge of the identity of the Mediator-in-Reserve, or whether the parties may have engaged his or her services at any point in the arbitration proceedings;

- The ICC's 2007 Report, titled *Techniques for Controlling Time and Costs in Arbitration*, provides (at paragraph 43) that *"*(t)*he arbitral tribunal should consider informing the parties that they are free to settle all or part of the dispute at any time during the course of the ongoing arbitration, either through direct negotiations or through any form of ADR proceedings."* Furthermore, "(t)*he parties may also request the arbitral tribunal to suspend the arbitration proceedings*

for a specific period of time while settlement discussions take place";

- Rule R-10 of the AAA's Construction Industry Arbitration Rules provides that "(a)*t 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";* and
- Article 1(4)(g) of the CIDRA Arbitration Rules provides that *"CIDRA arbitrators are committed to… encouraging settlement where appropriate."*

In these cited instances, though, the onus would be upon both disputing parties to initiate the settlement process voluntarily, and would not arise out of any rule or procedure mandating them to do so.

The ADR Institute of Canada Inc.'s National Arbitration Rules, though, are perhaps a bit more enlightened when it comes to the incorporation of settlement directives into the fabric of the arbitration process. Rule 22(c), for example, expressly provides that the Arbitral Tribunal is to call for a pre-arbitration hearing where *"the parties shall establish time periods for taking steps to deal with any matter that will assist the parties to* ***settle their differences****…";* Rule 38 provides that "(a)*t any time before the hearing on the merits, a party may deliver to the other party an offer marked 'without prejudice' to* ***settle*** *one or more of the issues between it and any other party on the terms specified in the offer,"* and "(t)*he Tribunal shall take into consideration the offer, the time at which the offer was made and the extent to which it was accepted when dealing with questions of costs and interest";* and Rule 43 provides that "(t)*he Tribunal may* ***encourage settlement*** *of the dispute and, with the written agreement of the parties, may* ***order*** *that mediation, conciliation or other procedures be used by the parties at any time during the arbitration proceedings to encourage settlement"* (emphasis added). Interestingly, these Rules give the Arbitral Tribunal the rather unique authority and jurisdiction to "order" the parties, with their general agreement, to engage in a settlement process.

Similarly, the Center for Effective Dispute Resolution (CEDR) Rules for the Facilitation of Settlement in International Arbitration (November 2009) provide, at Article 3(2), that *"the Arbitral Tribunal will take proactive steps in accordance with these CEDR Settlement Rules to assist the Parties to achieve a negotiated settlement of part or all of their dispute."*

As stated in their preamble, the Rules, which could be *"incorporated on an ad hoc basis by agreement of the Parties, as part of the institution's rules, or within a contract clause requiring arbitration,"* were *"designed to increase the prospects of parties in international arbitration proceedings being able to settle their disputes without the need to proceed through to the conclusion of those proceedings."*

Institutional ADR service providers might be well advised to look closely at the type of authority granted to arbitrators under both the ADR Institute of Canada Inc.'s National Arbitration Rules and the CEDR Rules, and to judges under the Federal Rules of Civil Procedure, in order to determine whether the incorporation of such mandatory provisions into their own arbitration rules would enhance the scope and quality of the services they offer to the construction industry.

As Judge Learned Hand might have taught us, although conflict may be normal in any litigation or arbitration scenario, its early resolution is an admirable objective. ■

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The Annotated Construction Law Glossary: A Book Review

By PHILIP L. BRUNER, ESQ.

Dictionaries and glossaries offering up-to-date, precise meanings of words and terms are crucial to the modern use and future development of human language. In our ever-changing world, words morph quickly in meaning from one context to the next. Rapid specialization and evolution have been a hallmark of human language for millennia, and were the motivation behind Samuel Johnson's publication of the first English word dictionary in 1755. In the Preface to his work, *A Dictionary of the English Language*, Johnson said:

> *[I]t must be remembered, that while our language is yet living, and variable by the caprice of every one that speaks it…words are hourly shifting their relations, and can No more be ascertained in a dictionary, than a grove, in the agitation of a storm, can be accurately delineated from its picture in the water.*

Johnson's Dictionary covered 40,000 words. Today we have over

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Annotated Construction Law Glossary

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a million words in the English language, with old words daily stretched in conversation to offer meaning to new technical and social inventions, customs and usages. It is, as it were, like "pouring new wine into old skins."

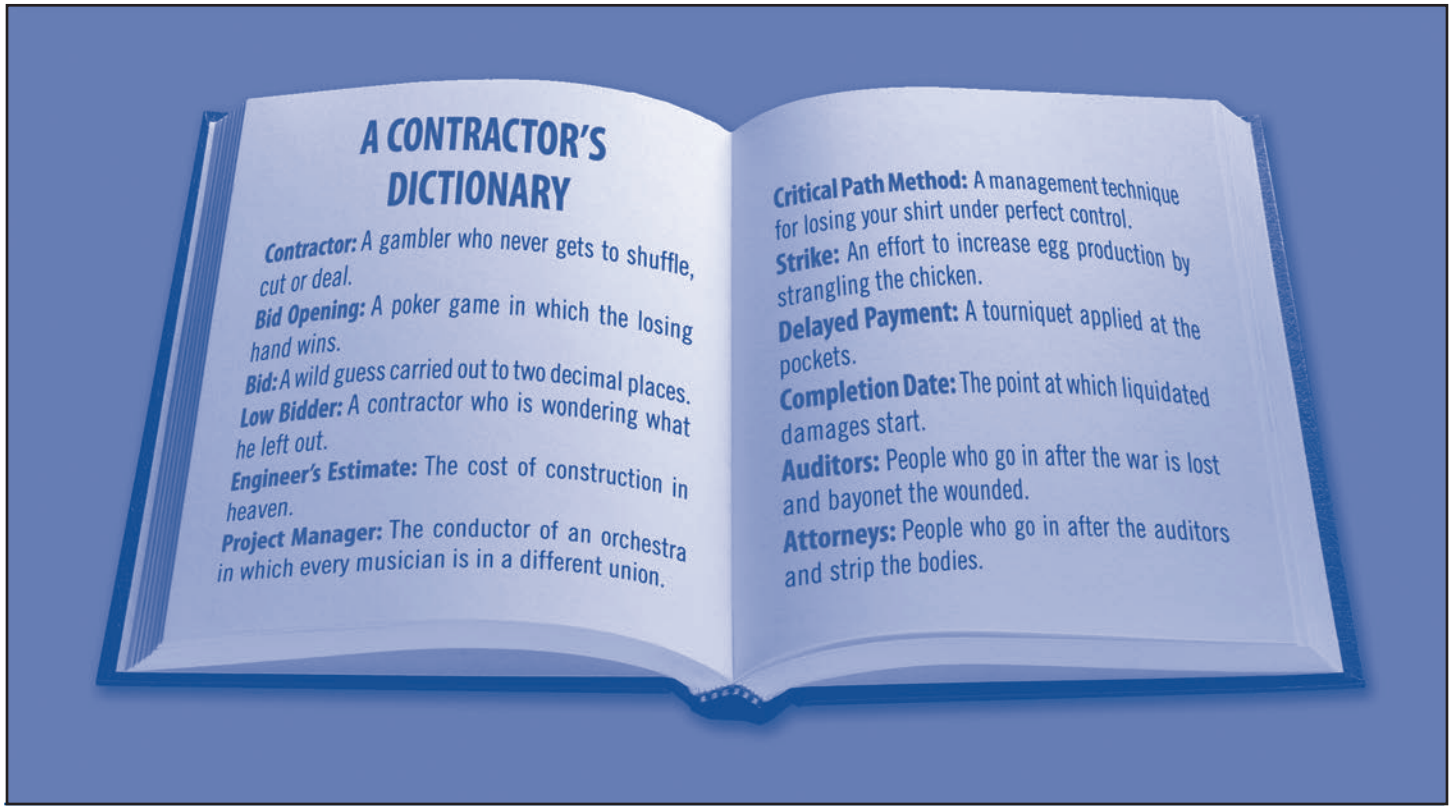
In the Construction field, there are now thousands of words with specialized meanings that have evolved and are used daily by participants in the building process to give reasonably precise definition and usage convention to underlying facts and applicable concepts of law.

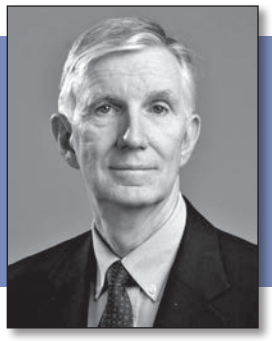
"Construction language" comprises, in addition to some terms understandable to the general public, myriad layers of specialized words arising from the host of design and construction specialties—architecture; engineering sub-specialties such as civil, structural, electrical, mechanical, geotechnical and acoustics; construction management; building trades such as carpenters, plumbers, steam fitters, brick layers, electricians, iron workers, sheet metal workers and equipment operators; sureties; cost accountants; insurers; building code officials; surveyors; manufacturers of building materials; and government regulators. Such specialization of language has led the judiciary to recognize construction law as "a separate breed of animal" distinct from other fields of law. See *Paul Hardeman, Inc. v. Arkansas Power & Light Co.*, 380 F. Supp. 298, 317 (E. D. Ark. 1974) ("[C]onstruction contracts are a separate breed of animal; and, even if not completely *sui generis*, still… [the] law must be stated in principles reflecting underlying economic and industry realities.") See also *The Society of Upper Canada, Standards for Certification-Construction Law.*

To aid practitioners and the judiciary in understanding the most significant of the specialized meanings used in construction is the objective of the recently published **The Annotated Construction Law Glossary**. The glossary was compiled by six able editors with industry knowledge and lengthy construction law experience—namely, Elizabeth Patrick, Robert Beaumont, Terry Brookie, Harvey Kirsh, Michael Tarullo and Kathryn Spencer—and published in August 2010 by the American Bar Association Forum on the Construction Industry.

The glossary's 215 pages are filled with detailed explanations of the meanings of many terms important to the construction process and, when available, with citations to relevant case law using or otherwise supporting the definitions **provided**.

The Glossary is a "must have" for any construction lawyer in the English-speaking world and is an important contribution to construction law and to understanding construction industry literature. ■





ADR in Federal Contract Disputes: What Law Applies

BY JAMES F. NAGLE, ESQ.

The federal government spends over $500 billion a year on contracts. Therefore, disputes between the prime and subcontractors on a federal contract are relatively common, but they may contain some issues unfamiliar even to the experienced practitioner.

Applicable Law

Certainly, the subcontract itself can identify the applicable body of law that will be used to interpret it. If the prime and subcontractor are both Washington corporations and the contract is formed and performed in Washington, it would be logical for the parties to agree that the law of Washington will apply. Frequently, however, the parties will designate "federal procurement law" as the body of law to be used in interpreting the subcontract.

What Is Federal Procurement Law?

Federal procurement law typically means the decisions of the federal forums in the area: the United States Court of Appeals for the Federal Circuit, the U.S. Court of Federal Claims, the applicable Boards of Contract Appeals and, in certain circumstances, the Government Accountability Office. At one time, there were numerous agency Boards of Contract Appeals. Now, there are two multiagency boards: (1) the Armed Services Board of Contract Appeals, which deals with appeals from the Department of Defense agencies, the Corps of Engineers, NASA, the CIA and a few other departments; and (2) the Civilian Board of Contract Appeals, which, in January 2007, replaced such former agency boards as those of the General Services Administration and the Departments of Energy, Interior, Health and Human Services, Transportation and Veterans Affairs.

Federal procurement law also includes the regulations set forth in the Federal Acquisition Regulation (FAR), 48 Code of Federal Regulations (CFR), Chapter 1. The FAR is also available at http://www.acqnet.gov/far/. Title 48 in its entirety is often referred to as the FARS—the Federal Acquisition Regulatory System—because while the FAR itself is Chapter 1, many agencies have issued their supplements to the FAR and these are scattered throughout the rest of Title 48. For example, Chapter 2 of Title 48 is the Defense Federal Acquisition Regulatory Supplement. Chapter 9 is the Department of Energy Acquisition Regulation. The FAR and its supplements (the size of a large city phone book) implement numerous statutes that apply to federal procurements, such as the Contract Disputes Act, Truth in Negotiations Act, Competition in Contracting Act and the Buy American Act.

Why Would Two Private Parties Choose Federal Procurement Law?

Choosing federal procurement law to govern a subcontract makes sense for two reasons. First, the prime contractor will often want to be bound by the same set of rules upstream (to the government) and downstream (to the subcontractor). The prime does not want to be caught in the middle and face the danger of inconsistent results between its dispute proceedings with a subcontractor and the government. Second, it is common that federal contract clauses are flowed down in the subcontract. While relatively few clauses are mandatorily flowed down, it is prudent for the prime contractor to flow down such clauses as the changes and termination clauses, as well as a host of others.

Even if a particular state's law is the applicable law, very often the parties will have to brief the judge or arbitrator on the meaning of "equitable adjustment," "allowable costs" or "component" under the Buy American Act as established by numerous federal court and board cases. In so doing, federal law will often be reviewed and applied to ensure consistency in interpreting terms in the contract.

If the subcontract does not designate what law will apply, a judge or arbitrator may sometimes fill the void by designating federal procurement law as the applicable law. This is done relatively rarely and normally only in those contracts, such as national defense or Energy Department contracts, for which the judge or arbitrator decides that uniform law across the 50 states must apply.

Applicable Terms and Conditions

Besides the applicable law, it is critical that counsel for the subcon-

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Federal Contract Disputes continued from Page 13

tractor review the prime contract with the government because the subcontract often states that the subcontractor will be bound by all of the terms and conditions in the prime contract. This very common clause is frequently inappropriate, such as when the prime contract with the government is a cost-reimbursable construction contract and the subcontract in question is a fixed-price supply contract. Such fundamental discrepancies are frequently overlooked.

Obviously you must comply with the applicable statutes, executive orders and regulations, but fortunately the federal government, unlike many other large owners, has put out a publicly available compilation of the rules it follows, and expects you to follow, in its contracting—the FAR.

The FAR is an attempt by the federal government to make uniform the contracting practices of the federal agencies so that the contract procedures and the contract itself for the Agriculture Department would not look radically different from a contract for the Department of the Army. In fact, it would look amazingly similar.

The FAR is composed of 53 different parts that are chronologically designed to walk the reader through the contracting process, from initial planning to termination. Its 53 parts are grouped into eight subchapters.

Part 52 is Solicitation Provisions and Contract Clauses. Provisions essentially apply only before the contract is awarded; clauses may apply both before and after the contract is awarded. The FAR is logically set out. All the provisions and clauses are in FAR 52.2. The next two digits will refer to the part dealing with the substance of the clause. For example, since FAR 49 deals with termination, all of the government's termination clauses will be in Section 52.249. That number will then be followed by a dash and another number, which will identify the specific applicable clause. For example, 52.249-10 is the default clause for fixed price construction contracts.

FAR 53 is a list of all the standard forms used in government contracts. They are all contained in FAR 53.301. FAR 53.301 will be followed by a dash and then the clause number. So, for example, if you wanted to locate Standard Form 1442 (Standard Form 1442, Solicitation, Offer and Award (Construction, Alteration or Repair)), you would go to FAR 53.301-1442. This is the standard form used for construction contracts.

Many agencies, not all, have issued their supplements to the FAR. These are specifically not to contradict or overrule the FAR, unless a statute unique to that agency authorizes such special requirements. These supplements are designed to implement agency-specific forms, clauses or procedures. So, for example, if you have a contract with the Army, you should review not only the FAR and DFARS, but also the AFARS, the Army Federal Acquisition Regulation Supplement. All of the agencies will follow the same numbering system as the FAR.

Photo courtesy of the Society of Construction Law Hong Kong

JAMS GEC Neutrals Philip Bruner, Katherine Gurun, Douglas Oles, James Nagle and Barry Grove at the American College of Construction Lawyers' Seminar, International Construction Law Conference in Hong Kong in December 2010.

Conclusion

Federal contracts are endemic in American society. So too are the disputes between general contractors and their subcontractors that inevitably result. Understanding the law and rules that apply typically to these subcontracts can help you avoid disputes or, if they do arise, at least enable a quicker resolution of the disputes on grounds of common and correct understanding. ■

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NOTICES

GEC NEUTRALS RESOLVE AN ARRAY OF CONSTRUCTION DISPUTES

- **PHILIP L. BRUNER, ESQ., JAMES F. NAGLE, ESQ.,** and **HARVEY J. KIRSH, ESQ.,** have been appointed as neutral members of an Appeal Panel, under JAMS' Optional Appeal Procedure, relating to the appeal of an Award issued by another institutional ADR service provider. The dispute relates to breach of warranty, limitations, and other procedural and substantive issues arising out of the supply and installation of an allegedly defective roofing system.

- **HARVEY J. KIRSH, ESQ.,** is a party-appointed co-arbitrator in connection with significant claims and counterclaims arising out of the construction of a number of pump stations that are part of a multi-billion-dollar oil pipeline project. Harvey is also a member of an arbitration panel that was constituted to deal with breach of contract claims and counterclaims arising out the construction of three wastewater treatment facilities in one of the maritime provinces in Canada. Harvey also recently conducted a complex multi-party mediation of a number of claims and crossclaims arising out of a fire, allegedly caused by building code violations, in an assisted-living retirement residence.

- **JOHN W. HINCHEY, ESQ.** is serving as a sole arbitrator in connection with a dispute between a manufacturer of wind turbines and its subcontractor, arising out of the design and construction of a wind farm located in Central America. John is also chair of an arbitral tribunal which was constituted to resolve a dispute arising out of the design and installation of a crude oil storage and pipeline facility.

BOOKS, ARTICLES AND SPEAKING ENGAGEMENTS

- The 1,000-page, 17th edition of ***California Construction Law***, co-authored by **KENNETH C. GIBBS, ESQ.**, was recently published by Aspen Publishers.
- The updated 3rd edition of ***A Guide to Construction Liens in Ontario***, co-authored by **HARVEY J. KIRSH, ESQ.**, is to be published in 2011 by LexisNexis Butterworths Canada. Harvey has also co-authored an article titled "Problems with Liens," which will be published in the 2011 ***Journal of the Canadian College of Construction Lawyers***.
- In October 2009, the College of Commercial Arbitrators ("CCA"), under the leadership of its then-President **HON. CURTIS E. VON KANN (RET.)**, convened a National Summit on Commercial Arbitration in Washington, D.C., addressing perceptions and concerns about the cost and speed of commercial arbitration. The CCA has now published its Protocols for Cost-Effective and Speedier Commercial Arbitration, suggesting procedures and processes that can be utilized to control the costs and duration of commercial arbitration. The supporting commentary and text was prepared by an editorial group headed by JAMS neutral **THOMAS J. STIPANOWICH, ESQ.,** of the Straus Institute for Dispute Resolution at Pepperdine University School of Law.
- **JOHN W. HINCHEY, ESQ.,** recently addressed the Indian Chartered Institute of Arbitrators, in Mumbai, about the new College of Commercial Arbitrators' Protocols.
- **RICHARD CHERNICK, ESQ.,** and **ZELA "ZEE" G. CLAIBORNE, ESQ.,** have co-authored an article for the ***National Law Journal*** titled "Achieving Efficiency & Economy in Complex Commercial Cases: What Providers Can Do."

RECENT HONORS AND APPOINTMENTS

- **JOHN W. HINCHEY, ESQ.,** has been elected an Honorary Fellow of the Canadian College of Construction Lawyers. His induction is expected to take place at the College's next annual conference in June 2011 in Ottawa, Canada.

- **HARVEY J. KIRSH, ESQ.,** has been elected as a Fellow of the American College of Construction Lawyers. His induction is expected to take place at the College's upcoming annual conference in February 2011 in Key Biscayne, Florida. Harvey has also been listed as a leading construction lawyer in the current editions of the ***Lexpert/American Lawyer Guide to the Leading 500 Lawyers in Canada***, ***Who's Who Legal***, the ***Canadian Legal Lexpert Directory*** and the ***Best Lawyers in Canada***.

JAMS GLOBAL CONSTRUCTION SOLUTIONS

Leading ADR Developments from The Resolution Experts

JAMS Global Construction Solutions seeks to provide information and commentary on current developments relating to dispute resolution in the construction industry. The authors are not engaged in rendering legal advice or other professional services by publication of this newsletter, and information contained herein should not be used as a substitute for independent legal research appropriate to a particular case or legal issue.

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