

CURTAILING LITIGATION COSTS: EFFECTIVE USE OF ARBITRATION

Litigation costs are a burden on any company's economic health. This is especially true in the construction industry where, despite popular belief to the contrary, profit margins are relatively thin. How often does any player in the industry, regardless of status, budget for litigation costs? Companies would price themselves out of work if they included litigation costs in any bid. Usually, companies do not anticipate disputes or litigation and consequently these costs are covered out of overhead. More than likely, if your company is embroiled in either numerous cases, or if one or more of these cases are of significant size or complexity, the carrying cost of litigation alone will usurp overhead and eat into and possibly devour profit. Does anyone think there will be less litigation of construction disputes in the future? Does anyone think the costs of litigation will decrease? Not a rosy picture is it? Fortunately, there is light at the end of the tunnel if the problem is tackled aggressively and head-on. An understanding of why construction litigation costs are so high is a good place to start.

COMPLEXITY

Often overlooked by everyday practitioners in the industry, the fact is that construction in and of itself is exceedingly complex. Stop and think how many intricate layers of work must be intertwined with each other and at the appropriate time. Complexity is simply part of the business. Imagine taking conceptual discussions about the way a project will look, putting those discussions down in a flat drawing, and having a stranger to the design process interpret those drawings in an effort to appropriately price and build the end result. Further imagine organizing site work, concrete, structural steel fabrication and erection, mechanical, electrical, plumbing, masonry, glass and glazing, drywall, millwork, flooring, wall-coverings and a hosts of other trades such that the flat, linear drawings become real, tangible improvements. Although consistently taken for granted by industry professionals, the task of construction is quite overwhelming.

To the lay person (read "lawyer and/or juror") these complexities appear enormous. Unfortunately, in the world of legal fees and costs, the greater the complexity, the greater the cost necessary to "handle" those issues. What appears to be a rather simple construction dispute can (and usually does) turn into a process involving the reconstruction of the events not only of the issue involved but many times of the entire job. As an example, project delays are a typical construction dispute. However, it is rare that an investigation of the delay would not involve scheduling issues for the entire job and many times necessitate a full-blown CPM schedule analysis involving all trades, most of whom are not remotely involved in the dispute. The number of parties involved in a construction project and the number of moving parts required in that project will, in and of themselves, create significant legal costs when litigation ensues.

PROCEDURE

The inherent complexity of construction is difficult to address, at least in terms of curtailing litigation costs. However the way in which most lawyers process a case is an equally significant

factor in spiraling costs. Under the rather liberal discovery rules adopted in American jurisprudence for the last several decades, lawyers have assumed it is their inherent right to turn over every rock in every case until every question is answered, before the case reaches the inside of a courtroom. There is now a generation of lawyers who have known nothing but full blown discovery in litigation practice. Do not be too harsh on them. They have taken an oath to zealously represent their clients to the best of their abilities. The civil procedure rules in most states allow liberal discovery practices. Given the ability to learn everything about a case and to lock down witness testimony before it is heard in the courtroom, it is easy to understand why lawyers avail themselves of the opportunity.

The problem, of course, is that the combination of the construction industry's complexity and the ability of legal counsel to "discover" the entirety of the project from stem to stern, results in exorbitant litigation costs. Additionally, this is true regardless of the amount in controversy or the relative simplicity of the dispute. In fact, it can be argued that litigating a construction case with an amount in controversy less than one hundred thousand dollars is a poor business decision, given the legal carrying costs involved.

FEES

This just in, attorneys' hourly fees are not going down. Multiply ever increasing hourly rates by the significant number of hours "required" in construction cases due to complexity issues and the procedural mind-set of lawyers and the reason why construction litigation costs are high becomes readily apparent.

ANSWERS

Fighting the increase in attorneys' hourly rates may be a losing battle. Similarly, attempting to "simplify" the inherent complexity of construction seems like an impossible task. However, there may be a way to attack the procedure used to resolve construction disputes, such that less time is spent and perhaps more importantly, less lawyer time is needed.

The alternative dispute resolution process most familiar to the construction industry is arbitration. While mediation and partnering are particularly useful in resolving or preventing disputes, binding arbitration clauses are written into many standard form agreements used in the industry, such as the forms promulgated by the American Institute of Architects and the Associated General Contractors. Arbitration is, essentially, a private trial using industry professionals and attorneys with subject matter expertise as an alternative to an elected judge or jury. The hallmarks of arbitration are a quicker and more efficient process, theoretically resulting in less legal fees. The undisputed beauty of the process for construction disputes is the judge and jury (the arbitrators) will have some grounding in the industry or in construction law. The case is easier to present to an arbitrator who is familiar with industry terms and processes instead of trying to make an unsophisticated jury (at least in construction terms) understand those complexities.

Most arbitrations are administered by independent, neutral third party administrators, such as the American Arbitration Association ("AAA"). These administrators shepherd the process through

from start to finish in an unbiased fashion. The AAA has governing rules for arbitrating construction disputes, including specifically a reduction in the discovery process. While many experienced lawyers and most arbitrators understand that the arbitration process is supposed to be efficient, or at least more efficient than litigation, there is still a tendency for the arbitration process to become too legalistic. When lawyers from both sides of the dispute are begging the arbitrator (who often times is also a lawyer) for multiple depositions because the facts of the case are so unique that the demands of justice require it, many times it is difficult to hold the process in check. After all, since arbitration is “by agreement”, if both lawyers agree to take substantial numbers of depositions and go through the other formal discovery processes (interrogatories, requests for production, etc.) many arbitrators feel forced to go along. Is there a way to curtail the pressure to expand the process and to reign in zealous lawyers?

CONTRACTUAL CLAUSES

Arbitration is, after all, a creature of contract. The process is defined and controlled by the arbitration clause in the contract between the two parties to the dispute. Arbitrators, at least those on the panel of arbitrators for the AAA, are trained to believe the parties’ agreement, as expressed in the arbitration clause, is sacrosanct. In fact, case law throughout the country has held that arbitrators lose their authority and jurisdiction and arbitration awards can be overturned if an arbitrator exceeds the limits contained in the parties agreement. Consequently, arbitrators are trained to strictly follow the jurisdiction given them in the clause. It is here companies can actually mandate an alternative process to resolving construction disputes, with the objective being to save time and money, while still having a meaningful, fair process.

Most arbitration clauses are generically broad, to cover any type of dispute relative to the project. A typical clause is as follows:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Construction Industry Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

There is nothing wrong with this clause. It is broad enough to send essentially every issue that could become a dispute on a project to arbitration. It does not, however, give any specific guidance to the arbitrator as to the arbitration process, other than the adoption of the AAA rules. If your company is interested in limiting the discovery process across the board, consider the following clause:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Construction Industry Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. *There shall be no discovery except for a complete exchange of documentary information and except for the taking of up to three (3) depositions per side, even if discovery is provided for by AAA rules or applicable law.*

This clause has the virtue of unambiguously telling the arbitrator the parties are agreeing to restrict the discovery process. The arbitrator will have no recourse to do otherwise, unless the agreement is changed by the parties in writing.

Does this clause adequately handle a small case? If the amount in controversy is less than say \$100,000 (or whatever your company's tolerance level), do you want to pay the cost of depositions at all? Consider a "stepped" approach as follows:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Construction Industry Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. For cases in which the amount in controversy is less than \$100,000, there shall be no discovery other than a complete exchange of documents relative to the dispute. For cases in which the amount in controversy is between \$100,000 and \$500,000, there shall be no discovery except for a complete exchange of documentary information and except for the taking of up to three (3) depositions per side (including expert depositions, if any). For cases in which the amount in controversy exceeds \$500,000, there shall be no discovery except for a complete exchange of documentary information and except for the taking of up to five (5) depositions per side (including expert depositions, if any). No formal interrogatories, request for admissions or formal request for production of documents shall be allowed under any arbitration process.

Because arbitration is by contract, you can create different rules for different levels of cases as show in the above clause. The numbers shown can be adjusted upward or downward, depending on the specific needs of your company.

Some companies (and their counsel) get squeamish over the issue of limited appeal rights in the arbitration context, especially in a "bet the company" type of case. Although uncommon, protections can be built in by adding an appeal component to the arbitration clause, or including "opt-out" language, which provides that any dispute over a threshold amount must be litigated. While this option defeats the purpose of trying to lessen litigation costs, companies must carefully weigh the trade-offs between litigation and arbitration.

TIME

Another critical factor in the cost of either litigation or arbitration is simply the time it takes to get to the hearing on the merits. The longer the period of time from the initiation of the case to the actual hearing, the more expensive the carrying costs will be. If an attorney is given twelve months to prepare a case, the case will be prepared in twelve months. Likewise, if the hearing on the merits will take place in four months, the attorney will have the case prepared within that time frame. Whatever time frame is given, responsible attorneys will do what is necessary to prepare the case for hearing. Consequently, the sooner a case can reach the ultimate hearing, the less chance for an unnecessary run-up of fees. Because time is a significant factor in legal costs (not to mention the man-hours lost by company personnel handling the dispute, rather than concentrating on more profitable company business), companies may consider inserting time restrictions into their

arbitration clauses. Remember that arbitrators lose jurisdiction if they violate express limits in an arbitration clause. For example, consider adding the following time limitations to an arbitration clause:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Construction Industry Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. *The hearing on the merits will be completed no later than ninety (90) days after the initial demand for arbitration is made.* There shall be no discovery except for a complete exchange of documentary information and except for the taking of up to three (3) depositions per side, even if discovery is provided for by AAA rules or applicable law.

Likewise, it is also possible to use time limitations in the “stepped” process as well. Similar wording can be added for disputes ranging from \$100,000 - \$500,000, requiring the hearing to take place within 120 days. For cases involving amounts greater than \$500,000, consider language requiring the hearing within 180 days, and so on.

SELLING THE CONCEPT

In all likelihood, your lawyer will not like the limitations proposed herein. Anything outside of the “comfort zone” of full discovery will not be met with positive acceptance, even though such limitations apply to BOTH parties to the dispute. However, since the company’s money is being spent, the company, not its counsel, should have the ability to control the process in an effort to reduce costs. If your lawyer forbids inclusion of such cost limiting arbitration clauses, perhaps it is time to find new counsel. For years, industry professionals have ceded too much authority and decision making in such matters to counsel. A quick review of construction litigation costs should convince companies to make decisions in the best interest of the bottom line.

CONCLUSION

Disputes are inevitable in the construction industry. The carrying costs of litigating construction disputes, particularly on the legal fee side, are inexorably increasing. If your company has been good enough or lucky enough to ward off significant litigation, congratulations. To those companies laboring under the drain of excessive litigation costs with no apparent end in sight, consider aggressively attacking the problem by altering the process by which disputes are handled. Because the arbitration process is a creature of contract, contract drafters are working with a blank page, limited only by imagination and tolerance level. The goal is to provide a forum that will resolve disputes in a fair, efficient and less expensive way. Crafting arbitration clauses to meet these goals is a first step towards that end.