

“Defending the Construction Claim in Arbitration”

Marc A. Young
Cokinos, Bosien & Young
2919 Allen Parkway, Suite 1500
Houston, Texas 77019
(713) 535-5500
Fax: (713) 535-5533
myoung@cbylaw.com

CONSTRUCTION LAW SEMINAR
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Marc A. Young, born San Angelo, Texas, February 5, 1957. Admitted to bar, 1983, Texas; also admitted to practice before United States District Court (Southern, Eastern, and Western Districts of Texas). Preparatory education, Texas A&M University (B.A., 1979); legal education, South Texas College of Law (J.D., 1982). Board Certified, Personal Injury Trial Law, Texas Board of Legal Specialization. Member: College of the State Bar of Texas; Houston Bar Association (Sections: Litigation and Construction Law); Fellow: Houston Bar Foundation; State Bar of Texas (Sections: Litigation and Construction Law). Texas Association of Defense Counsel. Defense Research Institute [Charter Member, Construction Law Committee; Chairman, Construction Law Insurance Subcommittee (1995-98); Member, Steering Committee (1995-); Program Chairman, Construction Law Committee (1999-00); Committee Chairman (2001-present); Medical Liability Committee; Co-Chairman, Pharmacy Subcommittee (1999-00); Insurance Law Committee; Products Liability Committee (2003-present); Board of Managers, Lake Houston Y.M.C.A. (1996-Present), Chairman, Board of Managers (1998-99), Board Member (1996-2000), Executive Committee Member (2003); Speaker and Author: "OSHA and Personal/Injury Claims," 1st Annual Construction Law Conference, Defense Research Institute, San Diego, California (1996); Speaker and Author: "Ethical Considerations in Handling Construction Law Cases," Construction Law Seminar, Defense Research Institute, Chicago, Illinois (1996); "Interrelated Risk Transfer Devices--Part 1: Indemnity and Additional Insured Protection", 11th Annual Texas Construction Law Conference, San Antonio, Texas (1998); "Right of Control in a Personal Injury/Fall Protection Case Against a General Contractor", Defense Research Institute, Construction Law Seminar, San Antonio, Texas (1998); "Subcontract Risk Allocation: Fair or Foul?", 18th Annual Construction Insurance Conference, International Risk Management Institute, Inc., New Orleans, Louisiana (1998); "Who Pays Next? Analysis of the Role of Excess and Umbrella Coverage in Large Construction Losses, Including a Discussion of the Impact of Additional Insured Status and Contractual Indemnity Obligations", Defense Research Institute, Construction, Litigation, Insurance and Surety Seminar, Phoenix, Arizona (1999); "What Do You Do When the Claim Comes In? Good Faith and Ethical Issues," Defense Research Institute, Construction Litigation, Mold & Related Toxins Seminar, San Diego, California (2002); "Disputing the Extent of Mold-Related Personal Injury Claims," Defense Research Institute, Construction Law Seminar, Las Vegas, Nevada (2002); "From the Bench and Trench: Views from Judge and Lawyer," Defense Research Institute, Mold Seminar, Houston, Texas (2003); "Defending the Construction Claim in Arbitration," Defense Research Institute, Construction Law Seminar, San Diego, California (2003).

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The use of arbitration as a forum for the resolution of construction disputes is proliferating rapidly. In 2000, nearly 200,000 arbitration claims were filed with the American Arbitration Association (“AAA”). In the residential construction arena, except where excluded by state law, the arbitration of disputes between home owners and home builders is now the norm in many parts of the country. There is an ever-increasing number of commercial projects which are choosing arbitration over litigation as a means of resolving disputes relating to construction defects. This paper will discuss the common rules, procedure and suggested methods of defending the Construction Claim in arbitration.

Arbitration Clauses

Arbitration clauses are typically contained in construction contracts signed by the parties. One of the most common forms used in commercial construction today is the AIA Document A201–1997. This form contains the general conditions of the contract for construction. Section 4.6 deals with arbitration and specifically states as follows:

4.6.1 Any Claim arising out of or related to the Contract, except Claims relating to aesthetic effect and except those waived as provided for in Subparagraph 4.3.10, 9.10.4 and 9.10.5 shall, after decision by the Architect, or thirty days after submission of the Claim to the Architect, be subject to arbitration. Prior to arbitration, the parties shall endeavor to resolve disputes by mediation in accordance with the provisions of Paragraph 4.5.

4.6.2 Claims not resolved by mediation shall be decided by arbitration which, unless the parties mutually agree otherwise, shall be in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association currently in effect. The demand for arbitration shall be filed in writing with the other party to the Contract and with the American Arbitration Association, and a copy shall be filed with the Architect.

4.6.3 A demand for arbitration shall be made within the time limit specified in Subparagraphs 4.4.6 and 4.6.1 as applicable, and in other cases within a reasonable time after the Claim has arisen, and in no event shall it be made after the date when institution of legal or equitable proceedings based on such Claim would be barred by the applicable statute of limitations as determined pursuant to Paragraph 13.7.

4.6.4 **Limitation on consolidation or joinder.** No arbitration arising out of or relating to the Contract shall include, by consolidation or joinder, or in any other manner, the Architect, the Architect's employees or consultants, except by written consent containing specific reference to the Agreement and signed by the Architect, Owner, Contractor and any other person or entity sought to be joined. No arbitration shall include, by consolidation or joinder, or in any other manner, parties other than the Owner, Contractor, a separate Contractor as described in Article 6 and other persons substantially involved in a common question of fact or law whose presence is required if complete relief is to be accorded in arbitration. No person or entity other than the Owner, Contractor or a separate Contractor as described in Article 6 shall be included as an original third party or an additional third party to an arbitration whose interest or responsibility is insubstantial. Consent to arbitration involving an additional person or entity shall not constitute consent to arbitration of a Claim not described therein, or with a person or entity not named or described therein. The foregoing Agreement to arbitrate and other Agreements to arbitrate with an additional person or entity duly consented to by parties to the Agreement shall be specifically enforceable under applicable law in any court having jurisdiction thereof.

4.6.5 **Claims and timely assertion of Claims.** The party filing a notice of demand for arbitration must assert in the demand all

Claims then known to that party on which arbitration is permitted to be demanded.

4.6.6. Judgment on final award. The award rendered by the arbitrator or arbitrators shall be final, and judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof.

The American Arbitration Association recommends insertion of the following clause in the contracts where arbitration is appropriate:

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 AAA recommends the following language where parties wish to agree to arbitrate existing disputes where the contract does not contain an arbitration provision.

We, the undersigned parties, hereby agree to submit to arbitration administered by the American Arbitration Association under its Construction Industry Arbitration Rules the following controversy:(cite briefly). We further agree that the above controversy be submitted to (one) (three) Arbitrator(s). We further agree that we will faithfully observe this Agreement and the Rules, that we will abide by and perform any Award rendered by the Arbitrator(s), and that a judgment of the court having jurisdiction may be entered on the Award.

Most states have specific statutes dealing with the legality of arbitration provisions. These provisions vary from state to state and are more restrictive in some states than others. California, for instance, is quite restrictive with regard to the uses of arbitration, particularly relating to individual consumers. In general, however, arbitration agreements are enforceable if the parties executing the agreement had fair notice of their waiving their right to trial by jury and agreeing to arbitrate rather than litigate their issues. This paper will not attempt to address the enforceability or limitation of arbitration agreements, but instead, focus on defending a proper claim.

Demand for Arbitration

A claimant is required to file a Demand for Arbitration in accordance with the contractual arbitration provision. In the most common case, the claimant is required to file Demand for Arbitration with the Arbitrating Association such as the AAA with a copy to the architect of record and a copy to the Respondent. The arbitration group will typically provide a copy of the filed claim to the Respondent within a short period of time after the Demand has been filed. The Demand for Arbitration should provide specificity as to the claim, the parties, the source of the arbitration agreement and the value of the damages claimed.

Under the normal AAA Rules, the Responding Party has 15 days in which to file a Response. However, failure to file a Response does not result in the entry of any type of default, but is simply considered to be a general denial of all claims. The Demand for Arbitration should provide specificity as to the claim, the parties, the source of the arbitration agreement, and the value of the damages claimed.

Locale Determination

Once a Demand for Arbitration has been filed, you next have to determine whether venue is appropriate.

Venue or “locale determinations” are required to be made or objected to no later than the Respondent’s answering statement. If the locale is not defined by the Arbitration Clause itself, the party filing the arbitration may choose any locale they prefer subject to the Responding Party’s entitlement to object to the locale. In the event of an objection, the Case Manager will require the parties to submit written statements regarding its reasons for preferring a specific locale. In preparing the statements, the parties will be asked to address the following issues:

1. Location of parties and attorneys;
2. Location of witnesses and documents;
3. Location of records;
4. If construction, location of site, place of materials and the necessity of an on-site inspection;
5. Consideration of relative difficulty in traveling and cost to the parties;

6. Place of performance of contract;
7. Place of previous court actions;
8. Location of most appropriate panel;
9. Any other reasonable arguments that might affect the locale determination.

Following submission of this information, a determination of locale based on the party responses is made by the Department of Case Management of the American Arbitration Association's New York headquarters. The locale determination, once made by the Association, is final and non-appealable.

Locale determination can be important in construction cases where contracts are often performed by contractors who do not live, work or have an active office in a particular locale. Since many arbitrations are filed well after completion of a project, an owner might be perceived to have a distinct advantage by filing the claim where the owner prefers. While a great deference is given to the site of the actual construction, a defendant should make all reasonable efforts to contest any locale which it deems to create any disadvantage.

Answering Statement

A Respondent's Answering Statement, like a Claimant's Demand, should be persuasive and contain as many facts as are actually known at the time. Use of litigation-type forms should be avoided at all costs. Litigation forms over the years have tended not to focus on persuasion, but focused instead on providing adequate notice. In discussions with numerous arbitrators, they claim the most effective documents are more literary and make great use of persuasive statements, significant background reasoning and detail. However, great care should be used to avoid the use of emotion, as this may detract from your overall presentation.

Selecting the Arbitrators

Selection of arbitrators is one of the most significant responsibilities in arbitration. It constantly amazes me how little effort some people spend in discovering the backgrounds of the potential arbitrators. The AAA Rules specifically allow for parties to be involved in the creation of the initial list of potential Arbitrators. Following receipt of a Demand for Arbitration, you should contact the Case Manager and begin your dialog concerning potential arbitrators for your particular claim. The Case Manager will not be making any decisions

with regard to the merits of your claim. The Case Manager's role is to assist administratively in the arbitration process. You may therefore discuss with the Case Manager the background facts of the case in order to assist that person in understanding the necessary qualifications or potential biases that certain arbitrators may have.

Since the American Arbitration Association Rules are the most common sets of rules used today in construction litigation, I will be referring principally to their rules throughout the remainder of this paper. The arbitration agreement dictates the number of arbitrators, whether one or three, that are to be used to decide any potential dispute. In the absence of specific language within the arbitration agreement, the parties may agree on the number of arbitrators to be used. If the parties fail to agree on the number of arbitrators, a three-arbitrator panel system wins by default. In this scenario, each party will select its own arbitrator and those two arbitrators will pick the neutral arbitrator.

The selection of arbitrators or de-selection of arbitrators, as the case may be, is no different than picking a jury. You should use the same level of skill and effort in determining the backgrounds of the arbitrators as you would any potential juror in a case to be tried. In a case involving a single arbitrator, it is incredibly important to understand their background. For instance, if the arbitrator commonly represents general contractors, and your claim involves a claim by a general contractor, the arbitrator, whether consciously or subconsciously, may have a preference for the general contractor. While the opposite may also be true, you have to stick with generalities just as you would in jury selection to err on the side of caution. In a single arbitrator situation, your best arbitrator is someone who has either represented both types of parties or who has represented neither type.

Selection or de-selection of arbitrators in a three member panel takes on an entirely different review process. In the three member panel scenario, your job is to select an arbitrator who will be an advocate for your position. You want someone who is not only committed to your position, but who also has effective, persuasive skills. Depending on the rules that apply to your particular arbitration, your party selected Arbitrator may be entitled to speak with you during the pendency of the hearing to advise you on the strengths and weaknesses of the testimony presented up to that particular point in time. You need to be able to select someone who will talk with you candidly and let you know how you're doing, even if it means telling you your presentation is weak or your witness is not credible. You can't afford to have a party appointed Arbitrator who will only tell you what you want to hear.

Following your discussion with the Case Manager, the Case Manager will send out a list of proposed Arbitrators for you to strike. You will get to strike any Arbitrators whom you deem to be inappropriate for your particular case. Any Arbitrators who remain on the list will be numbered in the order of your preference. Once your list and the Claimant's list is returned to the Case Manager, the Case Manager will then select the Arbitrator in a single Arbitrator case, who has the highest ranking on both strike lists.

Once the Arbitrator is selected, the case moves rather quickly.

Initial Conference

An Initial Conference is scheduled once an Arbitrator is chosen in order for them to outline and discuss with the parties the method and manner of how the case will move forward. This conference may be held in person or by telephone. During the conference, the Arbitrator(s) will set forth what discovery will be allowed, what deadlines are to apply, and the parties will agree upon a date for the hearing.

It is important to understand the limitations of discovery. Rule 24 of the American Arbitration Association Construction Industry Dispute Resolution Procedures sets forth the limits of discovery and it reads as follows:

R-24. Exchange of Information.

- a. At the request of any party or at the discretion of the Arbitrator, consistent with the expedited nature of arbitration, the Arbitrator may direct (i) the production of documents and other information, and (ii) the identification of any witnesses to be called.
- b. At least five (5) business days prior to the hearing, the parties shall exchange copies of all exhibits they intend to submit at the hearing.
- c. The Arbitrator is authorized to resolve any disputes concerning the exchange of information.
- d. There shall be no other discovery, except as indicated herein or as ordered by the Arbitrator in extraordinary cases when the demands of justice require it.

As you can see from a review of Rule 24, discovery in an arbitration proceeding is supposed to be extremely limited. The Rule indicates that discovery beyond the exchange of relevant documents, exhibits and witness lists is not allowed except in “extraordinary cases.” It has been my experience that Arbitrators only pay lip service to this Rule unless it is specifically pointed out. If you believe you need more discovery than Rule 24 allows, you need to be prepared at the preliminary conference to detail what discovery you need and why you need it. On the other hand, if you believe limited discovery aids your case, you need to be prepared to attempt to limit the discovery to those provided by the Rules and to make the claimant prove the case is “extraordinary,” and “the demands of justice require it.”

Arbitration is intended to be a process that allows for the parties to resolve disputes expeditiously. Agreeing to open-ended discovery defeats the purpose behind the parties’ original intent to arbitrate.

The danger to the Respondent in an arbitration typically involves the lack of knowledge of the details of what the claimant’s experts intend to testify to. I traditionally request, and Arbitrators typically grant a request for the claimant to provide reports from its experts that provide extreme detail concerning the experts’ complete opinions as well as the underlying basis for the opinions. Following receipt of that report, you are allowed to petition the Arbitrator for the right to either depose the expert or to require a more detailed report so that “justice may be done.”

While the Rules of Procedure with regard to discovery call for limited discovery, the Arbitrator is allowed to modify the Rules to serve the purposes of justice. Arbitrators will freely consider requests for additional discovery so long as the requests are reasonable and made timely.

Summary Proceedings

As in litigation, Arbitrators are allowed to grant summary judgments, injunctive relief, or any other ruling, whether it be evidentiary or otherwise which limits the ultimate case which will have to be heard. Arbitrators are more likely to grant interlocutory summary judgments if you can show not only your entitlement but that the granting of the interlocutory summary judgment will greatly decrease the overall length of the final hearing.

Presentation of summary judgments should be done in a manner similar to a litigation setting. However, you may consider including more references to

construction trade publications, construction book materials and even construction seminar materials to support your position. Remember, your arbitrator is trying to be not only legally correct, but also providing an equitable result. In a litigation setting, the judge's principal concern is whether he is legally correct. Because there is no appeal, absent the arbitration parties' agreement, the Arbitrator is not concerned about his decision being overturned. The Arbitrator is therefore allowed to render his decision based on a review of all matters, including the Arbitrator's opinion of whether the result is equitable.

Rule 33 relating to Arbitrator's discretion provides as follows:

b. The Arbitrator, exercising his or her discretion, shall conduct the proceedings with a view toward expediting the resolution of the dispute and may direct the order of proof, bifurcate proceedings and direct the parties to focus their presentations on issues the decision of which could dispose of all or part of the case. The Arbitrator shall entertain motions, including motions that dispose of all or part of a claim, or that may expedite the proceedings, and may also make preliminary rulings and enter interlocutory orders.

In the normal construction case, there are numerous preliminary rulings that a Respondent should make in an effort to minimize the issues which are ultimately to be heard.

Case Presentation

The case hearing is the final presentation of all evidence. It is the litigation equivalent of the trial. Rule 33 states:

a. The claimant shall present evidence to support its claim. The respondent shall then present evidence supporting its defense. The witnesses for each party shall also submit to questions from the Arbitrator and the adverse party. The Arbitrator has the discretion to vary this procedure, provided that the parties are treated with equality, and that each party has the right to be heard and is given a fair opportunity to present its case.

Other than this Rule, the rules concerning case presentation are non-existent. This allows a Respondent a great opportunity to organize his case in the most effective way possible. For instance, my standard practice with regard to the presentation of defense experts is to create a power point presentation that essentially allows the defense expert to provide a nearly uninterrupted presentation

of his or her position. The power point presentation includes references to contract language, slides containing blueprints and a myriad of photographic evidence. This type of presentation allows your expert the opportunity to command the room. The format of the presentation necessarily requires your expert to be standing and using a pointer to direct the attention to those areas deemed important.

It is therefore important to understand the strengths and weaknesses of your experts with regard to testifying. I have seen great witnesses flounder when presented with an opportunity to speak in an uninterrupted fashion. These witnesses tend to do much better when responding to questions. It is therefore important to tailor your presentation to not only your strengths but to the strengths of your witnesses.

Due to the informal nature of an arbitration, it is customary to be able to lead witnesses, even your own, through difficult testimony. Since the formal rules of evidence and procedure are not applicable, objections are usually not allowed. Be careful, however, that Arbitrators, while not officially allowing objections, may not consider the evidence or testimony as credible if you are having to do it in a method which in a state or federal court setting would not be admissible.

The presentation of documentary evidence follows the same format. No specific set of rules is required to be followed. However, Arbitrators tend not to rely as heavily on documents which have questionable validity.

Do not underestimate the power of hearsay in an arbitration proceeding. Since the rules of evidence do not apply, claimants and respondents alike are entitled to provide testimony that under normal circumstances would be excluded as violating the rules against hearsay. Finally, as in a litigation setting, it is important to watch the ultimate decision makers to determine how they are viewing the testimony and other evidence as it is introduced. In the same manner that you might watch a juror, you need to also position yourself within the hearing room so that you can see not only the witness but also the Arbitrators. Arbitrators are allowed to ask the witnesses and lawyers questions during the case hearing. Pay specific attention to the questions asked, as they often foreshadow the Arbitrator's concerns or view about some particular aspect of the case. It is also common during an arbitration for the arbitrator to take a lot of notes in order for him to be able to make a decision at a later time. Every Arbitrator has his or her own method for determining what information is important, critical, case-determinative and other. Certain Arbitrators will use different color highlighters to express different levels of importance, while others will make different kinds of marks in the margins. You are oftentimes jammed into a room that is really too small to provide any party privacy. It is impossible to avoid seeing how the Arbitrator is

compiling his notes. While I'm not advocating peering over the Arbitrator's shoulder to review his confidential notes, I do believe that watching what the Arbitrator writes and how he writes it is no different from watching what and when jurors take notes while sitting in judgment of a case.

Hopefully, by keen observation and attention to what the Arbitrators have viewed as important, you can prepare a closing argument that addresses the points you believe they deem important. A closing in a long arbitration can be quite important in order to rebalance the importance of certain evidence. Early in a case, an Arbitrator might not view certain evidence as important, as it turns out to be later in the case. By stressing the importance of certain evidence, you may be able to change the Arbitrator's view of what he thought was important early in the case. In a short case, I believe it more important to focus on the equitable issues. The Arbitrators should have a good memory of the important evidence. I therefore think your time is better spent explaining to them why your side should win, rather than rehashing the facts.

Often, Arbitrators will give you the option of submitting a closing in writing, rather than presenting it orally. This option is typically given at the very last minute when the parties are tired, the arbitration has gone long, and everybody would like to leave. However, think twice. If you agree to present written closings, the claimant will have one more opportunity to come before the Arbitrator in a method or forum that he may be more comfortable with. It's not uncommon to find counsel who provides persuasive written motions and pleadings but has trouble presenting a coherent, persuasive oral argument. Do not fall victim to the desire to leave as quickly as possible following the close of evidence. If you believe your verbal skills are more effective than your opposition, then strongly urge the closings be made immediately even if they are necessarily short. It is my experience that a written closing argument takes anywhere from 4 to 16 hours to prepare, whereas a typical closing argument can be completed within an hour. The other benefit to oral closing arguments is the starting of the time limit for the Arbitrator's decision. In the absence of a request from the Arbitrators for additional briefing, the hearing is closed at the conclusion of the closing arguments. However, it is not unusual for Arbitrators to request additional briefing, often in order to extend the time for them to make a decision. Arbitrators typically have 30 days from the close of evidence to prepare an award. This length of time varies, depending on the amount in controversy. Most construction cases, however, fall within the category of a 30 day decision window. The decision period may be extended by agreement.

Award

Following the case presentation, the Arbitrator(s) will present an award. Prior to the entry of the award, it's common for the Arbitrator to ask the parties what level of detail they would like to see in the award. There are often other related cases whose result will hinge on the findings of the arbitration. For instance, declaratory judgment actions. For this reason, it's important to reach agreement with opposing counsel concerning what you do and do not want in terms of an award. An award may be as simple as a ruling that one party prevails in the amount of x or as complicated as a ruling on each legal issue presented and a factual basis or rationale for each ruling.

Arbitrators prefer not to provide too much detail since it creates less second guessing of the quality of the ruling. Remember, arbitration tends to focus more on equitable results as opposed to legal results. Because of this leaning, Arbitrators do not often want to express the reasons behind their equitable rulings.

Following receipt of the award, either party may petition the Arbitrator within 20 calendar days after transmittal of an award, to correct any clerical, typographical, technical or computational errors in the award. The Arbitrator is not empowered to redetermine the merits of any claim already decided. Once the modification request is made by a party, the other party shall be given 10 calendar days to respond to the request. The Arbitrator is required to dispose of the request within 20 calendar days after the transmittal by the AAA to the Arbitrator of the request and any response thereto.

Once the award is made, subject to any minor modification which may be requested by the parties, the award is final and non-appealable. Most states have methods of domesticating arbitration awards. The domestication allows the parties who prevailed to attempt any judicial collection efforts which may become necessary.

Split the Baby

For years, some have turned up their nose to the arbitration process and referred to it as a process that simply attempts to "split the baby." However, statistics compiled by the American Arbitration Association reflect that 75% of awards have a clear cut winner for one side. In 9% of the awards, awards range from 41% to 60% of the amounts claimed. This 9% category, which seems to reflect a splitting of the baby, is actually reflective of the number of cases that you would expect both sides to have some level of damages that might equal one another. Finally, 71% of all counterclaims heard by AAA in the year 2000 were denied in their totality. Do not fall prey to those who suggest the Arbitrator is more likely to rule in a fashion that provides both parties a little bit of what they

want. Current statistics dictate that most decisions rendered reflect a clear winner and a clear loser. I hope this presentation provides you with what you need to be on the winning side.