College of Commercial Arbitrators

Arbitration of Construction Disputes

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I. Introduction

For more than a half-century, the domestic construction industry has been a leader in utilizing binding arbitration as a dispute resolution process. A number of factors regularly make arbitration of construction project disputes preferred over litigation. The combination of multiple parties, voluminous documents and correspondence, and layers of regulations and project requirements render a construction dispute difficult and inordinately expensive to prepare and present in court before a lay judge and jury. In arbitration, disputants are able to protect confidentiality, limit the amount of pre-trial discovery, and receive a decision from professionals experienced in the construction industry. Arbitrated construction disputes are also resolved more quickly than those that are litigated,[1] and are easily enforced.[2]

This article will discuss generally common types of disputes that reoccur in construction projects, the facets that characterize those disputes, and drafting tips for arbitration clauses for construction and related contracts.

II. Overview of Common Construction Disputes

A construction project is a monumental mix of goods and services combined to create a new and functioning edifice. Whether a building, a water-retaining structure, or a system to generate or distribute power, today's projects are complex, requiring coordination among numerous participants who have different expertise. Specialization in the furnishing of construction goods

[1] Compare Lynn Langdon and Thomas H. Cohen, Civil Bench and Jury Trials in State Courts, 2005,US Dept. of Justice, available at https://www.usdoj.gov/bjs/pub/pdf/cbjtsc05.pdf and AAA Arbitration Roadmap, available at https://www.adr.org/aaa/ShowPDF?doc=ADRSTG_003838

[2] See RUAA Sections 25 and 26, which provide that an arbitration award may be reduced to judgment and enforced by state courts. Likewise, the federal courts have jurisdiction under the FAA, and international disputes under the New York Convention. See also Edna Sussman and John Wilkinson, Benefits of Arbitrations for Commercial Disputes, available at http://www.americanbar.org/content/dam/aba/publications/disoute_resoultion_magazine/March_2012_Sussman_Wilkinson_March_5_authcheckdam.pdf; and PriceWaterhouseCoopers, International Arbitration, Corporate Attitudes and Practices (2008) at 8.

and services permeates the construction industry. We still build with bricks and mortar, but we rely upon sophisticated components installed by specialists using delivery systems with ever-more-complex risk allocations. Amenities found in today's starter houses make them complex structures in comparison to the multistory office buildings of the 1930s.

Construction disputes regularly include thorny questions of what efforts—design, construction, or both—are at issue; whose scope of work is involved; the terms of all contracts and subcontracts relating to the affected area or event; the scope and reach of regulations, building codes, or other over-arching project requirements, and so on. It is an area that commercial arbitration by industry professionals is well-suited.

III. Construction Industry Developments and Trends that Contribute to Disputes

Construction projects in the 21st Century are high-tech. Commercial office buildings, for instance, are replete with energy-saving, "smart" systems which govern the building's ambient conditions and the safety and security of its inhabitants. As construction projects become more complex, they cost more. Owners, like all consumers, resist higher costs.[3] This puts pressure on construction design, especially the design of components. Cost concerns filter the design of every construction material and component. And because speed of installation is a function of overall cost, price also affects components' means and methods of application.

Designers of construction materials and components continually look for ways to make products that cost less, are quicker and easier to install, have a more desirable appearance, and perform better than last year's models.[4] But as construction component design is revisited and revised in the name of cost, performance characteristics are affected. When the performance criteria of components are materially altered, the performance of major building systems may be compromised. The redundancies of conservative design that were *de rigueur* for buildings in decades past too often play second fiddle to the latest bells and whistles of convenience.

The increasing complexity of buildings has challenged the architect's role. Architects formerly were the arbiters of component design and selection. This has changed, especially in the commercial and industrial construction market. Product design and, recently, system design have devolved to component manufacturers. No longer is the architect the project's most knowledgeable leader. As observed by a leading Columbia University professor, by the end of the 1970s architects came to know less and less about more and more until some were said "to know nothing about everything."[3]

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[3] Many off-the-shelf consumer goods decrease in price as availability increases. Consumers of many goods—especially newer technology goods—have become accustomed to getting more for the same price as last year, or even more for a lesser price than last year.

[4] A quantifiable improvement in any of these characteristics will increase market share.

[3] MARIO SALVADORI, WHY BUILDINGS STAND UP: THE STRENGTH OF ARCHITECTURE 24 (1980). No longer is the architect capable of the expertise required by the court in Hubert v. Aiken, 2 N.Y.S. 711 (Ct. Com. Pl. 1888), *aff'd*, 25 N.E. 954 (N.Y. 1890) ("he is an expert in carpentry, cements, mortar, in the strength of materials…new conveniences…").

Construction design in the 21st Century is more and more led by designers working for component manufacturers. Selection and coordination of building components, long the province of design professionals, are in today's world being usurped by contractors and component manufacturers. Through "value engineering" or outright design delegation,[4] architects defer to component and system designers. Contractor-led design/build arrangements often relegate the architect to backroom subcontractor status.

The right of component selection carries with it the responsibility to coordinate the chosen products with the building's structure and complementing systems. It is in this task that design professionals of record can play a significant role—to ensure that their overall project design is not miss-matched. Nevertheless, design professionals of record (and their insurance carriers) today also hand off much of their former role, if not all of their responsibility.[5] To a larger and larger degree, construction services have become coordinated deliveries and installation of products.

Specialization in the construction industry has also morphed the contract process. Virtually all projects have dozens of contractual arrangements. Specialized equipment must be furnished and installed by ever-more-specialized subcontractors and suppliers. The traditional design-bid-build project delivery method is but one of many available contractual vehicles. Owners can choose among construction managers (agent and at-risk), multi-prime contractors, design-builders, joint ventures, "lean" construction, integrated project delivery, and so on—the ability to customize the process grows every year.[6] But there is one industry constant—there are more and more entities providing specialized goods and services.

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[4] The American Institute of Architects' standard general conditions of the contract between owner and contractor now explicitly allow the delegation of the architect's design responsibility to the general contractor and its subcontractors. *See* AIA Document A201–2007, General Conditions of the Contract for Construction ¶¶ 3.12.10.

[5] Design professionals "of record" retain liability, especially to their clients, for adequate and code-compliant design, whether the design professional performs the work or delegates it to others. *See* 5 PHILIP L. BRUNER & PATRICK J. O'CONNOR, JR., BRUNER AND O'CONNOR ON CONSTRUCTION LAW §§ 17:70-71, 17:73 (2009). *See also* Johnson v. Salem Title Co., 425 P.2d 519 (Or. 1967) (structural engineering requirements were nondelegable, even to a professional engineer). The result is different if the design professional never had the responsibility as part of its scope of services. *See* Aleutian Constructors v. United States, 24 Cl. Ct. 372 (1991) (specifications required contractor to design and build roof); Mudgett v. Marshall, 574 A.2d 867 (Me. 1990) (error of structural engineer hired by design-build contractor not imputed to owner's design professional not hired to design building).

[6] The American Institute of Architects' Standard Form of Agreement Between Owner and Architect, AIA Document B101-2007 (formerly B151–1997) Standard Form of Agreement Between Owner and Architect), provides owners a menu of architectural services from which to choose. *See also* AIA Document B102–2007 (formerly B141–1997 Part 1) Standard Form Agreement Between Owner and Architect without a Predefined Scope of Architect's Services and AIA Document B201–2007 (formerly B141–1997 Part 2) Standard Form of Architect's Services: Design and Construction Contract Administration.

The specialization of construction goods and services, and reliance upon newly-designed, prefabricated construction products,[7] has strained the law of contracts. When something goes wrong on a construction site, or when the completed edifice does not meet expectations, there are usually a number of entities with a hand in the cause. Products that perform well in one setting may, for instance, lack the robustness to weather ambient conditions in another place.

As product diversification expands, the importance of selecting complementary construction components has increased. It is now as significant to select and coordinate as it is to install properly. When problems occur, are they the fault of the design professional, the installer, the manufacturer, the supplier, the maintenance team, or all of the above? Getting to the bottom of a construction problem often requires a detailed investigation, and a good deal of finger-pointing regrettably ensues. Major responsibility may lie far down, or even outside, the project contractual chain.

In prior decades, a contractor would directly employ different types of skilled labor for a job (carpenters, masons, iron workers, pipe fitters, concrete finishers, etc.). Today's builder retains separate subcontractors and suppliers, each with its own separate scope of work. When problems develop today, claims are often passed among multiple entities, with multiple contractual arrangements. For many issues, the common law contract causes of action can be cumbersome in the extreme. If a problem takes several years to manifest itself, if contractual responsibilities for the work are not the same up and down the contractual chain of specialization, or if there are gaps in the scope of and responsibilities for the completed work, damages may occur for which there is no common law contract remedy. Into this fertile field, the seeds of tort law have taken root. Many construction disputes now include claims of professional negligence and design deficiencies, as well as construction-related issues including defects and delays. And because design responsibility is located throughout the contractual chain, a number of different parties are often involved.

Contract law has adapted in several areas to market conditions. Warranties from manufacturers of certain goods (typically finished goods, specially-designed equipment, and appliances) allow affected parties to leapfrog gaps and broken links in the project's contractual chain.[8] There is also a federal statutory remedy for certain types of defective household goods, but this remedy does not carry over to commercial projects—it is available only to household consumers.[9] Under

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[7] Many of these products are designed to meet a specific price point to achieve market share.

[8] *See, e.g.*, Groppel Co. v. United States Gypsum Co., 616 S.W.2d 49 (Mo. Ct. App. 1981); *see also* authorities cited at West's 343 SALES, k255, k427.

[9] The Magnuson-Moss Act, 15 U.S.C.A. § 2301 *et seq*. (2002), provides consumers with statutory remedies for breach of a manufacturer's or vendor's written or implied warranty of a consumer product. The Act also provides certain minimum requirements for written warranties. Upon establishing that the warranty was breached, the consumer may elect the remedy of refund, repair, or replacement, and may recover attorney's fees if he prevails. The Act applies to personal, family, or household products, but may include "building materials" such as paneling, siding, or storm windows, when purchased in connection with remodeling a home. In one of the leading cases, the Act was applied to roofing materials. Muchisky v. Frederic Roofing Co., 838 S.W.2d 74 (Mo. Ct. App. 1992) (affirming verdict, and award of attorney's fees, in favor of

the common law of contracts, privity reigns. Further, under the common law, providers of services and labor were often immune from responsibility once their work was accomplished and accepted.[10]

Construction disputes, therefore, regularly include thorny questions of what types of services—design, construction, or both—are at issue; whose scope of work is involved; the terms of all contracts and subcontracts relating to the affected area or event; the scope and reach of regulations, building code or other over-arching project requirements, and so on. It is an area that commercial arbitration by industry professionals is well-suited.

IV. General Types of Construction Disputes

There are two broad areas of construction disputes: those involving defects and deficiencies (design and construction), and those involving time and extra costs or backcharges claimed but disputed.

Defect and deficiency claims involve costs of correction, diminution in value, and loss of use. Many defect and deficiency claims are, or are claimed to be, insured risks, and therefore involve insurance carriers and the insurance defense bar.

Disputes involving extra costs and time or backcharges arise from claims of added scope, unforeseen conditions, delayed completion, loss of use, and extended time-related activities, or the compression and acceleration of activities which add costs due to lost productivity. Resolution of these claims often turns on the terms of the many contracts and subcontracts within a project, and generally do not involve insurance unless the claim is of professional negligence.

Regardless of the type of dispute, construction disputes often turn on complex technical questions of engineering, accounting, and scheduling that are outside the normal workfare of most state court judges.

> **A. Defects and Deficiencies.** Every project suffers from a certain number of defects—design or construction. Most are repaired or removed and reconstructed while the work is underway, or accepted as is. But if the defects are not discovered until after the project has been put to use, or if the responsibility for the deficiency is shared, a dispute often occurs, especially if one of the parties is insufficiently capitalized to weather the cost of repair. These types of disputes also often involve insurance carriers, which, if in court, normally result in an extended discovery process (including multiple depositions) attempting to determine fine distinctions of responsibility. Insurance carriers ordinarily

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homeowner on a re-roofing project).

[10] *See, e.g.,* U-Haul Int'l, Inc. v. Mike Madrid Co., 734 N.E.2d 1048 (Ind. Ct. App. 2000). As with many other judicially-created defenses, exceptions to the accepted work doctrine have swallowed the rule. *See* Suneson v. Holloway Constr. Co., 992 S.W.2d 79 (Ark. 1999), and the discussion below as to the erosion of this judicially-created defense. One year after *Suneson,* however, the Arkansas State Legislature reinstated the doctrine as it relates to public projects. *See* ARK. CODE ANN. § 16-56-112(h) (2001 Supp.).

do not choose arbitration, and normally participate only if the chain of contracts and subcontracts specify arbitration.

Arbitration of defect cases is almost universally quicker and superior to litigation, due to the expertise of the tribunal members in the workings of the construction industry, and what characterizes a well-run project from one less so. For instance, construction arbitrators don't have to be taught the difference and legal significance between a shop drawing and a design drawing.[5] This means that drawn-out depositions are less likely to be needed to get to the "meat of the cocoanut" involving the root cause of the defective work or design, and less investigation is needed to determine the scope of repair or diminution.

B. Time-Related and Extra Cost Disputes. Projects which are not completed timely cause all sorts of mischief. Virtually all project participants—owners, prime contractors, design professionals, subcontractors and suppliers—will experience added costs when a project runs late.[6] Although the cause(s) of a construction or design defect or deficiency may have many contributors, defect claims are not nearly as complex as time-related extra cost and lost productivity claims ("delay claims"). On even a medium-sized project (e.g., less than $50MM in construction cost), 40 or more different subcontractors/suppliers are often onsite at the same time performing work pre-planned by a project schedule.[7] Each of these subcontractors will generate daily reports, emails, letters or other communications, and report issues and problems, often related to a claimed delay to its activities.

Additionally, the general contractor and the design professionals will issue another layer of project documents, including minutes of meetings, update completion reports, re-sequence various construction activities, answer field questions, issue written directives or bulletin drawings, and so on. As most mid-sized projects take more than 12 months to construct even if not delayed, the volume of information generated by a year's worth of daily activities can be more than daunting. To compound the difficulty, human beings are not perfect, and it is often that some documents contain inaccurate information. And, many participants often contribute in some way to a delay—making this a fertile field for disputes.

Time-related claims arising from late completion also tend to be high in asserted costs both from the contractor side and as an owner backcharge. The daily carrying costs for a mid-sized project (which costs general contractors refer to as general conditions costs)

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[5] The distinction and difference, legally, between the two once took the author ¾ of a court day to explain through several witnesses.

[6] This statement presumes that the project pricing is lump-sum; if the project is cost-plus and the extended time is not due to the fault of the contractor team, only the owner will incur additional costs due to extended performance.

[7] Additionally, there may be a dispute about the schedule itself. If the baseline schedule, or any of the updates, contain flawed logic or have been manipulated to produce a result, the delay analysis becomes suspect.

are thousands of dollars, depending upon the staffing. Then, the costs to accelerate and recover from a delay are substantially greater than the costs to perform the work without disruption. In turn, the judicial or arbitral task of sorting out the intricacies of who was responsible for a delay, or the proportionality of such responsibility, involves experts and extensive reports, further increasing the dispute resolution costs.

Extra work claims tend to run the gamut from differing site conditions to differences of opinion as to the scope of relevant work (contractor or subcontractor). Often these claims also involve time, and when that occurs, these claims take on the same time-related difficulties that are discussed above. Even in a discrete subcontractor v. contractor extra work claim, arbitration is the more efficient dispute-resolution model, and just as durable, if for no other reason than because of the better-educated decision maker.

V. Drafting the Arbitration Clause

A construction project is governed by many layers of contracts and subcontracts, so it is vital that arbitration agreements bind all potentially responsible parties. This is generally accomplished by a main arbitration clause in the prime contract between owner and general contractor, which is then incorporated by reference within all the prime contractor's subcontracts and supply contracts. If the owner contracts separately with the design professional team, then the main design contract (generally between the owner and architect) should have an arbitration clause.[8] Likewise, if the owner has several prime contractors, a separate arbitration agreement should be in each such agreement, together with a joinder and consolidation provision allowing all project disputes to be heard once, in one arbitral proceeding.

Arbitration clauses should also be tailored to the type of pre-hearing discovery, or document exchange, desired by the parties. Because of the huge volume of correspondence and communication that takes place at a construction project, once the relevant documents are exchanged and examined there are generally few factual evidentiary surprises.[9] Limiting pre-hearing discovery to an exchange of requested, relevant documents between the disputants, plus the ability to obtain documents and information from third parties (e.g., governmental agencies, third-party inspectors, etc.), will adduce a vast amount of information—often all that is needed for the disputants to evaluate and prepare their case, and for the respective experts to prepare reports.

It is wise to avoid allowing discovery as if the dispute were subject to the Federal Rules of Civil Procedure. The vast majority of the cost expended in arbitration is spent by counsel and experts

[8] For many years, the standard form owner-architect agreement published by the American Institute of Architects (AIA) provided that a dispute between the owner and architect could not be joined with any other dispute (e.g., a dispute between the owner and prime contractor) without the architect's consent, but that provision was deleted in the 2007 revisions to the AIA family of documents. See, AIA B101-2007.

[9] Construction participants whose work is being negatively affected generally have no compunction about complaining.

obtaining, organizing, and evaluating information, just as it is in litigated disputes. To be able to limit the number of depositions, and do away with interrogatories and requests to admit, will go a long way toward making the experience more cost-effective and palatable.

The arbitration clause may also specify the type of tribunal. For instance, the clause may provide that a dispute of less than $500,000 is to be heard by a single arbitrator, but that all other disputes are to be heard by a tripartite tribunal.

The clause may also specify that the dispute is to be administered by a service provider, such as AAA, JAMS, or CPR if the dispute is domestic, or ICDR, ICC, UNCITRAL, LCIA, or other international provider with separate arbitral rules.

Although it is difficult to convince parties to discuss dispute resolution while planning a project, the more the parties think about what should happen in the event of a dispute, the more the parties are likely to obtain a streamlined, focused resolution.