CHAPTER 8

Dispute Resolution, Arbitration and Litigation

NON-LITIGATION ALTERNATIVES

The construction industry, like the rest of the world, has become increasingly litigious. Needless to say, this adds substantial costs to the business without really aiding the objective of constructing buildings.

Negotiation

The most important, quickest and cheapest non-litigation alternative is to simply communicate with and negotiate a resolution with the other parties involved. The best lawyer will work his way out of a job by helping to fashion a resolution short of litigation or arbitration. Clients certainly benefit from such a resolution. It is surprising, however, how many construction clients will appear with instructions to their lawyer to commence litigation, ready to go to battle, when communication and negotiation can successfully obtain a better resolution. Your ability to communicate with thorough documentation and a clear, well-reasoned position will dramatically increase the chances of a favorable resolution without litigation.

Administrative Claims

Administrative claims are an effective and often required forum for government procurement contract disputes.[1] Many counties are also permitted to create their own administrative appeals procedure in their county code.[2]

A contractor or lawyer considering any monetary claim against a government owner must be sure to follow the procedures for making an administrative claim *before* resorting to litigation.[3] Courts have held that administrative claims are a condition precedent to the right to litigate.[4]

Mediation

In mediation, both parties agree to air their differences and their evidence before an impartial mediator. The mediator will usually take a very limited position as to the correctness of each party's position and instead will focus primarily on getting each party to compromise. Neither side can be forced to accept the mediator's recommendation.

Mediation is an effective tool to further the communication and negotiation process discussed above. Used for this purpose, mediation can be very helpful, especially to parties who are reluctant or unable to communicate effectively. The non-binding nature of mediation, however, limits its effectiveness in obtaining a resolution in many cases.

Alternative Dispute Resolution

Alternative Dispute Resolution (ADR) is a more recent non-litigation alternative. Although there is no precise definition of ADR, it can be any method of dispute resolution that is "alternative" and not conventional. Some ADR systems involve only some form of arbitration, mediation or summary jury trial.[5] When ADR is applied to construction contracts, it most often means a dispute resolution system that begins earlier in the progress of the construction project including increased communication, increased cooperation and a much earlier resolution of all disputes.

There has never been any doubt that increased communication and cooperation can help parties avoid disputes. Project "partnering" is based on the idea that everyone involved in the construction process shares most of the same objectives. This is hardly a revolutionary idea, but it is becoming more standard in private and public construction projects.

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1 Va. Code Anno. §15.1-550, *et seq.* (Michie 1950).

2 Va. Code Anno. §11-71 (Michie 1950).

3 *Stamie E. Lyttle Co. v. County of Hanover*, 231 Va. 21, 341 S.E.2d 174 (1986).

4 *Nuckols v. Moore*, 234 Va. 478, 362 S.E.2d 715 (1987).

5 *See e.g.,* Va. Code Anno. §8.01-576.1 through 576.12 (Michie 1950).

Many construction contracts now include compulsory ADR systems. The contract identifies "dispute resolution advisors," similar to mediators or arbitrators, whose decisions will usually be binding upon the parties. Periodic job progress meetings will also include the resolution of disputes that have arisen since the last meeting. This avoids project delay and usually leaves all parties with a better feeling about the resolution.

Under conventional litigation or arbitration approaches, a dispute will usually be left unresolved until the project is finished. Even if a lawsuit is filed during the project, it will probably not be over until after the project is complete. Both parties to the dispute must continue to work together while the dispute is both outstanding and, most likely, escalating. Under an ADR system, all parties benefit from the fact that a resolution is reached quickly, and the chance that a dispute will disrupt the balance of the project is minimized.

ARBITRATION

When parties arbitrate, they agree to be *bound* by the decision of one or more impartial arbitrators. Each side is permitted to submit documents, witnesses and other evidence. The arbitrator renders a decision after all the evidence has been heard. There is considerable debate about the advantages of arbitration over litigation.

When Arbitration is Available

Arbitration can be compelled only by agreement.[6] Many modern construction contracts contain arbitration clauses that compel one or both parties to submit disputes to arbitration.[7] In the absence of a contract clause, arbitration is available only by the agreement of both sides. On the other hand, any person doing business in the United States is subject to the jurisdiction of at least one court. Litigation, therefore, is always an available method to resolve a dispute, unless there is a binding arbitration clause or a mandatory administrative proceeding.

Arbitration clauses are favored by the courts and will be enforced. Even if one party to the contract is in bankruptcy, it is still possible that both parties will be compelled to arbitrate a contract dispute.[8] Frequently, one party to a contract containing an arbitration clause will file a lawsuit without first seeking arbitration. Unless the arbitration clause is avoidable or unenforceable,[9] the other party can compel arbitration and cause the lawsuit to be stayed or dismissed. As a practical matter, however, this does not always happen.

Waiver of the right to compel arbitration often becomes an issue. However, waiver of a contractual right to arbitrate disputes ordinarily turns on the factual circumstances of each case and must be clearly established and will not be inferred from equivocal acts or language.[10] The plaintiff that files a lawsuit has probably irrevocably waived its right to compel arbitration.[11] However, by filing an answer in the litigation the defendant most likely does not waive its right to arbitration. Filing a mechanic's lien does not waive the right to arbitration.[12] The defendant eventually will be deemed to have waived arbitration by its actions in the lawsuit, such as filing a counterclaim, engaging in discovery, or simply waiting too long. When a claimant considers ignoring an arbitration clause to file suit, there is a risk that the lawsuit will be stayed or dismissed several months after the initiation of the suit.

A motion to compel arbitration is usually brought in the court where legal action was taken. However, challenges to the validity of the contract as a whole are decided by an arbitrator, not a court. In other words, the court decides a motion to compel arbitration if the validity of the contract is already established and only the validity of the arbitration clause was an issue.[13]

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[6] *Doyle & Russell, Inc. v. Roanoke Hospital Assoc.*, 213 Va. 489, 494, 193 S.E.2d 662 (1973).

[7] AIA Document A201-1997 (General Conditions of the Contract for Construction), Section 4.6.

[8] *Whiting-Turner Contracting Co. v. Elec. Mach. Enters. (In re Elec. Mach. Enters.)*, 479 F.3d 791, 796 (11th Cir. Fla. 2007) [In general, bankruptcy courts do not have the discretion to decline to enforce an arbitration agreement relating to a non-core proceeding. However, even if a proceeding is determined to be a core proceeding, the bankruptcy court must still analyze whether enforcing a valid arbitration agreement would inherently conflict with the underlying purposes of the Bankruptcy Code].

[9] *ProBuild v. DPR,* 90 Va. Cir. 383 (Va. Cir. Ct. 2015) [inability to resolve dispute in mediation is a condition precedent to right to compel arbitration].

[10] *Brendsel v. Winchester Constr. Co*., 392 Md. 601, 898 A.2d 472, 477-78 (2006).

[11] *United States ex rel Air-Con, Inc. v. Al-Con Development Corporation*, 271 F.2d 904 (4th Cir. 1959); *But see Brendsel v. Winchester Constr. Co*., 392 Md. 601, 898 A.2d 472, 477-78 (2006).

[12] *Paragon Ltd., Inc. v. Boles*, 987 So. 2d 561, 566 (Ala. 2007).

[13] *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445-446 (U.S. 2006) [as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. Second, unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance. Third, this arbitration law applies in state as well as federal courts].

Better Quality and Better Result

Arbitrators are usually chosen for their expertise in the subject matter at issue. Arbitration can lead to a better result in a complicated construction case. The alternative is a result reached by a jury of lay people or a judge unfamiliar with construction law. In most metropolitan jurisdictions, however, construction contract litigation is common and most judges have experience in hearing these disputes.

The informality of arbitration proceedings is often cited as an advantage. Although the informality makes it easier for non-lawyers to handle arbitration disputes, it probably leads to inferior results. The lack of evidentiary rules means that a lot of unreliable evidence is considered by the arbitrator. Also, arbitrators are not bound by the law or by previous decisions in similar cases. This makes it possible for arbitrators to rule on their whim, makes it difficult to predict results and those results can be very unfair. The risk of a "loose cannon arbitrator" is reduced by the use of a three-arbitrator panel. However, this will triple the cost of the panel.

Cases in litigation often have a better chance of settling since both parties can better predict the outcome of a trial. A party with a weak case in arbitration, however, has more incentive to go to hearing because they may win despite their weaknesses. As a result, it seems that claims in arbitration more often go to a full hearing.

Expense

Preparing the initial demand for arbitration is considerably easier and cheaper than preparing a lawsuit. This is partly because the demand for arbitration does not require a party to provide any detail about the claim. This makes it difficult for the opposing party to know what it is defending and leaves the door open for many unforeseen claims at the hearing.

The cost of the actual arbitration proceedings will generally be higher than the cost of a court hearing. Taxpayers subsidize litigation. "Court costs" are usually very low and bear no real relation to the costs of having a judge, jury and courtroom. Arbitration must carry its own financial weight. Hiring expert arbitrators, especially with a three-arbitrator panel, will run hundreds or thousands of dollars per day. Arbitration also normally requires a much higher filing fee.

It is often believed that the lack of discovery makes arbitration preparation cheaper than trial preparation. This may be true for a smaller dispute. In litigation, parties can be required to provide depositions, answer interrogatories and produce documents. However, in the arbitration of a small dispute where the issues and facts are clear, the parties can save the time and cost associated with formal discovery.

Since arbitrators can allow discovery in large construction claims, lawyers will almost always be involved. Otherwise, there is no way to obtain details about the opposing party's claim. If discovery is allowed in arbitration, this elevates much of the perceived cost savings in arbitration. If there is no discovery in arbitration, a good lawyer will be forced to over-prepare—that is, prepare for many defenses or claims that may or may not be a part of the opposing case. This extensive preparation can also increase the costs of arbitration considerably.

Most importantly, cases in litigation are much more likely to settle, and this creates the greatest expense savings. A large portion of the costs in any litigation or arbitration case is incurred immediately before and during the actual hearing. This is discussed below in the section titled Advantages of Litigation.

Arbitration Followed by Litigation

Because of litigation following arbitration, total costs can be higher in cases involving arbitration. Often, some parties in a case can be compelled to arbitrate while other parties cannot. Payment bond litigation provides a good example. A contract between a general contractor and subcontractor includes an arbitration clause and, consequently, their dispute is resolved by arbitration. However, after completing the arbitration process, the subcontractor may have to file a lawsuit against the general contractor's bonding company in order to collect the arbitration award. This is discussed in the chapter Performance and Payment Bonds; section, Pitfalls for Claimants; subsection, Arbitration Clauses.

It has also become more common for the unsuccessful party in arbitration to challenge the arbitration award in a court of law. This can result in multiple arbitrations and court proceedings.[14]

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[14] *See e.g., Trustees v. Taylor & Parrish, Inc.*, 249 Va. 144, 452 S.E.2d 847 (1995).

Advantages of Arbitration

Arbitration can save time and money, especially for small claims. However, a claimant should consider the court schedule in the area in which they work. Some court dockets proceed promptly and can actually result in a faster resolution than arbitration.

The lack of rules can be a terrific advantage for a litigant whose case has technical problems. A claimant with a technically weak case or problems obtaining quality evidence, but with a story that sounds good and a situation that sounds unfair, should actively seek arbitration. On the other hand, if either your claim or defenses are technical and have an element of unfairness, arbitration should be avoided. Smaller claims are often better handled by arbitration simply because claimants and defendants are better able to handle the claims themselves. There will be an unpredictable result that might be unfavorable, but at least there will be a resolution and expenses will be lower.

LITIGATION

All persons doing business in the U.S. are subject to the jurisdiction of a court of law. Although it may be difficult for lay persons to understand the system in place and the system may be costly, the law always provides a mechanism to resolve a dispute.

Pretrial Negotiations and Settlement Techniques

The objectives of trial preparation are two-fold. First, the litigant must become prepare to go to trial procedurally, legally and from an evidentiary point of view. Secondly, if good lawyers are involved, trial preparation is a continuation of the "communication and negotiation" or the "mediation" process. Trial preparation is often the first time that one or both sides are forced to become familiar with the weaknesses of their case.

Pretrial negotiations should always be entered into from a position of strength. The litigant should be doing everything possible to get ready for trial. This does not mean that it should be the litigant's objective to get to trial and that negotiation should be discarded. Experience, however, will show the truth of the adage: "When you are ready to go to trial, the case will settle favorably for your client." If you fail to prepare because you expect the case to settle, you can be sure that the case will be tried and you will be at a serious disadvantage. Lawyers and claimants know when the other side is not prepared. Preparation allows you to effectively show the other side their weaknesses and also makes them certain that you will try the case if they do not make concessions.

Trial

The majority of litigation expense is incurred in the weeks just prior to trial and at the trial itself. At this point, the litigant has one or more lawyers working eight to twelve hours a day at $100 to $300 an hour on his case. It does not take a mathematical wizard to figure out what this means. If a case is going to trial, however, there is absolutely no substitute for thorough preparation. Every possible claim or defense of the opposition must be anticipated and a response prepared. All witnesses must be thoroughly prepared, and all documents must be organized.

It is extremely important for a legal claimant or defendant to choose their lawyer very carefully. Once this choice has been made, however, it is important to recognize that the lawyer is an expert in litigation. The construction client knows much more about his business and the *facts* of the case, including the plans, the quality of the work and scheduling events. A good lawyer, however, is the experienced expert who can get through trial with the best result. The client runs the construction site. Let the lawyer run the trial.

Advantages of Litigation

In addition to discovery, the court's power to compel the attendance of witnesses can often be very important to the proper resolution of a dispute. The right to a jury may also be very valuable to one or more litigants. Finally, the existence of an appeals process can be critical. There is not much a party can do about an unfavorable or even horrible arbitration award. The party is more often stuck with what he gets. If a judge errs, however, the decision can be appealed to a higher court.

In litigation, the pretrial discovery and resulting familiarity with the case increase the chances that the case will be settled. The fact is, a very small percentage of litigation cases actually go to trial. To prepare for trial, a good lawyer will first develop and assess their client's case, then request discovery, assess the opposing case and, finally, discuss the relative strengths and weaknesses of the case with the client and the opposing side. When this system works, the lawyers will negotiate a settlement close to the expected outcome of a trial. The parties are saved the considerable expense and anguish of a hearing, and the resolution comes sooner. Both parties can feel that they have taken part in the decision, rather than having had a resolution forced upon them.