The Effect the Ongoing Assault Against Arbitration Nationwide has on Arbitration Provisions Contained in Construction-Related Contracts

Presented by:

MARTHA Y. CURTIS

SHER GARNER CAHILL RICHTER

KLEIN & HILBERT, L.L.C.

NEW ORLEANS, LOUISIANA

Overview

- Information regarding arbitration, including differences from litigation, advantages and disadvantages, and American Arbitration Association procedures for construction-related arbitration
- The court's authority to decide arbitrability and the recent United States Supreme Court decision regarding same
- Other recent cases/issues involving arbitration

Arbitration Clauses

- Many construction-related contracts contain arbitration clauses such as:
  - All claims, disputes, and other matters in question between the contractor and the owner arising out of, ... or relating to, the contract documents or the breach thereof, ... except for claims which have been waived by the making or acceptance of final payment ... should be decided by arbitration in accordance with construction industry arbitration rules of the American Arbitration Association.

Arbitration Clauses (continued)

- Any controversy or claim arising out of or relating to the construction contracts, as amended by this Agreement, or any breach thereof, shall be settled by arbitration in accordance with the rules of the American Arbitration Association (hereinafter referred to as AAA), except to the extent that the rules of the AAA are in conflict with this Agreement.”

- This agreement is subject to arbitration under the Commercial Arbitration Rules of the American Arbitration Association.

History of Arbitration

- Arbitration is governed by the Federal Arbitration Act and individual states' arbitration law.
- Courts were initially skeptical of arbitration.
- Federal Arbitration Act (1925) created to overcome courts' hostility. *Allied-Bruce Terminix Companies v. Dobson*, 513 U.S. 265 (1995) (stating that the "basic purpose of the [FAA] is to overcome courts' refusals to enforce agreements to arbitrate.").
- Courts and commentators have identified the U.S. Supreme Court's decision in *Prima Paint Corp. v. Flood & Conklin Mfg, Co.*, 388 U.S. 395 (1967), as declaring the national policy in favor of arbitration.

Federal Arbitration Act ("FAA")

- 9 U.S.C. §2, *et seq.* A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

State Arbitration Acts

- States have similar arbitration acts, and their courts often rely on federal case law, which is more developed than state law
- FAA preempts state arbitration provision if arbitration provision is in a contract evidencing a transaction involving interstate commerce
- “Involving interstate commerce” = “affecting commerce”
- FAA’s reach coincides with Commerce Clause
- FAA likely applies unless a contract unequivocally does not concern interstate commerce

Arbitration

- Marketed as an alternative to litigation where parties agree to arbitrate disputes and accept the ultimate decision as final
- Arbitration promises cost-effective, speedy, and efficient method of dispute resolution as an alternative to the allegedly slower and more expensive litigation process. *See* Statutory Note following FAA § 16 by David Siegel:

  [A]rbitration is a form of dispute resolution designed to save the parties time, money, and effort by substituting for the litigation process the advantages of speed, simplicity, and economy associated with arbitration.

Basic Differences between Arbitration and Litigation

- Litigation - a lawsuit is filed with the court and a judge or jury ultimately renders a decision after a trial
  - The parties may appeal the decision, and the appellate courts could overturn it.
- Arbitration – Instead of a judge or jury, a third-party neutral (*i.e.*, the arbitrator or a panel of arbitrators) renders a decision after an evidentiary hearing which is similar to a trial.
  - The parties have limited appeal rights.
  - After arbitration in most states, the winning party must go to a trial court and register the award as a judgment so that it can pursue collection.

Advantages of Arbitration

- **Cost if simple matter**– *Typically* less expensive if amount in dispute is minimal or subject matter is simple due to an expedited procedure, lack of court fees, and lack of a full discovery period
- **Scheduling and Timeliness if simple matter** – *Typically* quicker than litigation because arbitrators are presiding over less cases that judges and can work with parties on scheduling matters, rules are simplified, and generally no appellate process

Advantage of Arbitration (continued)

- **Privacy** –arbitration is a private process and parties can typically resolve the matter while keeping the details confidential.
- **Decision Maker with Expertise and Experience in Subject Matter –** parties may choose arbitrators with construction experience that a judge or jury may not have
- **Finality (also a disadvantage)–** Arbitration decisions are binding and typically cannot be appealed.

Disadvantages of Arbitration

- **Cost if complicated matter**– **-** arbitration could end up costing more if complicated matter as parties pay: (1) Attorneys' fees; (2) Costs; (3) Arbitrator fees; and (4) AAA (or other arbitral organization such as JAMs (formerly known as Judicial Arbitration and Mediation Services, Inc.) fees
- **Scheduling and Timeliness if complicated matter** –Complicated schedules, protracted discovery, and bifurcated hearings make arbitration rarely quicker than traditional litigation.
  - *Advanced Micro Devices, Inc. v. Intel Corp.*, 36 Cal. Rptr. 2d 581 (Cal. 1994) – Estimated 4-6 weeks for arbitration, entire process took four and a half years, plus two and a half years in appeals.

Disadvantages of Arbitration (continued)

- **Finality (also a disadvantage)–** Arbitration decisions are binding and typically cannot be appealed.
- **Lack of transparency –** Typically no oversight or transparency in the process
- **No requirement to follow rules of evidence or law –** No traditional safeguards of discovery process. The strict evidentiary rules do not apply which could lead to evidence being presented that may be prejudicial or misleading

Disadvantages of Arbitration (continued)

- **No precedents -** Varying decisions from arbitrators
- **No meaningful recusal process** to guard against bias
- **Inefficiency for parties -** Summary judgment and dispositive motions rare
- **Subpoenas –** process for forcing a witness to participate in a hearing tends to be much more difficult than in litigation.

Mediation

- Mediation – a settlement conference where a third-party neutral meets with the parties and attempts to facilitate a settlement.
  - The mediator does not render a decision and has no power to compel a settlement.
  - The parties can ultimately decide not to settle.
  - Some contracts may require the party to attempt mediation before pursuing litigation or arbitration.
  - Parties may also decide to mediate while in litigation or arbitration to attempt to resolve the matter before the court in litigation or an arbitrator in arbitration renders a decision.

Administration of Arbitration

- The two most common organizations that administer arbitrations are:
  - the American Arbitration Association ("AAA"); and
  - JAMS, which was formerly known as the Judicial Arbitration and Mediation Services, Inc.
- Many construction-related contracts require that AAA oversee the arbitration.
- They may also require that the AAA rules apply.
- The AAA has specific construction arbitration rules called “Construction Industry Arbitration Rules and Mediation Procedures Including Procedures for Large, Complex Construction Disputes.“

AAA

- Typically, arbitrators are selected by the parties.
- According to the AAA, the AAA panels are comprised of:
  - accomplished attorneys with exceptional subject-matter expertise;
  - former federal and state judges; and
  - Professionals who understand the essence of the dispute.
- The arbitrators in construction related-arbitrations are typically:
  - construction lawyers or
  - someone with extensive construction experience
- The AAA has a “Construction Panel” which has additional requirements to be a member.

AAA Panel of Construction Arbitrators qualification criteria:

- Construction Industry Experience: The business experience qualification varies depending upon the current background of the individual:

  Construction Industry Professional: Minimum of 10 years of professional experience as a construction professional demonstrating progressive project responsibilities and performance.

  Construction Industry Business Executive: Minimum of 10 years construction experience with at least 7 years in one or more senior-level positions of a construction industry company, firm or organization.

  Legal Professional: Attorney with a minimum of 10 years in legal practice with at least 50% of practice for the past 10 years devoted to the practice of Construction Law.

AAA Panel of Construction Arbitrators qualification criteria (continued):

- Educational degree(s) and/or professional license(s) appropriate to the neutral's field of expertise.
- Honors, awards and citations demonstrating leadership in the construction industry or field.
- Training in dispute resolution and experience in arbitrations and other forms of dispute resolution.
- Membership in relevant business, trade or professional associations.
- Other relevant experience or accomplishments (*e.g.*, published articles).

AAA Construction Rules Provide Four Tracks for Construction Disputes

- If the parties agree that AAA rules apply, there are four tracks/procedures they can also agree to use:
  - Regular Track Procedures (Section R)
  - Procedures for the Resolution of Disputes through Document Submission (Section D)
  - Fast Track Procedures (Section F)
  - Procedures for Large, Complex Construction Disputes (Section L).

Regular Track Procedures

- A party files a demand and respondent answers within 14 days.
  - There are not many other strict deadlines.
- Parties select arbitrators or have one to three arbitrators appointed.
- Arbitrators hold preliminary conference and select hearing dates.
- Parties may exchange discovery.
- Parties may file motions upon an application to do so.
- Award shall be rendered within 30 days of the hearing.

Procedures for the Resolution of Disputes through Document Submission for Construction Cases under $25,000 or if parties agree

- Where no party's claim exceeds $25,000, exclusive of interest, attorneys' fees and arbitration costs, the dispute **shall be resolved by submission of documents**, unless any party requests an oral hearing, or the arbitrator determines that an oral hearing or conference call is necessary. The arbitrator shall establish a fair and equitable procedure for the submission of documents, as set forth in the D-Procedures of these Rules.

Procedures for the Resolution of Disputes through Document Submission for Construction Cases under $25,000 or if parties agree

- Arbitrator shall set up preliminary telephone conference and set deadlines for document submissions
- If parties subsequently request a hearing, arbitrator shall conduct the hearing
- Arbitrator shall render decision within 14 days unless parties request a “reasoned award” which shall be rendered within 30 days.

Fast Track Procedures for Construction Cases under $100,000

- The Fast Track Procedures shall apply to all two-party cases where no party's disclosed claim or counterclaim exceeds $100,000.
- If a claim or counterclaim is amended to exceed $100,000, the case will be administered under the Regular Track Procedures (or Large, Complex Case Procedures, if applicable) unless all parties agree that the case may continue to be processed under the Fast Track Procedures.
- The AAA, in its discretion, may reassign a matter to the Regular Track Procedures or, if applicable, Large, Complex Case Procedures, upon the occurrence of any of the following events:

  (a) the case is to be decided by more than one arbitrator;

  (b) the parties agree to any information exchange beyond that permitted by Section F-8;

  (c) the timing of the case exceeds the Time Standards set forth in Section F-12; or

  (d) hearing time exceeds what is allowable under Section F-11.

Fast Track Procedures for Construction Cases under $100,000 (continued)

- Under the fast track, deadlines are shortened.
- 7 day deadline to file answer or counterclaim
- 7-day deadline to return list of acceptable arbitrators from list to be provided by AAA immediately after answer is filed.
- Preliminary telephone conference to be set 10 days after arbitrator appointment
- No discovery allowed except for exchange of exhibits, affidavits, or information to be used at the hearing.

Fast Track Procedures for Construction Cases under $100,000 (continued)

- Hearing is to be scheduled not more than 45 days from the preliminary telephone conference.
- Hearing shall not exceed 1 day.
- Award shall be issued within 14 days of hearing.

Procedures for Large, Complex Cases over $1 million

- The Procedures complement the Regular Track Procedures unless there is a conflict.
  - There are not many other strict deadlines.
- Arbitration is to be heard by one to three arbitrators.
- Preliminary conference is to be held within 14 days of administrative filings.
- Arbitrators shall take steps to avoid delay.
- Parties may conduct discovery if agreed by parties under limitations set by arbitrators.
- Parties may take depositions in exceptional circumstances.

“Baseball Arbitration” Clause

- Instead of agreeing that AAA rules apply, parties could elect to add a “baseball arbitration” clause. It arises from the procedure used for salary disputes in Major League Baseball
- This would only be suitable for simple construction disputes and even then parties may decide it’s not the best procedure.
- Procedure:
  - Both parties submit their evidence, arguments, and proposals to an arbitrator.
  - Both parties submit rebuttals and revise their proposals if necessary.
  - Both parties argue live before the arbitrator with no live testimony from witnesses
  - Arbitrator selects one proposal within 30 days typically.

Appeals

- Manifest disregard – no longer a viable judicially created appellate avenue
- Judicial review is “exceedingly deferential” to arbitrators, and review is extraordinarily narrow.
- Doubt or uncertainty resolved in favor of upholding award
- Neither mistakes of law nor fact are reviewable.

Exceedingly Deferential Standard of Review

- "A court must affirm an arbitral award as long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority." *Resolution Performance Prods., LLC v. Paper Allied Indus. Chem. & Energy Workers Int'l Union, Local 4-1201*, 480 F.3d 760, 765 (5th Cir. 2007) (citation and quotation marks omitted).
- "It is not enough for petitioners to show that the panel committed an error–or even a serious error. It is only when [an] arbitrator strays from interpretation and application of the agreement and effectively dispense[s] his own brand of industrial justice that his decision may be unenforceable." *Stolt-Nielsen S.A. v. Animalfeeds Int'l Corp.*, 130 S.Ct. 1758, 1767 (2010) (citations and quotation marks omitted).

Vacatur of Arbitration Award - Arbitrators Exceeded Powers

- Section 10(a)(4) of the FAA provides for vacatur of an award where an arbitrator exceeded his or her powers.
- Doubts are resolved in favor of upholding the award.
- "Excess of authority" motions are subject to limited review.
- "[I]t is particularly necessary to accord the 'narrowest of readings' to the excess-of-authority provision of section 10(d)[, current section 10(a)(4)]. That provision does not, it must be stressed, confer on courts a general equitable power to substitute a judicial resolution of a dispute for an arbitral one." *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1180 (D.C. Cir. 1991) (citation and quotation omitted).
- Arbitrators' decision to accept arbitration can be challenged on "exceeded powers" basis.

Vacatur of Arbitration Award - Evident Partiality

- Section 10(a)(2) provides for vacatur when there is evident partiality on the part of any one or all of the arbitrators.
- Any tribunal permitted by law to try cases must be unbiased and must avoid even the appearance of bias.
- It must clearly appear that the arbitrator was biased, prejudiced, or personally interested in the dispute.

Vacatur of Arbitration Award - Misconduct

- Section 10(a)(3) provides for vacatur where the arbitrators were guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown or refusing to hear evidence pertinent to the controversy or other misbehavior that has prejudiced a party.
- Arbitrary denial should constitute grounds to vacate an award; however, the standard is exceedingly high.

Courts Have Power to Decide if Arbitration Agreement Exists in the First Place

- There is a well-recognized principle that courts make the threshold determination whether an agreement exists in the first place. *First Options of Chicago, Inc. v. Kaplan*, 514 US 938 (1995); *Fluid Disposal Specialties , Inc. v. UniFirst Corp.*, 50,356 (La. App. 2 Cir. 1/13/2016), 186 So.3d 210.

Courts Have Power to Decide Whether There is Consent to Arbitrate

- U.S. Supreme Court in *Granite Rock Co. v. International Brotherhood of Teamsters*, 130 S. Ct. 2847 (U.S. 2010)*:* "Arbitration is strictly a ***matter of consent***."
- Louisiana Supreme Court in *Duhon v. Activelaf, LLC*, 50-356 (La.App. 2 Cir., 1/13/2016); 186 So.3d 210*:* Courts "consider the issue of consent in any contract. ***Lack of consent is a generally applicable contract defense***."
- Louisiana Second Circuit in *Fluid Disposal Specialties, Inc. v. UniFirst Corp.*, 757 F.3d 460 (5th Cir. 2017)*:* "Both federal and Louisiana jurisprudence provide[] that the issue of the existence of an agreement to arbitrate is ***to be decided by the courts***."

The "Wholly Groundless" Exception to Arbitration, Which Previously Gave Courts Certain Powers is No Longer Valid

- U.S. Fifth Circuit Court of Appeal in *Douglas v. Regions Bank:* even where the contract calls for the arbitrators to decide the arbitrability of the dispute, "[i]f the argument that [a] claim . . . is within the scope of the arbitration agreement is 'wholly groundless,' surely [the party opposing arbitration] ***never intended that such arguments would see the light of day*** at an unnecessary and needlessly expensive gateway arbitration."
- The U.S. Fifth Circuit held in December 2017 in. *Archer & White Sales, Inc. v. Henry Schein, Inc.*, 878 F.3d 488 (C.A.5 (Tex.), 2017), that courts – not arbitrators – make the initial inquiry into whether a claim in arbitration is "wholly groundless," and that this inquiry "***requires the courts to examine and, to a limited extent, construe the underlying agreement***."
  - ***This decision, however, was recently vacated and remanded by the United States Supreme Court.***

Archer & White Sales, Inc. v. Henry Schein, Inc. No. 17-1272, 2019 WL 122164 (U.S. 1/8/2019).

- The United States Supreme Court recently eliminated a ground under which parties could seek to avoid arbitration.
- The Court invalidated the "wholly groundless" theory of arbitrability that had previously allowed "the court rather than an arbitrators [to] decide the threshold arbitrability question if, ***under the contract***, the argument for arbitration is wholly groundless."

Schein case (continued)

- Case involved claim for injunctive relief where contract with dental supplier ***expressly excluded claims for injunctive relief from arbitration.***
- A party sought to have the court invalidate arbitration.
- This doctrine thus ***presumes the existence of a contract***

Schein case (continued)

- The Court held as explained in the Court's Syllabus:
  - The "wholly groundless" exception to arbitrability is inconsistent with the Federal Arbitration Act and this Court's precedent. Under the Act, arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms. *Rent-A-Center, West, Inc.* v. *Jackson*, 561 U. S. 63, 67. The parties to such a contract may agree to have an arbitrator decide not only the merits of a particular dispute, but also "'gateway' questions of 'arbitrability.' " *Id.*, at 68– 69. Therefore, when the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract, even if the court thinks that the arbitrability claim is wholly groundless.

Schein case (continued)

- The Court vacated and remanded the case to the Fifth Circuit so that it "may address the question whether the contract at issue in fact delegated the arbitrability question to an arbitrator, as well as other properly preserved arguments, on remand."

Schein case (continued)

- The ruling in *Schein* relates to a discrete issue. It ***only*** involves the viability of the "wholly groundless" doctrine, whereby a party seeks to ask a court to decide that the **basis for arbitrability of a dispute is "wholly groundless"** because it is excluded by the underlying contract
- Doctrine has ***nothing to do*** with challenges to the underlying existence of a contract or a party's consent. The ruling **does not speak to the arbitrability of tort claims or otherwise change the law.**
- The Court ***expressly refused to rule*** on whether reference to AAA rules constitutes an express, "unmistakeable" delegation of arbitrability question to arbitrators (second to last paragraph of ruling). Also, it doesn't affect or invalidate jurisprudence holding that the Court is the gatekeeper.

Applicability of *Schein* case (continued)

- Thus, the recent ruling in *Schein* eliminates the ability of parties to argue that a matter should remain in court if the opposing party's arbitration bid is wholly groundless, but it should not affect claims challenging the underlying ***existence*** of a contract or a party's ***consent*** to an arbitration provision in a contract based on fraud in the inducement of the arbitration provision. 2019 WL 122164 at *3.

Additional Arbitration Issues/Cases

Paulozzi case*:* upholding arbitration despite unavailability of Selected Arbitration Forum

- In *Paulozzi v. Parkview Custom Homes, L.L.C.*, 2018 Ohio 4425, ¶ 31, 2018 WL 5734658, at *6 (Ohio App. 8 Dist., 11/1/2018), the Court upheld an arbitration clause despite unavailability of arbitration forum selected in contract.
- Homeowners sued their contractor alleging breach of contract, unjust enrichment, and fraud.
- The contractor moved to stay the litigation and compel arbitration under the agreement's arbitration provision.
- The parties did not dispute that the contract required them to proceed through arbitration.
- But the contract also specified that "the arbitration shall be conducted under the auspices of the Ohio Arbitration and Mediation Center in accordance with its rules, at Cleveland, Ohio." When the homeowner filed suit, the OAMC appeared to be defunct.

Additional Arbitration Issues/Cases

Paulozzi case*:* upholding arbitration despite unavailability of Selected Arbitration Forum (continued)

- The homeowners argued that, because the chosen forum no longer existed, the arbitration provision was unenforceable.
- The district court held that, because the original forum was defunct and because the arbitration provision did not provide for an alternative forum, the arbitration clause was unenforceable under the doctrine of impossibility.
- On appeal, the Ohio Court of Appeals reversed it, finding that another arbitrator could preside over the arbitration.

Additional Issues/Cases

SMA case*:* Finding no appellate jurisdiction by court

- In *SM Architects, PLLC ("SMA") v. AMX Veteran Specialty Services, LLC ("AMX")*, 2018 WL 5839657 (Tex.App.-Dallas, 11/8/2018), the appellate court held it had no jurisdiction over an interlocutory appeal of an arbitrator's decision denying motion to dismiss based upon the certificate of merit requirement despite statute that seemingly allowed it.
- AMX filed a demand for arbitration alleging professional negligence against an architecture firm, SMA.
- A Texas statute required that AMX as a plaintiff in an action or arbitration involving architectural services to file a certificate of merit affidavit by a third-party licensed architect in support of its claims. AMX attempted to meet this requirement.
- SMA moved to dismiss AMX's claims for failure to comply with the certificate of merit requirement.

Additional Issues/Cases

SMA case*:* Finding no appellate jurisdiction by court (continued)

- The arbitration panel denied SMA's motion.
- SMA filed an appeal to a Texas district court based on the Texas statute which provides that "[a]n order granting or denying a motion for dismissal" for failure to meet the certificate of merit requirement is "immediately appealable."
- AMX moved to dismiss the appeal for lack of jurisdiction. The district court refused to vacate the arbitration panel's order. SMA appealed.

Additional Issues/Cases

SMA: Finding no appellate jurisdiction by court (continued)

- The appellate court considered whether, by enacting the certificate of merit statute, the legislature intended to confer jurisdiction on the district courts to review an interlocutory order issued by an arbitration panel. The court found:
- Because Texas law favors arbitration, judicial review of arbitration proceedings is extraordinarily narrow. *See E. Tex. Salt Water Disposal Co. v. Werline*, 307 S.W.3d 267, 271 (Tex. 2010). The court's jurisdiction over an arbitration proceeding is limited to enforcing the agreement to arbitrate and rendering judgment on the panel's award. *See* Tex. Civ. Prac. & Rem. Code Ann. § 171.081. The filing of an application for an order concerning arbitration invokes the jurisdiction of the court. *Id.* § 171.082(a). But the "orders that may be rendered" include only those within the purview of section 171.086 of the TAA that assist with the arbitration process or involve limited review of a panel award. *Id.* § 171.086. Judicial review of an interlocutory order issued by an arbitration panel does not fall within the scope of section 171.086. *Id. at 2.*
- The court thus vacated the trial court's order as void and dismissed the action for lack of jurisdiction.

Conclusion

- There are many issues and challenges relating to arbitrability, arbitral awards, and arbitration that may affect whether construction-related businesses want arbitration clauses in their contracts, which sometimes may be glossed over.
- Based on *Schein*, there is less opportunity to challenge arbitrability with the Court.
- Construction professions should consider all these issues and decide if arbitration is in their best interest and if it is, to make sure the contract states what they agree to.

QUESTIONS?

MARTHA Y. CURTIS
SHER GARNER CAHILL RICHTER KLEIN & HILBERT, L.L.C.
909 Poydras Street, Suite 2800
New Orleans, LA 70112
Office: 504-299-2111
Cell: 504-782-4659
Facsimile: 504-299-2311
Email: mcurtis@shergarner.com