Binding or Not: Arbitration Clauses in Construction Contracts

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Construction contract disputes almost inevitably devolve into the quagmire of determining actual damages, identifying responsible parties, and mounting defense costs. As such, resolving construction-related disputes prior to costly litigation is the hallmark of successful cost containment.

The Federal Arbitration Act, in conjunction with similar state statutes, has galvanized the popularity of arbitration in the construction industry as the alternative dispute resolution process of choice. This is because arbitration not only avoids the costs and delays of litigation, but also puts the dispute in front of an arbitrator who has (or should have, if the arbitration clause is drafted properly) the necessary expertise to understand the issues at hand.

A well-drafted arbitration clause, therefore, can be the catalyst for resolving construction contract disputes quickly and cost-effectively. In most instances, courts literally interpret the written construction contract and enforce arbitration if the contract mandates arbitration for the particular dispute at hand. There is a strong policy at both the federal and state levels favoring arbitration.

In particular, the Federal Arbitration Act applies to interstate commercial transactions, which encompasses most construction contracts for sizable projects. The FAA states that "an agreement 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." 9 U.S.C. § 2. This embodies the FAA's expression of "a strong federal policy favoring arbitration as an alternative means of dispute resolution." (*Ragone v. Atlantic Video*, 2d Cir. 2010). In fact, the U.S. Supreme Court went so far as to call Section 2 of the FAA "a congressional declaration of a liberal federal policy favoring arbitration agreements." (*Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 1983).

In this vein, state courts, including New York and New Jersey, have consistently enforced arbitration of disputes governed by the FAA. See *Diamond Waterproofing Sys. v. 55 Liberty Owners Corp* (2005). (In a breach of contract dispute arising out of a construction project, the

Court held that since the contract had an effect upon interstate commerce, the FAA governed the parties' dispute.); *Tong v. S.A.C. Capital Mgt., LLC* (1st Dep't 2008); and *Carlton Hobbs Real Estate, LLC, v. Sweeney & Conroy, Inc.* (1st Dep't 2007). (The appellate division held that where the construction project involved retention of out-of-state subcontractors, the FAA applied, affirming the lower court's order compelling arbitration was affirmed.)

In addition, New York and New Jersey state law also strongly favors arbitration. New York has a "long and strong policy favoring arbitration." *People v. Coventry Fist LLC* (2009). In the absence of some compelling public policy, "arbitration is a preferred means for the settlement of disputes." *Prinze v. Jonas* (1976).

New York favors arbitration "as a means of conserving the time and resources of the courts and the contracting parties. Therefore, New York courts interfere as little as possible with the freedom of consenting parties to submit disputes to arbitration." *Smith Barney Shearson Inc. v. Sacharow* (1997).

In New Jersey, "arbitration is . . . favored . . . as a means of resolving disputes." *Angrisani v. Fin. Tech. Ventures, L.P.* (App. Div. 2008). "The affirmative policy of [New Jersey], both legislative and judicial, favors arbitration as a mechanism to resolve disputes." *Alfano v. BDO Seidman, LLP* (App. Div. 2007).

Once in arbitration, favorable results are contingent upon the technical knowledge and experience of the arbitrator, whose decision is binding. Obtaining a qualified and skilled arbitrator can be assured through the drafting of the arbitration clause. To this end, specific qualifications or a particular process for selecting the arbitrator are commonly set forth in the arbitration clause.

An additional consideration when utilizing arbitration is the speed at which the dispute can be resolved. This is contingent upon whether the contract provides for deadlines marking the end of the pre-arbitration negotiation and mediation periods, as well as limits on discovery.

As discussed above, arbitration is less costly than litigation for cases involving substantial damages because of the limits placed on discovery. However, it is important to keep in mind that the limited discovery common to most arbitrations, while cost saving, can in complex cases impose substantial difficulties in proving the case. Commonly, permitted documents are

restricted to those directly relevant to significant issues in the case, restricted in terms of time frame, and exclude the use of broad discovery phraseology, i.e. "all documents relating to." In addition, it is standard to have shortened deadlines for discovery, with 90 days being a common period. As in litigation, an arbitrator can order sanctions for failure of any party to comply with its obligations under the predefined discovery rules.

It is therefore significant whether the arbitration clause is drafted to include requirements that the parties attempt resolution through negotiation in advance of the arbitration. As there are some costs associated with the arbitration process, it can be fruitful to ascertain if the parties to the contract have attempted to resolve the dispute prior to arbitration, and to obtain information garnered from the good faith fact-finding sessions in advance of arbitration and/or litigation. Also of note, in cases involving multiple trades, the construction matrix is extremely helpful in identifying the contractors, their projects, and project completion dates.

Arbitration is a tool that can be utilized to resolve construction contract disputes quickly and cost-effectively, and given courts' consistent enforcement of arbitration clauses, it is a readily available tool.

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