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To Arbitrate or Not to Arbitrate? That Continues to Be the Question

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Like it or not, owners, contractors, subcontractors and construction professionals cannot avoid claims and disputes and, in turn, cannot avoid wrestling with the pros and cons of arbitration as opposed to litigation as the procedure for dispute resolution.

Parties to construction contracts must often consider whether to require or, if given the choice, accept common-law arbitration of claims and disputes as an alternative to litigation. As discussed below, upcoming proposed changes to the American Institute of Architects (AIA) A201 General Conditions of the Contract for Construction will likely cause parties to construction contracts and their counsel to give greater attention to these issues.

Approximately every 10 years, the AIA addresses and provides revisions to its construction documents. For many years, the A201 General Conditions provided for mandatory arbitration of all claims and dispute between the parties. The AIA arbitration requirement was similar to dispute resolution provisions in other construction industry form contracts. These form contracts were (and are) commonly used in the industry, and it is likely that little attention was paid to the dispute resolution clause. This will likely change under the proposed changes to the A201 General Conditions.

Proposed changes for the AIA 201-2007 include the following:

- Provisions establishing an “independent decision maker,” as opposed to

the architect, as the initial decision-maker for claims;

- Provisions promoting consolidation and joinder of arbitrations;
- Provisions altering the time upon which statutes of limitations commence; and
- Provisions changing arbitration from a mandatory to an optional means of dispute resolution.

All of the proposed changes impact claims and dispute resolution, but none more so than the proposed “optional arbitration.” Under the proposed changes, arbitration will become a contract option, requiring the parties to check one of three boxes for “binding dispute resolution” — arbitration, litigation or other. Consistent with the rule that arbitration must be by express agreement, the new A201 provides that if no box is checked, then the default is litigation. Accordingly, under the proposed changes, parties wishing to arbitrate will have to take affirmative steps to select arbitration and thereby avoid the litigation default choice.

Although the facts and circumstances of each project should have a direct bearing on whether mandatory arbitration is preferred over litigation, a variety of factors should be considered in most cases. These factors include the following:

- **Cost:** Although arbitration is often a more expeditious method of dispute resolution, it comes at a price. Hearing costs can be very high, particularly for lengthy arbitrations with a panel of three arbitrators. While these fees typically bring the significant benefit of having experienced construction lawyers or construction professionals hear and decide the case, the overall cost of arbi-



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tration must be considered.

- **Speed of decision-making:** This is a significant benefit of arbitration. In general terms, parties to an arbitration proceeding receive prompt hearing dates after arbitrators are selected and have the benefit of having input and participation in the scheduling process. Arbitration is often more expeditious than litigation for reaching a final determination of claims.

- **Decision-maker qualifications/expertise:** Arbitration offers the parties the opportunity to have experienced construction lawyers, contractors and design professionals/engineers hear and decide the

case. If the case is complex from a technical perspective, arbitration offers this benefit.

- Pre-hearing discovery: Litigation has far more expanded tools and methods to obtain information from parties and non-parties. Although many arbitration cases allow for some pre-hearing discovery and exchange of information, arbitration has limitations that must be considered.

- Joinder of third parties: Like other legal disputes, construction claims often involve multiple parties. Very often, some parties to arbitration will seek to join additional parties in the case or to consolidate with other cases. Accordingly, joinder and consolidation must be considered.

- “Upstream” dispute resolution procedure: The owner/general contractor agreement will likely have a dispute resolution procedure, and if not, the required procedure will be litigation. The general contractor will likely want to coordinate the dispute resolution procedure in its subcontract with the procedure in the general contract, particularly for subcontractor “pass through” claims to the project owner.

One compelling factor is whether decisions in common law construction arbitrations are “final and binding” or subject to judicial review or challenge.

In baseball, to quote the immortal Yogi Berra, “It’s not over until it’s over.” In litigation, appeals can extend “when it’s over” for years, as parties visit appellate courts for various levels and types of judicial review. Are common law construction arbitrations any different? In Pennsylvania, common law construction arbitrations are “over” — or at least should be “over” — when the arbitrators make their “final and binding” decision.

Presumably, one valuable aspect of common law arbitration is finality. The AIA A201 General Conditions provide that the arbitrators’ award shall be final, and Rule 47 of the American Arbitration Association’s Construction Industry Rules provides that an arbitrator is “not empowered to redetermine the merits of any claim” once the arbitrator has issued an award.

Under Pennsylvania law, Purdon’s Title 42, Section 7341, common law arbitration awards are binding and can-

not be vacated or modified unless “it is clearly shown that a party was denied a hearing or that fraud, misconduct, corruption or other irregularity caused the rendition of an unjust, inequitable or unconscionable award.” Although “fraud,” “misconduct” and “corruption” have fairly understood meanings, what exactly is an “other irregularity” sufficient to render an arbitration award “unjust, inequitable or unconscionable”?

The elasticity of the “other irregularity” phrase appears to leave the door somewhat open for a party to challenge what is otherwise a “final and binding” common law arbitration award, but even then, such an opening should and must be very narrowly confined in order to preserve the “final and binding” nature of common law arbitration awards in Pennsylvania. Pennsylvania case law not only sets a very high burden to establish any purported irregularity, but also provides that any such irregularity must relate to the process of the arbitration, not the result of the arbitration. Accordingly, the merits of a common law arbitration award are not before a Pennsylvania court in a challenge concerning a purported irregularity. Rather, the arbitrators make all final determinations of law and fact, and the court is not permitted to alter the arbitration award even if the arbitrators committed errors of fact or law. The often-heard argument that the arbitrators “really got it wrong” does not state an “irregularity” sufficient to challenge — much less modify or reverse — a common law arbitration award in Pennsylvania.

Moreover, some Pennsylvania courts have held that absent a transcript of the underlying arbitration proceedings, a party may be unable to present any claim of “irregularity” whatsoever. Absent a transcript, a court likely has nothing but argument and conclusory statements about the underlying arbitration before it, none of which is sufficient to challenge — much less modify or reverse — the award in question. To the extent that the parties accept the final and binding nature of the arbitration award, a transcript may be an unnecessary expense. However, if a party wants to preserve a possibility — however remote — of an “irregularity” challenge, thought should

likely be given in advance to having a court reporter transcribe the arbitration.

Given such high standards, can a party ever set forth an “other irregularity” resulting in an unjust, inequitable or unconscionable award? Until very recently, Pennsylvania courts were hard-pressed to provide any real examples, largely only hypothesizing about the possibility of such a case one day arising.

In the very recent case of *Alaia v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, however, the Superior Court of Pennsylvania appears to have found an example. There, the arbitrators awarded damages on the first count of a two-count arbitration claim against a party from whom the claimant did not seek damages in that count of the claim; and awarded damages on the second count of a two-count complaint against an employee of the defendant only — and not against the company defendant — even though respondeat superior was apparently uncontested.

The Superior Court, affirming a decision of the Court of Common Pleas of Allegheny County, found that such variations reflected a “flawed” award that was “totally irregular” and “completely contrary” to the claimant’s own claims for relief, “as asserted under the incontroverted facts presented to the arbitrators,” so as to “reek of misconduct or some other irregularity,” resulting in an unjust, inequitable or unconscionable award that “cries out for judicial intervention.”

But, even then, especially with regard to the “irregular” award on the second count of the claim, isn’t the Superior Court really saying that the arbitrators committed an error of fact and law with regard to the law of respondeat superior — that they “got it wrong”? Perhaps the apparently uncontested nature of the facts tilts the scale from mere “mistake” to “reeking of irregularity”? Perhaps the apparent disconnect between the claimant’s expressed claims and the damages awarded reflects an “irregularity” in the process as opposed to the result? That said, champions of the “final and binding” nature of common law construction arbitrations in Pennsylvania can only hope that the *Alaia* decision does not create a slippery slope of new “irregularity” challenges to arbitration awards based

merely upon a "smell test" — whether the award "reeks of irregularity."

Recently, construction contracts have begun to contain provisions providing for common law arbitration as the dispute resolution mechanism between the parties, but further providing that either party has the right to a trial de novo from any arbitration award issued and that the arbitration award only becomes "final and binding" if neither party seeks a trial de novo.

Unquestionably, Pennsylvania law does not permit parties to alter a judicial standard of review applicable to an issue or proceeding. Accordingly, parties cannot simply agree that a court can review a common law arbitration award de novo, as opposed to pursuant to the narrow parameters outlined above. If parties desire to expand the scope of review from an arbitration award, consideration

should be given to statutory arbitration under the Pennsylvania Arbitration Act, 42 Pa. C. S. sections 7301-7320.

In *Bucks Orthopaedic Surgery Assocs. v. Ruth*, the Superior Court of Pennsylvania upheld a contract that provided for common law arbitration followed by a trial de novo at either party's option. There, the Superior Court noted that the common law arbitration was only final and binding, by express agreement of the parties, if neither party requested a trial de novo and that the parties' agreement to have common law arbitration as a condition precedent to litigation merely preserved a right to a judicial forum and did not improperly alter the court's standard of review over common law arbitrations.

In such a case, the arbitration — far from being final and binding — is merely a stepping stone to increased costs and expenses and/or further delays until a

final adjudication of claims is one day reached in court. Such a dispute resolution provision emasculates any finality of common law arbitrations and plainly favors a party who wishes to postpone or avoid claims adjudication or otherwise get a "second bite" if the arbitration result is unfavorable.

Especially if or when the proposed revisions to the AIA A201 are published, parties to construction contracts will continue to need to consider dispute resolution options, including arbitration and litigation. In making the decisions, parties and their counsel are wise to consider that although construction claims and disputes may be "over when they're over," when and how claims and disputes "are truly over" or definitively decided varies markedly between arbitration, litigation and newly created hybrids of both mechanisms. •