



Taking Your Chances with Arbitration

Arbitrating a dispute can be risky business. What provisions can you incorporate into your contracts to avoid problems later?

Have you heard the one about the architect who designed a home for a wealthy client? By the time construction was completed, the client still owed the architect more than half his fees. After months of negotiations, the architect filed a lien to preserve his rights. The client responded with a demand for millions in damages from the architect.



The AIA contract between the client and the architect called for voluntary mediation, followed by mandatory binding arbitration. It also included a clause that limited the architect's liability to the amount of his fees, and a waiver of consequential damages.

The architect tried to mediate in good faith, but the client and the client's attorney had other ideas. After a lengthy and very expensive arbitration, the arbitrator found the architect negligent and awarded the client a staggering amount in compensatory damages. Further, the arbitrator obviated the limitation of liability contract clause and the consequential damages waiver, trebled the damages and awarded attorneys' fees to the client.

THE DISADVANTAGES OF ARBITRATION

As outrageous as the award against this design professional seems, it wasn't an isolated instance. Design Professional sees similar arbitration outcomes all too often. You just never know. The arbitrator may render an unexpected award and may not even follow the law.

Although arbitration can be an effective dispute resolution tool in certain situations (including limited fee disputes involving relatively small sums), there are several drawbacks to the process that can render it an unsatisfactory—and sometimes disastrous—remedy. Before consenting to arbitration provisions in your contract you and your attorney need to discuss the downsides.

For example, discovery proceedings are generally not allowed in arbitration. That means you may not be able to obtain documents and other information that could be vital to your case. Typically, you can't subpoena documents or require sworn testimony from witnesses.

Arbitration isn't necessarily quicker than litigation, either. If an arbitration requires three weeks of hearings, those hearing dates are often spread out over several months.

Arbitration doesn't follow the same rules of evidence found in civil litigation and this can result in proceedings that may not focus on relevant issues. Arbitrators can refuse to accept documentary evidence, for example, and even permit hearsay testimony.

In addition, arbitrators aren't required to apply legal principles—or even the terms of your contract—in reaching their decisions. And they're generally not required to state the grounds or reasons for their decisions.

Arbitration can be costly and isn't necessarily cheaper than litigation. Unlike litigation, the parties must pay for the time of the arbitrators and other associated fees. The arbitrators' fees can be high, and some attorneys complain that there's no incentive for a

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speedy resolution. Moreover, to the extent that the hearings are spread out over a considerable period of time, the required re-mobilization adds costs to the process. Here's a great example: A case took almost two years of arbitration sessions to conclude. Even though the case was won on the technical issues, several hundred thousand dollars were spent on defense costs. Beyond the hard costs, the "soft," or indirect, costs to the insured were substantial.

If you lose, the chances of having the award set aside on appeal are extremely low, even if the arbitrator's decision appears to be entirely erroneous. The problem is that the courts give great deference to the ADR process and unless the arbitrator has committed fraud or certain very limited exceptions apply, it is very difficult to overturn the award. Appealing—or even seeking reconsideration—can be costly and rarely succeeds.

LESSONS LEARNED

For all the reasons mentioned above, the Design Professional group of XL Insurance recommends A/Es try to delete from their contracts with clients, any clause that calls for binding arbitration. If it cannot be deleted, seek contract language that the decision to arbitrate must be by mutual consent.

Since the arbitrator isn't required to follow legal principles or rules of evidence, the parties to the contract should agree to incorporate a clause stating that discovery and rules of evidence shall be in accordance with the code of civil procedure in the particular state or venue. An additional provision could be incorporated stating that the decision by the arbitrator may be excepted to, challenged and appealed according to law.

If arbitration is inevitable, it's crucial to select a qualified arbitrator with construction industry experience, and to rule out any conflicts of interest among the participants.

Conclusion: The design professional should carefully weigh the consequences of filing a lien or lawsuit against a client for fees. In almost every case, the client will file a counter claim. (For more information about fee claims see How Far Should You Go to Collect Your Fees?)

A BETTER IDEA: MEDIATION

What's the alternative to binding arbitration or litigation? Try mediation. It's much safer to mediate, since it's voluntary. You have more control of your destiny than in binding arbitration and it's much less costly.

Voluntary, non-binding mediation offers many advantages over litigation or arbitration. Relatively quick, inexpensive and confidential, mediation often allows parties to settle their disputes while preserving their working relationships.

Although the fee claim described above wasn't successfully mediated, that's unusual. Mediation is successful in more than 80% of the business disputes that use the process. Even if you participate in a mediation that's not totally successful, it can clarify the facts in a case and narrow the issues that remain to be resolved, thereby reducing costs and shortening the life of a conflict.

If every contract you enter into calls for mediation, you and your client will have on tap a proven means by which you can inexpensively settle most disputes and very likely emerge from the process with your business relationship intact.

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