Scribbles Squibs # 13 (June 17, 2013): Thirteen reasons not to agree to an arbitration clause in your contract.

By Attorney Jonathan Sauer

Problem: You are presented with subcontracts and general contracts every day that have arbitration clauses in them. Maybe not such a bad deal. After all, there is very limited discovery and you get to hearing quicker. That means there might be fewer months you get that annoying bill from your lawyer. And, don't people usually settle on the courthouse steps? Uh oh! There are no courthouse steps in front of the American Arbitration Association (AAA) office at One Center Plaza in Boston. The following assumes an arbitration between a subcontractor and a general contractor with regard to a claim with a value of one hundred thousand dollars. And, this article reflects my own experiences as an attorney in construction arbitration. Other peoples' experience (and opinions) might be different.

What's wrong with arbitration? There are at least a baker's dozen things potentially wrong with the construction arbitration process:

1. **There are generally no appeals available in arbitration**. In court, there is almost always an opportunity for an appeal. In the superior court, you can appeal to the Appeals Court. Then, under certain circumstances, you can *then* appeal to the Supreme Judicial Court. Every trial judge knows this. He/she does not want to be embarrassed by having one of their decisions reversed due to errors with evidence, in applying the law, in making procedural errors or in having a difficult personality. Which reversal goes into a book. Which is part of Massachusetts legal history. *Forever.* In addition, the court system has the Massachusetts Commission on Judicial Misconduct, where complaints can be filed against individual judges. And, in addition to this, I am frequently asked by various judicial supervision authorities to write reviews as to judges I have been in front of. If one notices Headline News recently, you'll see that they are increasingly reviewing (and showing) various trials. And, locally, TV stations cover local trials of interest. All of these safeguards are factors that keep most judges from getting too extreme with their rulings and with their conduct.

To the best of my knowledge, there are none of these safeguards with regard to arbitration. And, with arbitration there are extremely limited grounds for appeal. There have been Massachusetts law cases holding that when an arbitrator makes a clear error of law and/or a clear error as to the facts, this is not grounds for a judicial appeal. *The arbitrators know this.* Since there are only infrequent grounds for appeal, there is no built-in limitation or control as to what an arbitrator can do. Most lawyers who have arbitrated construction cases can tell you that they feel that they (and/or their clients) sometimes have been treated unfairly by an arrogant arbitrator. There is little to reign in any particular arbitrator in any particular matter.

2. **Judges are better-educated than arbitrators and have no financial interest in having matters run longer**. As someone once said: 'That's the fact, Jack.' There is a saying about teachers: those who can, do; those who can't, teach. Since arbitrators aren't in a judicial class, they principally work as contractors, architects, engineers and attorneys. This cannot be perceived as 'giving back' or 'public service' where typical charges per hour for an arbitrator in a construction case are frequently between three and four hundred dollars per hour.

All judges have both a bachelor's degree and a doctor of law degree, which is usually at least seven years of difficult collegiate study. (For this writer, it was nine years.) They are trained to look at legal disputes analytically with an attention to legal precedent. As most of these judges practiced law as attorneys, they are aware of the difficulties and issues in trying a case. Most judges before being appointed were either partners at significant law firms, assistant attorneys general or assistant district attorneys. These are hard jobs to get and are not generally handed out to people who are lightly talented. While it is said that to become a judge one has to be a friend of the governor's, how many of you know the governor? Judges work for a salary. Therefore, whether they put fewer hours into their work or more hours into their work, their pay is the same. Arbitrators, however, are paid by the hour. When matters run longer, this means more income for them. It is both an advantage and disadvantage of arbitration that cases tend to last longer at trial. And, since many construction arbitrations don't go every day at trial – could be two days of hearings this week, two days of hearings a month from now – this tends to increase the length of the proceedings because continuity of the trial and of the evidence is interrupted. Judges have the incentive of high workloads to try to shorten hearings, to streamline the process. Arbitrators have no such incentive. Their own personal interests would be to the contrary.

3. **You never really know who you are going to get as an arbitrator or *what* you are going to get as an arbitrator.** When an arbitration is filed, the AAA will send you a list of potential arbitrators with resumes. You have a very limited time period in which to investigate these individuals and strike names of those prospective arbitrators that you don't want off of a list you are given. Some of these choices are easier. If you are a subcontractor claimant, you don't want a general contractor arbitrator. But, if you are a subcontractor claimant, what do you do about engineers and architects looking to serve as arbitrators? Sure, they are probably more owner-friendly. But, are you safe if you pick one when you, as a subcontractor, are arbitrating with a general contractor? Chances are, architects and engineers are not wildly enthusiastic about change orders and claims. How will they respond to a claim that is for something other than only seeking payment for clear contract work? Who is to say?

A goodly number of arbitrators are lawyers. But, if they are construction lawyers, who do they usually represent? Subcontractors? General contractors? Owners? Many construction lawyers primarily serve just one of these groups. But, a lawyer's typical clients is not information you are provided with. As a construction lawyer, you have to make a lot of calls to other construction lawyers and see if you can get the 'book' on them. This is not always possible,

given the time pressure within which to choose and the fact that your own group of contacts may not be familiar with the attorney in question. And, after a point, the arbitration service is likely to pick an arbitrator themselves if the parties cannot agree on who will be picked. Which means that no lawyer can just keep striking names from prospective arbitrator lists indefinitely.

4. **Do you want construction knowledge or legal knowledge?** As discussed below, arbitration can be *very* expensive. For the majority of claims, you will have only one arbitrator. Remember that in arbitration, the parties pay the arbitrator for every hour he/she works and, usually, in advance. If there are two parties, each pays one-half of several hundred dollars *per hour*. That is for every hour of preparation, every hour of hearings and for every hour of reviewing the evidence and writing a decision. So, a litigant generally has either someone with construction knowledge – a contractor, an architect, an engineer – or someone with legal knowledge but not necessarily construction knowledge, such as a lawyer. A contract is a legal document and construction legal issues can be myriad and quite technical. Do you want someone deciding your case who doesn't understand the law *at all?* I had a multi-million dollar arbitration in which there were significant legal issues. Any number of times, I would submit briefs as requested by the arbitrator and have the general contractor arbitrator then say 'I don't understand this stuff at all.' That doesn't tend to warm the cockles of one's heart!

If it were me, I would generally favor the legal knowledge, as you can have experts, even competitors, assist you with providing the construction knowledge. But, again, who does the lawyer typically represent? I once had a quality general contractor client tell me that his lawyer in arbitration had been too dumb to realize that the lawyer arbitrator selected worked primarily for a subcontractor legal firm. He felt his issues were not fairly dealt with.

5. **Arbitration favors general contractors, as a practical matter**. General contractors, generally speaking, are larger business entities than subcontractors. They have a greater tendency to include in their annual budgets legal costs. My experience with subcontractors is: not so much. My experience with material suppliers is: not at all. Justice may be blind but it certainly isn't cheap. There is almost always an inherent advantage for general contractors in arbitration. They have, generally speaking, a greater ability to finance their litigations. To be fair, this distinction applies many times in court, but not always. But, since the opportunity to recoup legal costs in arbitration is less than in court, this advantage may be enhanced.

6. **Arbitration lacks many of the procedural protections of court.** As an example, Rule 33 (a) of the Construction Industry Arbitration Rules of the American Arbitration Association (Rules) as currently listed on the internet provides that 'Conformity to legal rules of evidence shall not be necessary'. While court rules with regard to evidence are complicated, at least the intent behind them is to make sure that only the best evidence available is presented to the fact-finder.

Take the 'hearsay' evidence rule, for example. In Massachusetts, generally speaking, with the exception of statements made between the parties (one to the other), out of court statements by third parties cannot be admitted as substantive evidence in court proceedings.

Example. A sues B. While out of court statements made by either A or B can be introduced into evidence, statements by C can't. That way, people who said things outside of court (including the writing of letters) are required to attend court to be witnesses, offering both parties the opportunity to examine (and, cross-examine) the out of court statements. The whole essence of the litigation process is that one person has the right to question other persons as to their contentions which may affect the outcome of the matter. Although not quite the same thing, it is a constitutional guarantee in criminal cases that a party has a right to confront his accusers. Since A and B are parties, it is presumed that they will have available for testimony their employees and representatives to testify as to what they said.

In arbitration, there is a tendency to let *everything* into evidence. I had a seven figure arbitration where the general contractor's evidence against a town (which I represented) consisted largely of letters that the general contractor's project manager had written to the town. In court, technically, letters are mostly construed as statements that someone *said* something but not, generally, as substantive evidence as to what is stated therein. Yet, in this arbitration, these letters were primarily the general contractor's only evidence as to large portions of its case, almost all of it going into evidence. One of the claims the general contractor had, for a quarter of one million dollars, was a subcontractor's **<u>one sentence</u>** letter to the general contractor as to a claim. No back-up information as to the claim was presented. The subcontractor was never offered as a witness and didn't testify. In fact, the subcontractor had been involved in some kind of bankruptcy proceeding so that it wasn't even clear that the subcontractor still 'owned' the claim, let alone had the ability to pursue such a claim against the general contractor.

Huh? Does this sound *fair?* Fairness suggests that the arbitrator should never have accepted that letter into evidence without the subcontractor or one of its employees to present it (and defend it), requiring the subcontractor to present the kind and level of evidence one would expect from a quarter of one million dollar claim. But, there was only the one sentence for such a large claim, containing absolutely no back-up for the claim. This is the kind of thing that happens in arbitration each and every day of the week. While the town prevailed as to that claim, it could have been decided differently. Is this how you would like your rights to be protected?

In a multi-million dollar arbitration I had at the AAA, the arbitrator would request on occasion legal briefings on certain subjects, which briefs were due *the next day*. And, for this arbitrator, a general contractor, he would sometimes say that he wanted the briefs to be *one page long*. Just to insert the caption of the case on the piece of paper and have an attorney sign-off paragraph takes half of a piece of paper. So, in reality, the brief has to be one-half of a piece of a paper. This is patently absurd. And, what if a lawyer was not in when such a request was received? What if he or she was on vacation? What if the lawyer was busy trying another case? What if he or she were sick? I drew the inference – and, more than once – that the 'one day' requirement might have been caused by a case administrator who had simply let the matter languish on their desk for a period of time, necessitating the one day requirement because of an upcoming need for

this information. Such treatment would not likely happen in court. And, if it did, this might be the basis for an appeal. Not so with arbitration.

7. **Limitation as to attorneys' fee awards.** There are not generally any legal fees available in arbitration unless the following condition is met, as provided for by the Rules in Rule 45 (d) (iii): "an award of attorneys' fees if all parties have requested such an award or it is authorized by law or their arbitration agreement". Well, what if all parties don't agree this should be part of the award? What if there is no attorneys' fee provision in the arbitration agreement?

In court, on the other hand, where a party pursues meritless claims or defenses, there is always the possibility – although not often granted – to have the judge award attorneys' fees against one of the parties or even against their lawyer to the party having to deal with the meritless claim or defense. These can be awarded as authorized by a statute and/or as authorized by a rule governing lawyer conduct. And, for example, in claims against the general contractor's payment bond for public work, successful claimants are entitled to an award of attorneys' fees if they win their case in court as a matter of statute. This causes sureties to be more interested in settlements of such claims before trial and often well before trial (as it is possible to get such an award even with a settlement before trial.) There is Massachusetts case law that says that with such general contractor payment bond claims, no attorneys' fees are available for that portion of the case which takes place in arbitration, which would be the vast majority of the typical case. So, a successful claimant might get the attorneys' fees for the filing of the case in the superior court to preserve the bond claim (you have to sue in one year). For all aspects of the case as conducted in arbitration, the plaintiff claimant gets no attorneys' fees. There is less impetus, then, for the surety and, for that matter, the general contractor (the principal on the bond) to settle the case before trial as, call it what you will, the attorney's fee award is viewed by the surety as a penalty and, if this is not available because of the arbitration, then this issue largely doesn't exist.

8. **Parties are afraid of court and they are not afraid of arbitration**. **Cases may not settle as easily with an arbitration.** In a court case, you go to an unfriendly building. A lot of very unhappy people are wandering the halls, some of them crying, some of them very scary looking. In the courtrooms, there are a number of bailiffs – court officers - dressed more or less like police. Some of them are large and imposing. Some may prominently wear handcuffs. A judge wears a gown and sits way above everyone else. And, there are all of those jurors' chairs which just make everyone sweat, particularly in a construction case. (Juries seldom understand complicated contractual issues.) There are flags all around and certain speeches "Hear ye, hear ye, hear ye . . ." that occur at different stages of the proceeding which you might not understand. For these reasons – many of which are steeped in fear – court cases tend to settle on the courthouse steps or before. I once saw a judge order a party representing himself into handcuffs on a simple motion because the party made *one* disrespectful comment to the judge.

Arbitration services have no courthouse steps. There is no courtroom. There are no bailiffs. There is no jury. The arbitrator doesn't wear a gown and sits at the same level as everyone else.

All of this occurs around a conference room table. The hearing room is, in fact, just a conference room and we are all familiar with attending meetings in conference rooms.

My own experience has been that arbitration cases *don't* settle as frequently as do court cases. People are simply not as afraid – or afraid *at all* – about attending an arbitration hearing. Going to an arbitration isn't ostensibly anywhere near as stressful as is court. One factor contributing to this is that for longer hearings, they often don't go day to day. There may be two days hearings this week and no more hearings until next months. For the parties, attending arbitration may seem more like just going to a meeting. Because people are more comfortable with arbitration, my own individual experience has been that cases in arbitration don't settle anywhere near as frequently as they do with court cases. Statistics I saw several years ago indicated that only one percent of superior court civil cases go through a complete trial. That means that 99% *didn't!* Fear of the judicial process and of its intricacies contribute to that result.

9. **Arbitrators have fewer powers than judges do.** Until several years ago, arbitrators could not hear actions for unfair and deceptive trade practices. Still, there are things that cannot be heard. While an arbitrator may have the authority under the Rules to issue injunctive relief, it is probably unenforceable because sheriffs will ordinarily not enforce non-judicial orders. Only a court can really issue injunctive relief: issue an order for a party to do something or to *not* do something. This can be enforced by sheriffs and by contempt orders and citations issued by a judge. So, with complicated claims involving claims for injunctive relief and also for various contract claims, almost necessarily there will be *two* different proceedings required: one in court, one in arbitration.

Again, I recently participated in another multi-million dollar case where a plaintiff owner wished to both enjoin (prohibit) certain actions by a town and by a general contractor as well as process certain contractual claims against the town, which were subject to an arbitration clause. The owner tried for an injunction in court and failed, submitting to the judge about six inches of paper, matched by another six inches of paper as submitted by the town. Looking at the amount of paperwork filed and its content, this had to have cost the owner at least fifty thousand dollars in attorneys' fees. So, other than severely increasing your costs, you have two different fact-finders, which increases the chance for error and/or for inconsistent results. What happens if a judge interprets the parties' rights differently in hearing an injunction than does an arbitrator hearing the actual case? Whenever possible, you want one fact-finder as to your disputes.

10. **Arbitration can be *blindingly* expensive**. In superior court, a plaintiff files an action seeking one hundred thousand dollars from a general contractor and pays a $275.00 filing fee. In fact, such a claim could also be for billions of dollars with no increase in the filing fee. That is the only money ever paid to the court as to the resolution of the dispute, even if it takes six years to resolve the case (as many of them do). In arbitration, based on the 2010 rates currently on-line for the AAA (which may not accurate as of 2013) to sue that same general contractor for one hundred thousand dollars in arbitration requires a filing fee of $1850 plus a 'final fee'

(whatever that is) of $750. On a claim seeking $500,001, the filing fee is $6200 and the final fee is $2500. Then, you have to pay one-half of the arbitrator's hourly compensation. There is a 'room fee' charge if you use an AAA conference room. What if you have a case that will require six complete days of trial, not at all unusual with a construction case? Let's see. That's several days of arbitrator compensation – half of three hundred or four hundred dollars *per hour* – for preparation, six days for hearing and several days for 'deliberations' and the writing of a decision. You're paying a room fee this entire time for each day of the hearings if you use an AAA conference room. Does this look like it will get expensive? At some point, might you not wonder exactly who your adversary really is in this matter? Is it the general contractor (for the subcontractor) or the subcontractor (for the general contractor)? Or, might that adversary be the arbitration service *itself*?

11. **Half a loaf.** A maxim among lawyers is that in an arbitration, everyone gets something. This might be – my inference/opinion only – that an arbitrator doesn't want to alienate attorneys and parties who will be considering future lists of arbitrators. In other words, the arbitrator may be looking for future cases to hear and may not be anxious to offend any particular lawyer, particularly one who tries a lot of cases in arbitration, or a party which also frequently participates in arbitration. For, if he does, that attorney or party may be more likely to strike that arbitrator's name from a list of potential arbitrators for a future matter. This perception that many cases will conclude with a 'half a loaf' award is another factor that contributes to cases not settling as easily in arbitration as they do in court. Court is more of a 'winner take all' thing. One party wins; the other party doesn't.

12**. Unfair procedures**. We mentioned some of these above in number six. Asking for a brief in one day is simply not fair, particularly as some of these requests might be before a hearing commences or during the hearings, which are not generally 'day to day' until the case is over. In other words, there is not the time urgency that one might have in a court trial, which generally goes day to day until it is over.

Researching legal issues doesn't involve looking up an answer in the Encyclopedia Americana for ten minutes. It involves legal research among statutes, court cases, various administrative rules and other sources of law. The fact that some court cases may tend to hold (decide) one way and other cases may tend to hold another way requires analysis of the cases and comparisons with the various factual situations involved. To do the job right can be time-consuming. A one page brief requirement is ludicrous. In the superior court, as to pre-trial matters (motions), each party has at least twenty pages to submit its arguments as to important motions and, with court approval, the briefs may be longer. In one large case I had, the arbitrator would ask the attorneys – both well-experienced in construction law – to give him their opinion as to various issues in *other* cases he was handling. Is that *professional?* Isn't that a *conflict of interest?* This would never happen in court. And, in that case, when an important motion or issue was presented, the arbitrator would routinely take the attorneys to *another* room, a room the court reporter wasn't invited to. Thus, there would be no record of what action was taken – or not taken - and why.

This would minimize later attacks on the procedural aspects of the hearings, as there would be no record of them. Again, this would be much less likely in court proceedings. It is true that sometimes lawyers meet with the attorneys in the judges' chambers. Such meetings would be more frequent in a non-trial setting. Generally speaking, during the conduct of a trial, for a 'sidebar' conference, the court reporter would be able to take down what each person said. Having done a number of arbitrations, I cannot recall ever receiving from any arbitration service a request for me to comment on that service's performance or on any aspect of the arbitrator's performance after the case was over. As indicated elsewhere, I am *frequently* called upon by judicial supervisory authorities to submit comments on judges I have been in front of. One watching television and unfamiliar with actual court processes might infer that lawyers and judges get away with pretty much anything. This is not at all true. The judicial process watches both lawyers and judges to make sure their conduct conforms with significant written ethical standards. Such rules don't usually apply in arbitrations.

13. **Arbitration provides that only parties with arbitration provisions in their contracts – or, who, at least, agree to arbitrate - can be compelled to arbitrate.** At first glance, that doesn't look that bad. However, as to subcontractors' claims against general contractors for differing site conditions, delays and legitimate claims, in many instances, there may be pass-through possibilities with regard to those claims by the general contractor against the owner. After all, if the claim was caused by owner conduct, why should the general contractor have to own that exposure? In such a situation, there would be at least two contracts: the subcontract and the general contract. But, what if the owner did not have an arbitration clause in the general contract but there was an arbitration clause in the subcontract? It's no secret that many general contractors want their disputes with subcontractors resolved by arbitration for one or more of the reasons indicated in this article. One hopes in such a situation that those parties subject to the arbitration clause would agree to litigation so that only *one* case would be necessary and that all parties would be participating in that trial. But, this doesn't always happen. I have had various subcontractor claims where the very ability to sue the owner at the same time as suing the general contractor under one theory or another lead to a relatively quick resolution of the dispute. This might not happen as much where not all parties would be required to participate in the same hearing before the same judge (or arbitrator).

CONCLUSION: Does arbitration have *any* advantages? This depends on the case. I can think of **five** situations where arbitration has advantages over court. ***First,*** if you have a dispute that you need a resolution to within six months, this would be your forum. ***Secondly,*** if the dispute is relatively simple – who owns this particular piece of work (such as in a kind of jurisdictional dispute) – this might be the appropriate forum, particularly where the parties want someone else to decide the issue but are not terribly insistent that it be decided necessarily in their favor. (This might happen with disputes between a subcontractor and a general contractor who have worked together on several projects and who both wish to preserve that relationship, both for the present and for the future). ***Thirdly,*** for a relatively small matter, arbitration might have its

advantages. A quicker hearing with less discovery. ***Fourthly***, if you have a dispute where you have clearly *not* complied with required contractual procedures – such as with 'notice' as to a changed condition – arbitration is a better forum. There seems to be a lot less emphasis on complying with contractual requirements in arbitration than there would be with litigation in court. ***Fifthly,*** would be, uh, if yours truly was serving as the arbitrator. In the rotten construction climate of the last five years, many of us have found the need to supplement our incomes!

Otherwise? In this writer's experience, arbitration has more disadvantages than advantages. Some of these affect the parties' rights. Some of them simply affect the parties' pocketbooks. It is important to understand that one of the reasons courts will not lightly interfere with arbitration matters is because the parties 'chose' arbitration; they agreed to participate in that process with its various limitations. If you sign a tendered subcontract (or general contract) with an arbitration provision, the fact that you signed the contract means that you 'chose' this method of dispute resolution notwithstanding that you felt you had no option other than agreeing to this.

So, what do you do? My standard advice to a subcontractor having to sign a subcontract in the next ten minutes is this. The statutory filed subbidder subcontract – only two sides – is very fair and gives a subcontractor some protection against late backcharges from the general contractor. Failing this, sign an AIA subcontract form and strike all arbitration clauses and requirements.

At the bare minimum, having read this *Squib*, at least you are hopefully better educated as to the issues and know what you are getting into or *not* getting into by choosing this option.

(These materials are intended as general information only, not specific legal advice. When confronted with a legal problem you don't understand, seek the assistance of legal counsel. Construction law is something that most 'general' lawyers don't do a lot of. At Sauer & Sauer, we ***only*** *practice construction law.)*

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