CHAPTER 1

Drafting the Arbitration Clause

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I. Importance of Clause

Arbitration is a creature of contract. With few exceptions, an arbitrator has no jurisdiction to hear a case without a written agreement, whether in the form of a submission or a contract clause.\(^1\) The arbitration clause defines and may limit the powers of the arbitrator; it is irrevocable and enforceable unless legal or equitable grounds exist for revocation.\(^2\)

Other than unethical behavior or denying due process as delineated in the Federal Arbitration Act (FAA), 9 U.S.C. § 10(a)(1), (2), (3), the grounds for vacating an arbitral award are “where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.”\(^3\) Arbitral awards generally will not be overturned for mistakes of law.\(^4\)

The arbitration clause is severable from the rest of the contract. Thus, absent a limitation in the arbitration clause itself, the arbitrator has jurisdiction to decide issues such as the validity of the contract and unconscionability; in other words, the arbitrators have jurisdiction to determine their own jurisdiction.\(^5\)

II. Standard Forms

The importance of the arbitration agreement should be readily apparent. Given long experience with arbitration in the construction industry, it should be no surprise that construction contract forms with arbitration clauses are

\(^3\) 9 U.S.C. § 10(a)(4).
readily available. The most common sources are the American Institute of Architects, ConsensusDocs (which were drafted by a consortium of general and specialty contractors, architects, engineers, and owners), and the American Arbitration Association. All are available on the Internet.

Using standard forms gives counsel the advantage of being able to use clauses that are the result of years of experience and alleviates the need to reinvent the wheel; as the law evolves, the forms are occasionally updated so standard forms are generally relatively safe. On the other hand, certain projects may need special consideration. Attorneys should think about whether they need to draft the arbitration clause ab initio or modify existing clauses.

ConsensusDocs are available at the Associated General Contractors of America website, the AIA forms at the American Institute of Architects website; both charge for the contract forms. The American Arbitration Association in addition to having published booklets on drafting alternative dispute resolution (ADR) clauses has established a “clause builder” feature on their website, allowing users to build custom ADR clauses, free of charge. The AAA clause builder is limited to ADR issues while AIA and ConsensusDocs forms have complete construction contracts.

III. Modify Standard Forms or Ab Initio Drafting?

Whether drafting an original arbitration clause or modifying or adapting a standard clause, counsel should think about several matters. Most of the following topics are explored in greater detail in subsequent chapters.

1. Choice of law. A contract may be formed in a state other than where the project is to be built; financing and insurance may be issued by companies in other states; designers and owners may be located in yet different states or countries. Which jurisdiction’s substantive law should apply? Naming the substantive law jurisdiction can avoid choice of law conflicts; resolving claims provides conflict enough.

   The author recommends that the choice of law provision clearly articulate that it is the jurisdiction’s substantive law that applies. In terms of enforcement of the arbitration award, avoiding vacatur, compelling arbitration if need be, and other matters, there are sound reasons for allowing the FAA to apply. As construction projects affect interstate commerce (materials come from different states and countries), the FAA preempts state arbitration law.7

2. Name the ADR provider.8 The major dispute resolution services have established reputations, rules, and panels of neutrals with construction arbitration experience. There may be challenges with subpoenas

8. See Chapter 3.
III. Modify Standard Forms or Ab Initio Drafting?

from independent (as opposed to neutral) arbitrators and the case administration by major providers is very efficient. Providers’ rules are time-tested and designed to keep arbitration less complicated and time consuming than litigation.

3. Name the rules. In addition to naming the dispute resolution provider, the arbitration clause should name the rules under which the arbitration will proceed. Study the rules, which are freely available on the Internet. It may be that counsel may want to use a neutral associated with one provider but to proceed under the rules of another. For example, if your clause calls for arbitration by JAMS under the American Arbitration Association rules, the JAMS neutral will have to follow the AAA rules or the award could be subject to vacatur under 9 U.S.C. § 10(a)(4). Be very specific about this. If you use language such as “____ Construction Industry Arbitration Rules as they exist at the time of executing this contract,” parties will have notice of the rules applicable to their case and not have to worry about future rule modifications creating due process notice issues.

4. Do you want to provide for fees and costs to be paid to the prevailing party? If provisions for filing fees and costs are not included in the arbitration clause, most providers’ rules allow the arbitrator to award filing fees and costs to the prevailing party. Filing and administrative fees have escalating schedules at most providers. The larger the case, the larger the providers’ fees.

   Attorney’s fees must be specifically included in the clause, consistent with the law of contracts in most jurisdictions. This is truly a two-edged sword—the author has seen a few cases in which the requested attorney’s fees exceeded the amount of the actual claim. Remember, the losing side will be paying two fees, possibly more in multiparty cases. Arbitrators also have discretion under most rules not to award fees if there is not a clearly prevailing party. This most commonly occurs when offsets are awarded on a counterclaim.

5. Include a mediation requirement prior to arbitration. The advantages of mediation are well known and mediation can save the time and expense of arbitration. The mediation requirement can have a

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9. See Chapter 4.
10. See Chapter 12.
12. E.g., id.
13. The author has heard it argued that an attorney’s fee provision provides an incentive to settle. On large projects where claims could be numerous and complex, fees can run higher than an Ivy League education; likewise, in cases where the proofs are close, an attorney’s fee provision will certainly give parties food for thought.
14. See Chapter 16.
provision that if a party refuses to mediate, that party cannot claim fees if they prevail at arbitration. Many states have also developed this policy.

Some arbitration clauses require the parties to negotiate in good faith prior to mediation and/or arbitration. The author believes this is superfluous as negotiations normally take place anyway and defining “good faith” can be problematic.

6. Do you want to set time limits for filing claims? Some ADR clauses set shorter time limits for filing claims than provided by statutes of limitation. Shortening time can be helpful as closure is important, memory fades less, and documents and percipient witnesses may be more readily available without a long passage of time. Do not make the time limits unreasonably or unrealistically short, however.

7. Avoid mediation-arbitration (“med-arb”) and binding mediation. Med-arb uses the same neutral as the mediator and the arbitrator. If mediation does not result in a settlement, the mediator swaps hats and arbitrates the case, sometimes issuing an award without further hearings. Most experienced construction neutrals will not agree to sit on a med-arb case in the construction field, although it has had its successes in the labor relations area. Although med-arb may be economically efficient, the main problem is that during the mediation process, the neutral will likely be provided confidential information and/or information that counsel, for legitimate reasons, will not want in evidence for purposes of arbitration. It is very difficult for neutrals to exclude large amounts of information from their minds.

Some providers offer binding mediation. Binding mediation is essentially med-arb under a different name and is to be avoided in construction cases.

8. Venue. It is quite common for arbitration clauses to contain a venue provision. Convenience of the parties may be important. On a complex project, a site inspection by the neutral could be helpful. Transportation issues may be taken into account. There is no requirement of which the author is aware that requires venue and choice of substantive law to be the same. Just make sure the choice of venue is not oppressive or burdensome.

9. Do you want a single arbitrator or a panel of three? How do you want a three-arbitrator panel selected?

A common arbitration clause calls for each party to name an arbitrator, then requires the two party-selected arbitrators to select a third

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15. See Chapter 4, generally.
18. See Chapter 4.
arbitrator. Many of these clauses do not require the party arbitrators to be neutral. U.S. courts do not expect party-appointed arbitrators to be neutral. The author believes the better practice is to require all arbitrators on a panel to be neutral. All providers have a neutral selection process, and the panel may be chosen from the providers’ lists of neutrals if counsel cannot agree on neutral arbitrators. It should be noted as well that ethical guidelines issued by the American Bar Association and the American Arbitration Association discuss ethical duties of party appointed arbitrators.

Cost is another consideration. Three-arbitrator panels are simply prohibitively expensive in smaller cases. On the other hand, in a large case with a great deal at risk, a three-arbitrator panel reduces the chances of an aberrant award. Many providers’ rules set monetary thresholds for using three-arbitrator panels. For example, American Arbitration Association Construction Industry Arbitration Rules for Large, Complex Cases, Rule L-3(a) requires three arbitrators on large, complex cases unless the parties agree to a single arbitrator.

In a similar fashion, it is common for rules to provide for “desk hearings” or hearings on the documents in smaller cases. Each party has the opportunity to provide documentary evidence and written arguments. You may want to modify the thresholds for desk hearings. Fast-track arbitration is also available for smaller cases.

10. Resist expanding discovery beyond what the rules provide, resist incorporating codes of civil procedure, and resist incorporating evidence codes. Remember that one of the great advantages of arbitration is that it provides a simplified, efficient process. Many litigators who are used to the wide-open battles in courts are uncomfortable with the limited discovery and simplified rules of evidence and procedure in arbitration. Yet the rules evolve out of the experience of the users of the system—and the arbitration system works. Incorporating full-blown discovery and the other complexities of litigation only serve to cost time and money and do not increase the quality of justice arbitration achieves.


20. AAA Construction Industry Arbitration Rule D-1 allows desk hearings on any size claim.


11. Should arbitrators be selected at the time the contract is being drafted? Although it is rare, there is nothing that prevents it. Counsel will have to agree as to whom the arbitrators will be and this is probably only feasible when the parties and their counsel have a long history of working together on various projects. Naming arbitrators early provides predictability but does not guarantee the neutral will be available when the arbitration commences. Better practice would be to require neutrals to have specific backgrounds, that is, have experience with large, complex construction arbitration, be an engineer/arbitrator, and so forth.

On the other hand, a large complex project can include a dispute review board or on-site neutral; it is more practical to assemble the neutrals for these purposes at the time of contract formation or at the time work commences. The author recommends that the neutrals resolving disputes while the project is under way not be the same as the neutrals resolving postproject claims. On-site neutrals and dispute review boards generally are empowered to issue advisory opinions rather than binding awards, creating a situation similar to med-arb.

12. Think about the scope of the arbitration clause. Much has been written about the jurisdictional aspects of the arbitration clause, but in certain cases counsel may want to limit, expand, or define the remedies the arbitrators are empowered to order. Arbitration clauses often confer broad jurisdiction, using language such as “in the event of any controversy arising between the parties to this contract in the performance thereof, such controversies shall be resolved by binding arbitration under the rules of . . .” Such a clause, in addition to conferring broad subject matter jurisdiction within the four corners of the contract, does not address available remedies. If the clause does not limit remedies (there are good reasons not to) most provider rules give arbitrators generous powers. For example, American Arbitration Association Construction Industry Rule R-45, Scope of Award, reads:

(a) The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, equitable relief and specific performance of a contract.

(b) In addition to the final award, the arbitrator may make other decisions, including interim, interlocutory, or partial rulings, orders, and awards. In any interim, interlocutory, or partial award, the arbitrator may assess and apportion the
fees, expenses, and compensation related to such award as the arbitrator determines is appropriate.

13. While a specific project may demand limiting the substantive scope of the arbitrators’ jurisdiction, counsel should be careful not to define jurisdiction too narrowly.25

14. Consolidation and joinder provisions.26 All of the contracts and subcontracts on a project should require the other contracts to have ADR clauses. If you represent an owner in a design-build project, require the architectural or engineering firm to have ADR clauses with the prime contractor, all subcontractors, and materialmen associated with the project. If the owner retains a general contractor, require the general contractor to have the same or parallel ADR clauses with all subcontractors and materialmen; the contract with the design team should also include an ADR clause. If you represent a general contractor, not only include ADR clauses in your subcontracts and supply contracts, but make sure the owner and architect have compatible ADR clauses in their agreements and have the subcontractor include ADR clauses with its materialmen as well. This will help avoid a multiplicity of actions and make consolidation of claims easier, if it is appropriate to do so.

15. Consider a provision providing a remedy in the event a party does not post its required deposits for arbitrator compensation or administrative charges. Although it is not a widespread problem and in the author’s experience is more likely to occur in commercial rather than construction disputes, occasionally a party will not pay required administrative and arbitrator compensation fees. Although many ADR providers’ rules contain provisions ranging from allowing paying parties to move for sanctions to allowing the arbitrator to suspend or terminate proceedings,27 a provision in the arbitration clause may provide more

25. For example, the author once was selected to arbitrate a case in which the sole issue was the completion date of a large shopping center. Significant sums of rent would be due depending on the date. Rather than submit the case under the contract arbitration clause, the parties used a submission agreement that read: “The only issue before the arbitrator is whether rent commenced on [date A] or [date B].” After submitting the award, counsel for the prevailing party requested a correction of the award because the arbitration clause in the contract called for an award of attorney’s fees. The author had no jurisdiction to provide for fees as his jurisdiction was defined by the submission agreement rather than the original contract.


27. For example, AAA Construction Industry Arbitration Rule R-56 allows motions limiting a party’s ability to pursue their claim for nonpayment of fees. The moving party must still put on a prima facie case. Rule R-56 provides an allowance for the parties who have already paid to advance the required payment in order to allow the arbitration to proceed.
certainty. Language indicating a failure to pay a party’s required fees constitutes a waiver by that party to present evidence, and legal argument is recommended if the drafter decides to include such a provision.

IV. What to Insist Upon Retaining/Rejecting
When Negotiating an ADR Clause

If you are negotiating an ADR clause, the author suggests a few bright lines: Do not allow discovery to expand beyond the rules of your chosen provider unless compelling reasons make it necessary, and if so, keep the expansion limited. You can stipulate to limited expanded discovery once the arbitration is underway, if need be. Avoid binding mediation. If you are going to use a three-arbitrator panel, use neutral arbitrators. Remember to name both the provider and the rules.

Finally, use plain language in your ADR clause and in the contract itself, although construction industry terms are certainly acceptable. Many people who will be reading and relying on the contract will not be lawyers and both they and you want the contract and the ADR clause to be understood by everyone.

V. Analysis of Popular Form ADR Clauses

The AIA, which periodically revises its standard contract forms, made some significant changes to the ADR provisions in the current version, eliminating mandatory arbitration, implementing a preliminary decision maker, and changing the rules for those who do opt for arbitration. Contracting parties must now specifically include arbitration; otherwise, when the case cannot be settled at mediation, it must go to an undefined “binding dispute resolution proceeding.”

Some modifications to the arbitration rules are rather minor: Rather than the rules in force at the time the dispute arose, the rules in effect at the time the contract was entered into govern the arbitration, eliminating unpredictability, at least regarding the rules. A more important change is the provision that allows consolidation with subcontractors in arbitrations between owners and contractors. Prior versions of A-201 required all contracts with all parties to contain a consolidation provision specific to the contract. Under the revisions, if there are common questions of law and fact and the parties sought to be joined have arbitration agreements in their contracts or have signed a submission agreement, consolidation is available, and joining the architect is no

28. AIA Form A-201, General Conditions.
29. Id., § 15.2.3.
30. Id., § 15.4.1.
V. Analysis of Popular Form ADR Clauses

longer prohibited.31 While the author notes removing the prohibition against joining the architect is a positive development, counsel should consider having all contracts (e.g., subcontracts and materialman agreements) specifically compatible with joinder.

An important change is the revised A-201’s providing the parties an opportunity to appoint a third-party initial decision maker (IDM) to settle disputes between the owner and contractor, though the architect remains the default IDM if the choice is not made.32 The author believes this reflects the increased use of project neutrals and dispute review boards and recognizes the potential for conflicts of interest when the initial decision maker is the architect. When a third-party IDM is appointed, however, the architect retains authority over such matters as contract performance or investigating and deciding unknown and concealed conditions under AIA Form A-207.33

The changes to mediation provisions are minor. Both the mediation and arbitration provisions continue to call for the use of the American Arbitration Association rules. When considering any AIA standard clause, counsel should determine if it is appropriate for the client and the project. Modification or a different clause may be matters for negotiation depending upon whom you represent.

Contrasting the AIA approach with ConsensusDocs, while the AIA clause does not provide for the prevailing party recouping costs of the dispute resolution process, ConsensusDocs § 12.5.1 provides: “The costs of any binding dispute resolution procedures shall be borne by the non-prevailing Party, as determined by the adjudicator of the dispute.” Attorney’s fees are not mentioned, which of course can be a double-edged sword or an incentive to settle, depending on one’s point of view.

Unlike the AIA’s requirement of an initial decision maker, ConsensusDocs require direct discussions by representatives authorized to settle, then if no agreement is reached, senior management must talk.34 If the second level of direct discussions is not successful, the dispute goes to a “dispute mitigation procedure” under section 12.3. This involves the appointment of a project neutral or dispute review board—the choice is made at the time of contract formation. The opinion or report of the neutral or board is not binding but may be entered into evidence at a subsequent adversarial dispute resolution process. If the report is not accepted or timely provided, the case can go to arbitration or litigation, as discussed below.

In an interesting development reflecting the drafters’ attempt to give parties mechanisms to resolve disputes early, ConsensusDocs § 12.4 provides for mediation under American Arbitration Association Construction Industry

31. Id., § 15.4.4 et seq.
32. Id., § 15.2.1.
33. AIA Form A-207 § 15.2.1.
34. ConsensusDocs § 12.2.
Rules if the section 12.2 talks fail or no selection was made between a project neutral and the dispute review board provided by section 12.3.

Unlike the silent AIA form clauses, ConsensusDocs provides check off for choosing dispute resolution processes in section 12.5. Parties may choose between arbitration under AAA rules, some other rules of their choice, or litigation. Joinder, which remains a bit complex under the AIA clauses, is simplified by ConsensusDocs § 12.6: “All parties necessary to resolve a matter shall be parties to the same dispute resolution procedure. Appropriate provisions shall be included in all other contracts relating to the Work to provide for the joinder or consolidation of such dispute resolution procedures.” Note the requirement to include compatible clauses in all other contracts relating to the work, something the author strongly recommends.

The National Society of Professional Engineers has also developed construction contract forms, which are yet to be as commonly used as the AIA and ConsensusDocs. Developed by the Engineers Joint Contract Documents Committee, they have become known as EJCDC documents. While the EJCDC forms cover much of the same subject matter as the AIA form contracts and ConsensusDocs, there are some significant differences. Chief among the differences, EJCDC forms do not mention a prevailing party’s right to recover costs or fees. Multiparty cases and joinder are not addressed either. Presumably, if counsel uses EJCDC forms and does not provide additional language addressing costs (and perhaps fees and joinder), then the law of the jurisdiction in which contract formation took place would prevail. This is an issue that could in itself consume costly litigation time, illustrating the importance of considering naming choice of law and venue in your clause.

EJCDC documents require all claims to be submitted to the project engineer for decision with exceptions for certain waivers. This submission is a remedy that must be exhausted before any other dispute resolution mechanism may be engaged. Proceeding to a second-level disputing mechanism is trickier under the EJCDC clauses than with AIA or ConsensusDocs. A close reading of the EJCDC requirements, it seems to the author, reveals something of a bias toward having the project engineer be the final determinant of claims.

If a party using EJCDC wishes to go to mediation, it must do so during the window between the time a claim is filed with the project engineer and the time the engineer’s decision becomes final. Mediation will take place under AAA Construction Industry Mediation Rules; the submission stays the time for the engineer to issue a decision on the claim. If mediation is not successful, the aggrieved party has 30 days to file for dispute resolution or the engineer’s action or denial becomes final. Care must be taken during

35. EJCDC § 35.
36. Id., § 16.01(A).
37. Id., § 16.01(C).
the formation stage because the EJCDC provisions discussed above are in the general conditions portion of the contract, but the election of the dispute resolution process is in the supplementary conditions. Otherwise, the parties must agree to the choice of dispute resolution mechanism or the aggrieved party must file a notice of intent to litigate in court.\footnote{\textit{Id.}, § 16.01(C)(1–3).}

Such matters as notices, times to file notices, time limits, and so on differ somewhat between AIA, ConsensusDocs, and EJCDC. There is nothing unusual about the time limits and notice requirements in any of the form contracts, and as always, counsel and their clients should be aware of them.

When considering using any form contract, remember there is no requirement to use it as-is. The AIA, ConsensusDocs, and EJCDC standard form contracts were all written by committees composed of wide-ranging interest groups; indeed, the ABA Construction Industry Forum participated in drafting ConsensusDocs. All have been lauded and criticized in the industry. It is difficult at best for the most intelligent minds to create a generic one-size-fits-all document. Counsel should be open to picking and choosing clauses, negotiating and modifying clauses, and drafting original clauses to fit the needs of the particular project at hand.

If counsel desires to draft an original ADR clause and seeks information and guidance, the American Arbitration Association has added a somewhat remarkable “clause builder” feature on its website (http://www.adr.org), in beta format as of this writing. Users are presented with a series of topics and various alternatives for each topic. Most importantly, explanations of the context for the clause choices are provided. For example, under the topic of discovery, drafters can choose between discovery as defined by the arbitration rules, allowing depositions to be limited to a specific number, conditions for the exchange of documents, and so on.

Clause builder topics (to date) include number of arbitrators, qualifications of arbitrators, venue, governing law, discovery, form of the hearing, duration of the proceedings, remedies allowed or limitations on remedies, fees and costs, options as to the form of the award, confidentiality, and nonpayment of expenses. There is a separate clause builder for construction cases. Whether or not counsel chooses to use the clause builder’s forms, it can be used as a checklist for the drafter of an original clause.