

Arbitrary Arbitration Exercise

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Is Arbitration Arbitrary?

An exercise exploring the arbitration process and examining the vagaries of arbitration results.

This exercise describes a dispute scenario first presented in a Master of Dispute Resolution research survey to the construction industry. (Many of the 430 survey respondents affirmed the scenario as a realistic and plausible construction industry dispute.) In the exercise, the student is asked to serve as the disputing parties' arbitrator. The questionnaire following the scenario provides an open structure for the student's award and allows analysis and compilation of the awards for the class' consideration.

Is Arbitration Arbitrary?

An exercise to remind students that adjudicated fact decisions are not necessarily predictable. A dispute scenario is presented for the student to act as arbitrator (individually or in panels) and issue an award. Tabulation of the awards demonstrates the vagaries of adjudication and provides arbitration process insight.

The Exercise Scenario and Questionnaire

A dispute scenario describes a disagreement between a general contractor and a project owner, each claiming the other was responsible for a 30 day project delay. A subcontractor claims \$60,000 of damage as a result of the delay. The owner and the general contractor agree the \$60,000 is a valid measure of the subcontractor's damages and that the subcontractor is due compensation for those damages; however, each claims the other should pay the subcontractor's damages. The project's contract states dollars per day amounts for liquidated damages for the contractor's late performance as well as for delay compensation should the contractor be delayed by the owner.

A complete "win" for the contractor would be the owner's payment of delay damages of \$90,000 to the contractor and another \$60,000 to the subcontractor. A complete "win" for the owner would be the general contractor's payment of \$150,000 to the owner and another \$60,000 to the subcontractor. The award format is structured to allow the arbitrator to award all, nothing, or anything in between.

Each class member is asked to serve as arbitrator and issue a binding award, assuming that the Scenario summarizes the arbitrator's understanding of the dispute after hearing the proceedings and considering all of the evidence. The exercise includes a questionnaire providing a structure to the award, though the arbitrator is invited to award in any manner the arbitrator sees appropriate.

Survey Says! ...

For comparison to your class, 430 responses have been received and analyzed. Of those, 94% of the respondents awarded the subcontractor \$60,000. The 6% that did not award the subcontractor compensation generally found \$0 for all of the claimants, stating that their interpretation of the contract language did not allow delay damage payment for their understanding of the fact situation.

The only award consensus was payment to the subcontractor. The distribution of responsibility to pay the subcontractor was widely disparate and without consensus. About 34% of the respondents directed the general contractor and the owner to each pay the subcontractor \$30,000 and to exchange no further funds between themselves. Another 36% netted the award at \$60,000 or more to be paid by the owner. 18% netted the award at \$60,000 or more to be paid by the general contractor. The remaining 12% found somewhere between \$0 and \$60,000 for the subcontractor, in a variety of payment splits between the owner and general contractor.

Does Arbitration "Split the Baby"?

Arbitration studies, including surveys by the American Bar Association Construction Forum and the American Arbitration Association (see Stipanowich article in References below), have identified "splitting the baby" as an arbitration consumer complaint. The survey allows review of the awards providing that the subcontractor receive \$30,000 from the general contractor

Arbitrary Arbitration Exercise

and \$30,000 from the owner, with no further exchange of funds between the owner and general contractor.

For comparison: Many of the 30/30 awards in the survey responses explained that while the arbitrator might appear to be splitting the baby, the arbitrator believed that both parties were equally at fault, therefore each party should equally compensate the subcontractor for the subcontractor's agreed upon losses. Other respondents noted that a 30/30 award, while simple, would only fuel the too prevalent perception that arbitration has become a split the baby exercise. Those awards included explanations as to why the arbitrator decided that one party or the other was fully responsible for the subcontractor's damages – and many times went on to assess liquidated or delay damages as well.

Does the Arbitrator's Background / Experience Make a Difference?

All of the arbitrators read the same set of facts – yet the results vary widely. Of the 430 responses, there was no conclusive correlation between the arbitrator's stated industry background (owner, contractor, subcontractor, construction manager, or attorney) and that arbitrator's award.

Comparison of the pool of respondents stating they had served as a construction industry arbitrator versus the other respondents did not show any significant variation in results. One would note that taking our dispute to an arbitrator who will “really understand and make the right decision” may not actually produce a different result from that of the independent bystander.

Do The Results Commend a Panel of Three Neutrals?

Would having three neutral arbitrators help bring a consistency in the decisions? As food for thought for further study, some classes may prefer to have the classes break into three party panels with each panel issuing one award. This will likely also provide an understanding of the dynamic of a three-party panel.

Do the Results Condemn Arbitration?

Why would we arbitrate if we can't be reasonably sure of the results? The exercise may also be used to emphasize the considerations driving parties to arbitration.

(The survey was prepared for Thesis research for the Master of Dispute Resolution degree at Pepperdine University's Straus Institute for Dispute Resolution.)

Arbitrary Arbitration Exercise

Notes, References & Chart of Survey Results

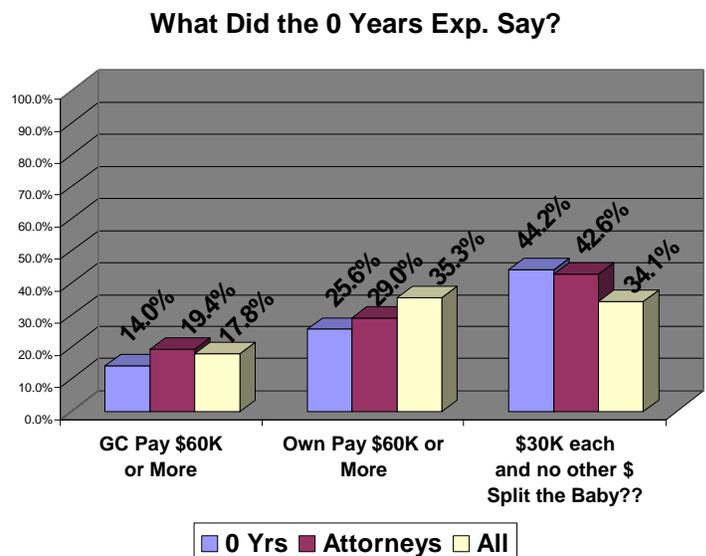
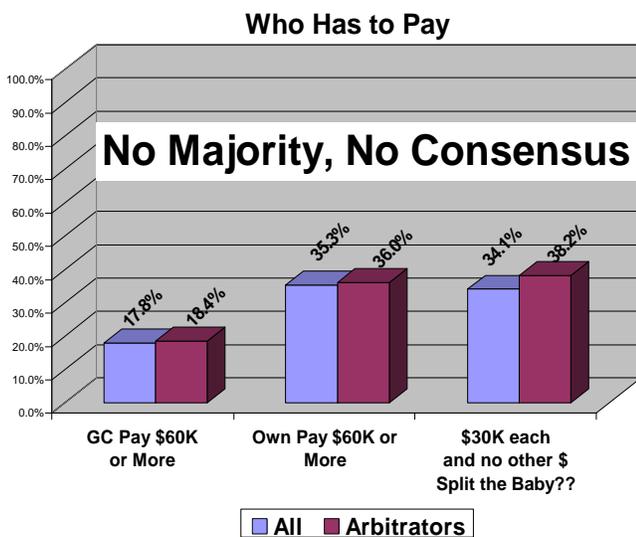
Equity vs. The Law

A number of survey responses discussed the instruction for “your decision to be based upon your determination of an equitable resolution of their dispute.” The wording was included to allow the student to focus on the facts, the dispute, and the fact-finding aspect of the decision. The goal was to not lose students in legal research, and to not have differing jurisdictions providing different results. The potential for geographical culture is noted and should be included in future national surveys.

AAA rule R-42 states "The arbitrator may grant any remedy or relief, including equitable relief, that the arbitrator deems just and equitable and within the scope of the agreement of the parties." Thus, there is at least some reasonable justification to allow the student to focus solely on the facts. The student should be aware that just as the arbitrator may choose to focus on the facts, the arbitrator may also choose to apply who-knows-what legal findings based upon their experience. A few of the survey responses did include some rather obtuse legal justifications.

A Few References:

- ?? Commercial Arbitration at Its Best: Successful Strategies for Business Users, A Report of the CPR Commission on the Future of Arbitration; Editors: Thomas J. Stipanowich, editor, and Peter H. Kaskell, associate editor. American Bar Association and CPR Institute for Dispute Resolution, 2001.
- ?? Stipanowich, *Beyond Arbitration: Innovation and Evolution in the United States Construction Industry*, 31 WAKE FOREST L. REV. 65 (1996).
- ?? Thomson, *Arbitration Theory and Practice: A Survey of AAA Construction Arbitrators* 23 HOFSTRA L. REV. 137 (1994).
- ?? 83 U. PA. L. REV. (1934). The entire issue was devoted to arbitration – fascinating read of how little life changes.



Arbitrary Arbitration Exercise

About Your Role: You are to serve as the “arbitrator” of the dispute described in the following scenario. The three disputing parties have accepted you as their binding arbitrator; they will abide by your award. Please assume that your understanding and perception of the pertinent facts, evidence, and testimony presented in the arbitration proceedings are summarized below.

The parties have requested that you apply your own industry knowledge and experience, and that you not consult anyone else. You are not bound to follow any law, precedent, or contract clause. The parties have selected you out of respect for your knowledge and want your decision to be based upon your determination of an equitable resolution of their dispute.

The Scenario: A construction contract for a one year project to install and connect manufacturing equipment at a privately owned industrial facility was completed 30 calendar days later than originally contracted. Three project participants, the owner (Owner), the general contractor (GC), and the GC’s equipment installation subcontractor (Subc), have a dispute regarding the responsibility for the extra 30 days and for costs claimed as caused by the delay. The three parties agree that the critical 30 days of delay started Monday, August 1 and ended Wednesday, August 31. The project began January 1.

At the end of the arbitration proceedings, you, the arbitrator, find the dispute distills to the following:

The Crane Broke: On Monday morning, August 1, the GC’s construction crane broke. All parties agreed the crane controlled the project’s critical path, and the project could not progress without a functioning crane. The crane is of foreign manufacture, 15 years old, maintenance records are sketchy, and the testimony is not conclusive as to the GC’s continuing proper maintenance of the crane. The GC procured the necessary parts and repaired the crane, completing the repairs August 30.

The GC’s testimony showed that the needed crane parts were proprietary and had to be custom machined by the overseas manufacturer. The GC expedited the crane parts incurring air freight costs of \$15,000. Immediately upon receipt of the parts the GC worked to complete the crane repair on Monday and Tuesday, August 29 and 30, so that project work could resume Wednesday, August 31.

The Design Changed: Also on Monday morning, August 1, the Owner advised the GC that a design change was being prepared revising the piping and electrical work to be installed by the GC at the connections to the next piece of equipment planned for installation. The Owner directed that all work should stop pending receipt of the design change. The change was optional - the project could have completed without the change. The Owner could have made the piping and electrical changes at a later date using the Owner’s in-plant maintenance crew.

During testimony, all parties agreed that the Owner’s design change and the direction on August 1 to stop work prevented the contract work from proceeding until the design change was received. All testimony and evidence indicate that the design work for the change was completed Friday, August 26. Materials to implement the Owner’s change were ordered August 26th. Delivery was expedited, and the materials were received on August 30 allowing project work to resume on Wednesday, August 31. The changed work did not increase nor decrease the remaining time of construction. All parties have reached agreement on the cost of the changed work, only the delay costs and responsibility remain in dispute.

Arbitrary Arbitration Exercise

Subcontractor Costs: On Monday, August 1, Subc was in the process of installing equipment which had to be maintained by Subc on a daily basis until the equipment was turned over to the project owner. Subc's daily cost for maintenance was presented as \$2,000 per calendar day. In testimony, all three parties agreed the \$2,000 per day was reasonable and concurred with the calculation.

As a result of the 30 calendar day delay Subc requests compensation of 30 days x \$2,000 = \$60,000. In testimony all parties agreed that Subc was not responsible for the 30 days of delay.

Timely Notice: You found through your assessment of the testimony and evidence that on Tuesday, August 2, each party informed the other of their dilemma. The GC advised the Owner of the costs to repair the crane and that the GC would airfreight the repair parts at extra cost. The Owner advised that a design change was being issued and all work should stop on the equipment installation. Subc, after learning that something was delaying its work, advised the GC that Subc would incur \$2,000 per day to maintain the equipment during the delay. The GC immediately forwarded that information to the Owner.

Mitigation: Testimony included discussion of the mobilization of a temporary crane to be used in place of the broken crane; however, the GC elected not to do so since the GC had not received the design change. The Owner stated the design change was not expedited because the Owner recognized that the GC's crane repair would not be complete for approximately 30 days.

Both the Owner and GC claimed that they could have reduced their own delay to 7 calendar days but saw no need to incur the extra expense since the other was causing the delay.

Contract Language: All parties agree that the general contract allowed for excused extensions of time and for compensation for those time extensions. The general contract stated that the Owner would receive \$5,000 per calendar day as full compensation for any GC caused project delays. The general contract also stated that the GC would receive \$3,000 per calendar day as full compensation for any Owner caused project delays.

The Owner and GC admitted and accepted the contract terms for delay compensation. However, for the arbitrator's information, both parties presented substantiation of their costs which approximated the contracted amounts. Neither substantiation included consideration of the Subc's \$2,000 per day delay cost. The GC's subcontract with the equipment installer was silent with respect to delays. The subcontract provided that the terms of the general contract were incorporated in the subcontract.

Arbitrary Arbitration Exercise

The Award: At the end of the arbitration proceedings, the parties request:

- a) Subc seeks \$60,000, and requests identification of the party(s) responsible to compensate Subc.
- b) GC seeks \$90,000 from the Owner (30 days x \$3,000), and denies responsibility for the Subc's \$60,000 request. If the Owner is found responsible for any of the Subc's costs, then the GC seeks compensation from the Owner per the general contract provision for 6% markup on subcontractor costs.
- c) Owner seeks \$150,000 from the GC (30 days x \$5,000), and denies responsibility for the Subc's \$60,000 request.

Your Award – The Parties request your award provide answers to the following questions:

- a) Amount, if any, to the Subcontractor, to be paid by: GC:\$_____ Owner:\$_____

The following exclude any amount to be paid to the subcontractor:

- b) The amount, if any, the Owner is to pay to the General Contractor: \$_____
- c) The amount, if any, the General Contractor is to pay to the Owner: \$_____

- 1. Your reasoning?

Please circle the appropriate responses:

- 2. Your years in the construction industry:
0 up to 5 6 to 10 11 to 15 16 to 20 20+
- 3. Your experience/background, the role you consider as defining your work experience?
Project Owner or Owner's Rep. General Contractor Subcontractor Construction Mngr.
Engineer Architect Attorney Judge Other: _____
- 4. Your education (please circle all that apply):
HS Apprentice Bach. Degree Master's Degree Ph.D J.D.
- 5. Have you ever served as an arbitrator? Yes No
- 6. Do you think your award conforms with that of other arbitrators? Yes No Don't Know
- 7. Would your award have been substantially different two years ago? (Has the last two years of your life's experience changed your view on this fact situation?)
Yes = different No = same

In Winter 2001 approximately 2000 surveys were distributed and 430 responses received as Master of Dispute Resolution thesis research.

For results, contact:
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