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WELCOME

Welcome to the first issue of the *NAF Construction ADR Monitor*. The *Monitor* is designed to keep you up to date with reliable information on the latest legal and practical developments in the rapidly growing field of construction dispute resolution. Each issue will contain important statutory law, case law, and regulatory updates, as well as practical tips on how to maximize the benefits of mediation, arbitration, and other out-of-court construction dispute resolution processes.

Revised AIA Design-Build Contracts Offer Dispute Resolution Choice

Standard Forms Permit Selection of Anyone on Whom "Parties Mutually Agree"

After a long history of requiring American Arbitration Association (AAA) mediation and arbitration in its contract documents, the new generation of American Institute of Architects (AIA) form contracts grants parties the freedom to designate the alternative dispute resolution provider of their choice.

The AIA Contract Documents

The AIA contract documents are recognized throughout the various facets of the construction and design fields as industry standard contract forms for structuring transactions and managing relationships among parties involved in construction projects. Constituting more than 80 individual form contracts, the AIA documents are intended for national use and provide a solid core of contract provisions on which parties structuring their legal relationships can rely.

This change is important because it allows... increased flexibility for managing project risks.

The AIA forms have existed for more than 115 years and, from their inception in 1888, have incorporated arbitration into their dispute resolution terms. Traditionally, AIA mediation and arbitration language exclusively specified AAA rules.

The Recent Updates

Recently, the AIA updated its Design-Build contract documents and made important changes to the dispute resolution terms. The new A141-2004 Design-Build form continues to mandate mediation as a prerequisite to binding dispute

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resolution, as did the A191-1996 form that it replaced. However, the new form permits selection of any mediation and arbitration provider on which the “parties mutually agree.” This change is important because it allows parties to construction contracts who use the AIA documents as a starting point increased flexibility for managing project risks and customizing the terms governing the resolution of any disputes arising during the project. To this end, parties can now easily modify the contract form to specify the National Arbitration Forum (NAF) and its Construction Mediation Rules and Arbitration Code of Procedure or any other set of ADR rules (see inset box).

Parties can now easily modify the contract form to specify the NAF and its Construction Mediation Rules and Arbitration Code of Procedure.

Another important change is that the new contract documents allow parties to choose which type of binding dispute resolution will govern the agreement. Where the old version mandated arbitration, the new version contains three

checkbox options:
1) Arbitration,
2) Litigation,
3) Other (specify).

Conclusion

Parties to construction contracts should use the occasion of the release of the new generation of AIA contract documents to evaluate their dispute resolution options. Those preferring National Arbitration Forum mediation and arbitration services may now simply write NAF into their AIA contract documents.

Timeliness of Arbitration Demand for Arbitrator to Decide

Under a broad arbitration clause, a claim that too much time has passed before submission to binding arbitration should be resolved by the arbitrator, according to the New York Appellate Division.

In *May v. Anspach*, 2005 WL 3485702 (N.Y.A.D. Dec. 19, 2005), Anspach stopped conducting remodeling work for May and claimed to be owed \$97,000 for work already performed. Two years later, Anspach submitted his claim to the project architect for nonbinding resolution.

The architect took no action before being discharged by May. Ten months later, Anspach submitted the claim to binding arbitration. May argued the claim was not submitted within a reasonable time after the dispute arose. The trial court held that submission to binding arbitration nearly three years after the dispute arose was untimely under the terms of the contract.

The Appellate Division reversed, holding that Anspach made a good faith attempt to comply with the architect review requirement and that “the issue of timeliness” was reserved for the arbitrator “in light of the all-encompassing language of the arbitration provision.”

Two-stage dispute resolution provisions—such as mediation/arbitration or architect review/arbitration—are common in construction contracting. *May* makes it clear that, under a broad arbitration clause, disputes about the interaction between the nonbinding and binding stages should be resolved in arbitration rather than in court.

How to Write NAF into AIA Design-Build Contracts

MEDIATION

- Specify NAF as the mediation provider in § A.4.3.2 of the Terms and Conditions.
- State that mediation “shall be conducted in accordance with the Construction Mediation Rules of the National Arbitration Forum currently in effect at the time of the mediation.”

ARBITRATION

Choose Either Method #1 or Method #2

- 1) Mark the “Arbitration” checkbox in § 6.2 of the agreement and substitute NAF arbitration language for the AAA language in § A.4.4.1 of the Terms and Conditions. State that arbitration “shall be in accordance with the Code of Procedure of the National Arbitration Forum currently in effect at the time of the arbitration.”
- 2) Mark the “Other (Specify)” checkbox in § 6.2 and specify arbitration under the NAF Code of Procedure there instead of in the Terms and Conditions.

Sample construction arbitration clause language suitable to insert into AIA contract documents is available on the NAF website at: <http://www.arb-forum.com/focus/construction/>. Also available on the site are the National Arbitration Forum’s Arbitration Code of Procedure and Construction Mediation Rules.

New Home Purchase Arbitration Terms Survive Reasonable Expectations and Unconscionability Challenges

A party's reasonable expectations are not violated when an arbitration provision includes no oppressive terms and there is no evidence that arbitration costs would prevent assertion of the claim, according to the Arizona Court of Appeals.

In *Harrington v. Pulte Home Corp.*, 119 P.3d 1044 (Ariz.App. 2005), Harrington sued Pulte for the failure to provide "full, complete and accurate disclosures." Harrington claimed he was not told his newly built home was near an "aerobatic box" used for pilot training and a jet engine test facility that operated twenty-four hours a day.

Pulte sought to compel arbitration. Harrington claimed the arbitration clause was unenforceable under Arizona's reasonable expectations and unconscionability doctrines.

Arizona's reasonable expectations doctrine allows a court to invalidate

a contract term if one party "has reason to believe" the other party would not have accepted if they had "known that the agreement contained the particular term." See *Darner Motor Sales, Inc. v. Universal Underwriters Insurance, Co.*, 682 P.2d 388, 396-97 (Ariz. 1984).

The court held that this clause was neither "bizarre nor oppressive," that the right to a jury trial need not be separately waived, and that standard arbitration terms rarely violate parties' reasonable expectations.

The court refused to craft a special reasonable expectations rule for arbitration clauses, realizing the Federal Arbitration Act preempts any state rule specifically inhibiting arbitration.

Regarding substantive unconscionability, the court concluded that "the [arbitration] costs of record are small when compared to the amount [plaintiff] seeks to recover and compared to the amount [he] would likely have to pay in litigation expenses if arbitration were not available." Absent a specific showing that fees were a prohibitive hardship, the court sent the parties to arbitration.

Harrington illustrates that arbitration terms will survive speculative allegations of

prohibitive costs. Here, the court recognized that arbitration would not place Harrington "in any worse position than litigation in allowing [him] to pursue [his] claims."

"The [arbitration] costs of record are small when compared to the amount [plaintiff]... would likely have to pay in litigation expenses."

—ARIZONA COURT OF APPEALS

Arbitrators Have Broad Latitude to Determine Available Remedies

Courts grant arbitrators broad discretion to construe statutory and contractual remedy provisions, and limits on contractual remedies must be stated "explicitly and unambiguously," according to California's Sixth District Court of Appeal.

In *Taylor v. Van-Catlin Construction*, 30 Cal. Rptr.3d 690 (Cal.App. 2005), Van-Catlin Construction (VCC) sought arbitration after Taylor refused to pay for home remodeling work. Taylor counterclaimed in arbitration for the amount incurred to repair alleged defects.

The arbitrator awarded Taylor \$100,000 in damages and \$75,000 in attorney fees. Taylor petitioned to confirm the award, while VCC argued the arbitrator exceeded his powers in awarding attorney fees without any "statutory or contractual basis."

The court noted that, absent explicit agreement otherwise, arbitrators "have substantial discretion to determine the scope of their contractual authority to fashion remedies." See *Advanced Micro Devices, Inc. v. Intel Corp.*, 9 Cal.4th 362, 376 (1994).

The arbitrator relied on California Civil Code § 3260, which authorizes attorney fee awards to prevailing parties in construction fee retention disputes. The court rejected VCC's contention that bad faith is an essential prerequisite for such an award. See *Darling v. Controlled Environments Const.*, 89 Cal.App.4th 1221, 1240-41 (Cal.App. 2001).

Practice Implications

If parties desire to restrict available remedies, *Taylor* advises that such limitations be stated "explicitly and unambiguously" in the agreement. Where parties adopt arbitration rules requiring application of the relevant substantive law, the arbitrator must do so or a court will readily vacate the award. See, e.g., *Vold v. Broin & Associates, Inc.*, 699 N.W.2d 482, 488-89 (S.D. 2005) (holding award "exceeded the arbitrator's powers because the arbitrator violated the rules he agreed to follow").

Accordingly, the best way to ensure that arbitration awards will be supported by law is to incorporate arbitration rules that require the arbitrator to do so. See, e.g., National Arbitration Forum Code of Procedure, Rule 20.

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Party Can Arbitrate After Filing Mechanic's Lien

Filing a mechanic's lien to protect an interest in unpaid services does not waive the right to arbitrate the underlying contractual dispute, according to the Supreme Court of Rhode Island.

In *Newman v. Valleywood Associates*, 874 A.2d 1286 (R.I. 2005), Newman accused Valleywood of "substandard" and "defective" construction work in building his new home. The construction contract permitted mechanic's liens and mandated arbitration of all disputes.

When Valleywood filed a mechanic's lien, Newman sued for breach of contract and slander of title. Valleywood then moved to dismiss pursuant to the arbitration clause. Newman argued that Valleywood waived the right to arbitrate by filing the lien.

Rhode Island's mechanic's lien statute explicitly states that "a party's rights to other remedies will not be limited by the filing of a mechanic's lien." General Laws § 34-28-10. The Court concluded that the state lien and arbitration statutes "function cohesively," and held that a party may proceed to arbitration after filing a mechanic's lien.

"Any holding to the contrary would frustrate the purposes of both statutes because it would require litigants to choose between arbitration and filing a mechanic's lien." Such a construction would invalidate arbitration clauses because Rhode Island prohibits contractual waiver of the right to file mechanic's liens. § 34-28-1.

After *Newman*, parties can explicitly agree that the filing of a mechanic's lien waives the right to arbitrate. Absent such agreement, the two rights do not conflict.

NATIONAL ARBITRATION FORUM

The National Arbitration Forum (NAF) is a leading provider of dispute resolution services, with over 1,500 legally-trained mediators and arbitrators located in all 50 states and 29 countries. NAF offers a full range of construction dispute resolution services, including arbitration and mediation programs tailored to satisfy state statutory construction dispute resolution requirements where relevant.

To receive more information about NAF, or for information about NAF's national panel of construction mediators, simply complete the enclosed reply card or contact NAF at 877-655-7755, x6425.