Due to dissatisfaction with the time and expense of litigation, arbitration has flourished as a method of alternative dispute resolution. In fact, the number of arbitration cases nationwide has doubled within the past ten years, providing an increased opportunity to evaluate whether arbitration is in fact the preferred means for the resolution of construction disputes.*

It is the authors’ opinion that while arbitration offers a more prompt and economical means of dispute resolution for small to medium-sized cases, litigation remains the preferred means for larger disputes.

Expense...

One of the most frequently cited advantages of arbitration is that it is relatively inexpensive when compared with traditional litigation. This, however, may not always be the case. Determining the true cost savings, if any, of arbitration involves primarily an analysis of two factors: arbitration fees and attorneys’ fees.

Arbitration Fees. In a typical lawsuit the only fees which must be paid to the court are filing and service fees which are relatively insignificant. In Pennsylvania, for instance, it costs approximately $65.50 ($36.50 filing fee and $29 service fee) to commence an action in state court, and $60 (docket fee) to commence an action in federal court.

In arbitration, however, the parties are obligated to pay administrative fees and arbitrators’ fees which in larger cases can be substantial. The administrative fee must be paid upon the filing of the demand for arbitration and is based on a regressive percentage fee structure with a minimum fee of $200 and a maximum fee of $13,900 on a $5 million claim.

In addition, while arbitrators are required to serve the first two days without compensation, they are thereafter paid a daily fee which varies from region to region but averages $250 per day per arbitrator. While these fees might not appear significant, in larger cases they can be substantial.

In a recent arbitration involving a $5 million impact and delay claim, the case required 34 hearing days to complete each party’s share of administrative fees and arbitrators’ fees which were in excess of $20,000, exclusive of each party’s share of the arbitrators’ expenses (including, in this case, out-of-state travel, food, and lodging).

Attorneys’ Fees. A primary reason arbitration is claimed to be less expensive than litigation is because attorneys’ fees are supposedly saved by virtue of the diminished use of formal pleadings, pretrial discovery, and pretrial motion practice. Nevertheless, while the more streamlined prehearing procedures in arbitration may produce some cost savings, the true cost savings are often insignificant for several reasons.

First, while it is true that formal pleadings and pretrial motion practice are practically eliminated in arbitration, discovery—which often is the most time-consuming phase of the prehearing stage—is not. Although interrogatories are infrequently employed, document exchanges are permitted and in fact encouraged. Moreover, in larger cases depositions are frequently requested by the parties and permitted by the arbitrators in the hope that they will make the hearing more manageable.

Second, the lessened use of discovery may actually serve to lengthen the number and duration of hearings because the issues in dispute and the

*While the authors will offer their opinion as to when arbitration is most cost effective, the determination in any particular case depends on an analysis of several factors, as outlined in this article.
positions of the parties have not been focused and crystallized prior to hearing as they would be through the use of discovery. This occurs when counsel for the parties attempt to take discovery of opposing witnesses during cross examination or when the parties request recesses and/or additional hearing days to present rebuttal evidence to evidence which was unanticipated.

These tactics are frequently accommodated by the arbitrators’ general reluctance to cut off the parties’ right to cross-examine opposing witnesses and to present additional material evidence. Since it is often difficult for the parties and the arbitrators to schedule consecutive hearing days, the effects of these tactics are exacerbated and the hearings can stretch out over many months.

Third, the lack of formal pleadings and prehearing motion practice often prevents the parties from attempting to agree to uncontested facts. The absence of a formal motion practice can preclude the possibility of terminating all or part of an unmeritorious case before proceeding to the hearing on the merits.

Fourth, the lessened use of discovery may impede the parties’ ability to effectively analyze the merits of their opponent’s case, thereby frustrating the possibility of amicably resolving the dispute prior to hearing.

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**About the Authors:**

**George M. Medved, Esq.**, a partner with Eckert, Seamans, Cherin & Mellott in Pittsburgh, Pennsylvania, specializes in construction litigation. He is a member of the American Bar Association Forum Committee on the Construction Industry, a lecturer on construction law, and a member of the Panel of Arbitrators of the American Arbitration Association.

**Christopher R. Opalinski, Esq.**, an associate with Eckert, Seamans, Cherin & Mellott in Pittsburgh, Pennsylvania, specializes in construction litigation. He is a member of the American Bar Association Forum Committee on the Construction Industry, a lecturer on construction law, and a member of the Panel of Arbitrators of the American Arbitration Association.

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**Speed of Resolution . . .**

The second generally recognized advantage of arbitration is the speed of resolution. In arbitration the average time from the filing of the demand for arbitration to award is approximately seven months versus 19 months in the average federal court litigation from commencement of the lawsuit to trial.

The American Arbitration Association (AAA) also has an expedited procedure for cases where the amount in controversy is under $15,000. Through this procedure one arbitrator is selected, the arbitrator selects the hearing . . .
“Although arbitration offers the parties a chance to select the individuals who will decide their fate, this advantage is not without risk.”

date, the hearing is generally limited to one hearing day, with any additional hearing day held within five days, and the award must be rendered within five business days.

Nevertheless, in large arbitration cases the time saved is often greatly diminished. While the case will get to the hearing stage before it would in court, the hearing itself can last several months because of, among other things, the inability or unwillingness of the parties and the arbitrators to schedule consecutive hearing days. This is largely the result of scheduling conflicts between the arbitrators, the parties and their counsel, witness availability, and requests by the parties for additional hearing days for rebuttal testimony.

Moreover, in large cases arbitrators are more likely to grant continuances to the parties for various reasons and the parties or the arbitrators frequently request post hearing briefs, both of which serve to lengthen the hearing stage.

The selection of arbitration does not altogether preclude the possibility of litigation. One party, for example, may seek to stay the arbitration under the Federal Arbitration Act or a state arbitration act, based on a claim that the dispute is not arbitrable. This might arise when one party claims that there is no agreement to arbitrate; the underlying contract is somehow invalid or unenforceable; the dispute in question does not fall within the scope of the arbitration clause; or that some condition precedent to arbitration has not been met by the party filing the demand for arbitration.

Similarly, after arbitration is completed, a dissatisfied party may seek to have the arbitration award reviewed by a court and either vacated, modified, or corrected. Although arbitration awards are generally given great deference by the courts and are not easily overturned, several jurisdictions have broadened appeal rights by statute or case law and in certain cases the parties themselves have provided for a broader scope of review in their arbitration agreement.

A good example of common delays experienced in a medium-sized arbitration is a recent arbitration in which a sewer contractor brought a $450,000 extra work and differing site condition claim against a public authority. The arbitration demand was filed in March, 1985. The authority contended that the dispute was not arbitrable because the demand for arbitration was not filed within the time limits set forth in the contract; accordingly, litigation was commenced to stay the arbitration.

As a result of this litigation the prehearing conference was not scheduled until October, 1985, after this proceeding was resolved. At the prehearing conference two hearing dates were scheduled for December, 1985. Since
the parties estimated that the hearing would take two days, only two hearing days were scheduled. Subsequently, at the request of one of the parties, the arbitrators granted a continuance and the hearings were rescheduled for January, 1986.

As frequently happens, the hearings took longer than anticipated and another hearing date had to be scheduled. Because of scheduling conflicts between the parties, their counsel, and the arbitrators, the first mutually agreeable hearing date was in late February. At the conclusion of these hearings, the claimant requested another hearing day to present certain rebuttal evidence. The arbitrators acquiesced in this request and another hearing day was scheduled in mid March.

At the conclusion of the hearings in March, the arbitration panel requested post hearing briefs from the parties, due 30 days after receipt of the hearing transcript. Briefs were filed in late April and the panel issued its opinion in mid May, within the 30-day time limit set forth in the AAA Rules.

Thus, in a case that was relatively uncomplicated and straightforward, the time from the filing of the demand for arbitration until the time of award was in excess of 13 months, and the hearing itself lasted for more than three months. While this still represents a time savings when compared with litigation, it nevertheless is much longer than the parties had anticipated given the size and complexity of the case. And larger cases can take as long or even longer than they would in litigation.

The Prehearing Stage . . .

Venue. In arbitration, unlike litigation, the parties are free to select the location for the hearing. This can be done in one of two ways: (1) the parties can designate a hearing location in their agreement; or (2) the party filing the arbitration demand can select the hearing venue if one has not been selected. In the latter case, if the respondent fails to object to the locale chosen by the claimant within seven days, then that locale is used. If the respondent raises a timely objection, then the AAA determines the appropriate locale based on such factors as the locations of the parties, the witnesses, the arbitrators, and the construction project.

The parties have less control over the location of court proceedings because the trial location is tied to well-established rules of jurisdiction and venue. As a result, parties may have to litigate in a jurisdiction that may be undesirable.

Selection of Decision Maker. Arbitration offers the parties the opportunity to select their decision maker. The parties can either name the arbitrators in their arbitration agreement, or failing that, select their arbitrators through the AAA selection process. Although arbitration offers the parties a chance to select the individuals who will decide their fate, this advantage is not without risk.

Since the AAA does not apply strict standards to those seeking to become arbitrators, it is likely that one or more of the arbitrators selected will be fairly inexperienced in construction matters. Moreover, in selecting arbitrators it is often difficult to predict how any one arbitrator may decide a particular case. Arbitrators frequently have their own professional biases and prejudices based on their arbitration experience, their backgrounds, and their knowledge of the parties or the parties’ reputation.

Counterclaims. In litigation, most jurisdictions require the assertion of certain counterclaims. These generally are “mandatory” counterclaims which arise out of the same facts and circumstances as those involved in the opposing party’s claim. In addition, most jurisdictions permit the assertion of certain “permissive” counterclaims, which generally can include any other related or unrelated pending dispute between the parties.

While this requirement for the assertion of counterclaims may somewhat complicate the dispute between the parties, it is generally to the parties’ benefit in the long run because it avoids the time and expense of piecemeal litigation.
In arbitration, however, there are no well established rules regarding the assertion of counterclaims. After the arbitrators are selected, a party wishing to assert a counterclaim must obtain the panel’s consent. Arbitrators may refuse to grant consent because of their reluctance to extend the original scope of the hearing. This potential for piecemeal dispute resolution not only serves to increase the overall cost to the parties but leaves open the possibility of inconsistent awards when separate panels decide a similar dispute in different fashions.

**Joinder.** In arbitration, only the parties to the arbitration agreement are required to participate in the arbitration. While this may simplify issues and streamline proof presentation at the hearing, the inability to join other parties intimately involved in the dispute can result in a piecemeal approach to the resolution of disputes involving more than two parties. It can also cause inconsistent and inequitable results.

In the arbitration mentioned earlier, for example, between the sewer contractor and the public authority, one of the contractor’s claims was an extra work claim. The contractor contended that it performed substantially more surface restoration than required under the terms of the contract. The authority essentially admitted that the extra work claimed was performed, but its position was that the additional surface restoration was performed not at the authority’s direction but at the direction of the township in which the work was being performed.

Because of the township’s involvement in the dispute, the authority petitioned the court to stay the arbitration and compel litigation on the ground that the entire dispute could be resolved only in court because the township had no contract with either the authority or the contractor; accordingly, it could not be joined in the arbitration.

The court held, in accordance with the majority view, that although other parties were involved in the dispute between the contractor and the authority, this fact alone would not allow the authority to avoid its contractual agreement to arbitrate disputes with the contractor. The contractor succeeded in obtaining an award against the authority when arguably the township’s conduct was the proximate cause of the contractor’s claim. The authority was then forced to commence an independent action against the township to recoup the monies paid to the contractor with the distinct possibility that before a new trier of fact it might be left “holding the bag.”

Another example which illustrates the disadvantage of non-joinder involves the typical dispute which arises out of claimed defective plans and specifications. A contractor initiates an arbitration against an owner for additional costs the contractor claims it incurred as a result of defective plans and specifications. The owner, however, is forced to defend the arbitration without having the right to join its architect, the party primarily responsible for claimed defects.

If the arbitrators find that the drawings and specifications are faulty, the contractor will recover against the owner. Nevertheless, should the owner initiate an arbitration against its architect, there is a distinct possibility that the architect, who is not bound by the initial arbitration award, can successfully defend the action brought by the owner. Hence, the owner incurs the time and expense of two separate proceedings and may be found solely liable to the contractor for faulty drawings and specifications when the party primarily responsible—the architect—escapes liability altogether.

**Public/Private Nature of Proceeding.** In a typical lawsuit all of the legal proceedings are a matter of public record. As a result, all court filings, including pleadings, depositions, interrogatory answers, and affidavits are available to the public and all civil trials are held in open court. In arbitration proceedings, the arbitration de-
mand and all other pre- and post-
hearing communications between the
parties and the arbitrators, as well as
the hearing itself, are private, unless
the parties agree otherwise. This fac-
tor may be important for many
parties.

A party, for example, that desires a
low-key resolution for its disputes for
public relations purposes, to protect
commercial or trade secrets, or for any
other reason is better off in an arbi-
tration. Parties that frequently find
themselves in construction disputes
may benefit from arbitration because
evidence given in an earlier proceeding
is not readily available to opponents
for use as impeachment evidence in
subsequent proceedings.

**Adjudication Stage** . . .

*Scheduling.* Arbitration offers cer-
tain advantages in scheduling prehear-
ing and hearing stages that litigation
does not. In arbitration, the parties
have a much greater opportunity to
determine the amount of time needed
for the prehearing exchange of infor-
mation, as well as when the hearings
will be held. In larger cases a schedule
will be set up for the exchange of in-
formation and the selection of hearing
dates at a prehearing conference. This
allows the parties a greater opportunity
to schedule the arbitration around their
business activities and to make them-
selves and any necessary employees
available for participation in the
hearing.

In litigation, however, determining
the date when a particular trial will
commence is very difficult. While most
courts issue trial lists each term, it is
almost impossible to determine the ac-
tual date when a particular trial will
commence because it is difficult to ac-
curately estimate the length of the trials
listed before your case, or the number
of cases which may settle or be
continued.

**Rules of Decision.** Arbitrators can
decide cases on equities as they see
them. Although evidence of equities
may play a part in litigation, it
becomes more pronounced in arbitra-
tion because the AAA expressly ad-
vises arbitrators that they need not
apply strict rules of law in fashioning
their decision. This means that the par-
ties often lose the benefit of the rights,
duties, and obligations which were
specifically bargained for in the con-
tract. And since there is no binding
legal framework upon which to advise
one’s client as to the likelihood of
success, results cannot be predicted.
Most importantly, however, the ar-
bitrators’ reliance on their perception
of the equities between the parties as
opposed to established rules of law or
rights and obligations set forth in the
contract often leads to compromise
awards.

**Rules of Evidence.** A frequently
cited advantage of arbitration is the
fact that arbitrators are not required
to adhere to strict rules of evidence.
While it is believed that this simplifies
the proceedings and allows the ar-
bitrators to decide a case unimpeded
by technical rules of evidence, non-
adherence to the rules of evidence
causes certain problems.

First, irrelevant testimony, such as
evidence of settlement discussions,
evidence relating to different construc-
tion projects or disputes, and reputa-
tion of the parties is often admitted.
While some claim that this enables the
arbitrators to get a better “feel” for
the real dispute, it also permits deci-
sions based on name calling, rhetoric,
and wholly irrelevant testimony rather
than on the facts and circumstances of
the dispute.

Second, the admission of evidence
which would be inadmissible in court
generally tends to lengthen the hearing.
Arbitrators frequently acknowledge
the inappropriateness of certain
evidence yet allow its admission “for
what it’s worth,” forcing opposing
counsel to present additional but often
unnecessary rebuttal evidence to blunt
the effect of this inappropriate
evidence.

**A Final Recommendation** . . .

On the whole, arbitration is more
cost-effective than litigation and
therefore more beneficial to both sides
Whether to arbitrate or litigate largely depends on the amount in dispute.

In small and medium-sized construction disputes. In these cases the AAA administrative fees and arbitrators’ fees are not substantial and a significant savings in legal fees is often possible because formal pleadings, full-blown discovery, and pretrial motion practice are for the most part unnecessary. An experienced arbitration panel will generally limit discovery to a document exchange reasonable in scope.

If the parties are reasonable in their estimate of the amount of time needed for the hearing, ample consecutive hearing days will be scheduled so that the hearing is not prolonged. These cases proceed to resolution much more quickly than they would through litigation, even when time is consumed for arbitrator selection disputes, scheduling of additional hearing days for rebuttal testimony, and post-hearing briefs. The need for prompt and economical resolution of disputes can outweigh the legal protections afforded by a court of law.

On the other hand, in large construction cases, litigation is more often the preferred means of dispute resolution. In large or complex cases the administrative fees and arbitrators’ fees will be significant; prehearing discovery may be extensive, and the hearings will be lengthy and protracted. As a result the parties may be better off resolving their dispute in a court of law where the issues would be crystallized and the positions of the parties ascertained through discovery.

In this setting, frivolous claims can be dismissed prior to hearing through pretrial motions, thereby lessening the possibility of a compromise verdict. The parties can resolve all disputes between them and join all necessary and interested parties in one proceeding. And the court will show greater deference for contractual rights and remedies which were expressly bargained for between the parties.

As a general rule, based on our experience, arbitration proves to be the most cost-effective means for resolving construction disputes where the amount in controversy does not exceed $200,000. Disputes provisions could be drafted so that disputes less than a certain dollar value, perhaps $200,000, proceed to arbitration, while larger dollar claims proceed to litigation. Or the contract could be drafted in such a manner that all disputes would proceed to arbitration, but with certain additional provisions for larger disputes. Such provisions could include those relating to discovery, recovery of legal costs from the losing party, and a joinder of additional parties, with the arbitration award subject to a stricter standard of review than that prevailing in the jurisdiction at hand.

Notes

1 Because arbitration before the American Arbitration Association (AAA) pursuant to the Construction Industry Arbitration Rules is the most common means of alternative dispute resolution in the construction industry, this article will focus on AAA arbitration.

2 Construction Law Advisor, No. 9 at p. 1, n.3 (September, 1985).


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