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Construction Arbitration in the US

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A Practice Note providing an overview of the key components of a construction arbitration in the US. This Note identifies the usual participants in a construction arbitration, notes the kinds of projects typically involved, explains some common construction jargon, and outlines the types of claims parties to a construction contract commonly arbitrate.

Arbitration is an important alternative dispute resolution (ADR) method for the construction industry. Many construction disputes involve features that may make it challenging to litigate the disputes before US or foreign courts, including:

- Many individual claims.
- Voluminous evidence and documents.
- Multiple parties.
- Technically and logistically complex issues.
- Industry-specific legal concepts.

Arbitration provides flexibility, control, and other efficiencies that can streamline the resolution of these disputes. For these reasons, arbitration is the most widely used form of dispute resolution for the construction sector.

This Note gives a basic introduction to some of the core concepts associated with construction arbitration and explains some issues parties should consider when deciding whether to select arbitration to resolve disputes involving construction contracts.

For more detailed information on construction arbitration, see Practice Note, Arbitrating Construction Disputes in the US.

US Domestic Versus International Construction Arbitration

The procedures used in construction arbitrations often vary depending on whether the proceeding is an international construction arbitration or US domestic construction arbitration.

International Arbitration

Outside the US, international arbitration is the dominant dispute resolution method for construction disputes. The ability to present a case before a neutral arbitral tribunal and enforce the resulting international arbitration award in numerous jurisdictions around the world, under the New York Convention or local law, makes international arbitration the preferred method of dispute resolution for most international construction projects. (See Queen Mary University of London & Pinsent Masons, International Arbitration Survey - Driving Efficiency in International Construction Disputes, 8-9, 23-24 (2019).) Some of the usual norms that govern international commercial arbitration proceedings also apply to international construction arbitrations (for example, the International Bar Association, IBA Rules on the Taking of Evidence in International Arbitration).

For more information on IBA rules, see IBA Arbitration Committee resources toolkit.

US Domestic Arbitration

Projects located in the US, where the parties are also all located in the US, do not face the same neutrality and enforcement concerns as international projects. Many construction agreements involving US-based projects use arbitration to resolve disputes in lieu of state or federal court litigation primarily because of the flexibility, cost-effectiveness, and control that arbitration affords the parties. For example, the ability to select arbitrators with specialized knowledge of the construction industry is among the most significant reasons parties choose arbitration to resolve US construction disputes.

Domestic US construction arbitrations do not normally follow the norms and procedures used in international arbitration proceedings. Instead, US domestic construction arbitrations often adopt practices used in US court litigation (such as some limited depositions and document production), although these practices tend to occur in a more informal and streamlined manner. As a result, domestic US construction arbitrations represent a relatively unique practice distinct from both court litigation and international arbitration.

Features of Construction Arbitration

Construction arbitration is a species of commercial arbitration, for example:

- As in commercial arbitration, one or more arbitrators preside over a construction arbitration.
- Like commercial arbitrators, construction arbitrators also have in-depth knowledge and expertise in the subject matter (see Construction Arbitrators).

However, construction arbitrations have certain unique features because of the peculiar qualities of many construction disputes. Construction arbitrations frequently involve:

- A single tangible project or a series of related projects (see The Project).
- Multiple actors (see Key Actors).
- Technical and logistical complexity (see Complexity of Disputes).
- Industry jargon (see Construction Industry Norms and Jargon).
- One or more issues from a relatively short list of issues that typically arise in a construction project (see Common Construction Arbitration Disputes).

Some arbitral institutions, such as the American Arbitration Association (AAA) and JAMS, provide arbitration rules specifically for the construction industry (see, for example, the AAA Construction Industry Arbitration Rules and Mediation Procedures and JAMS Construction Arbitration Rules and Procedures). Even where an institution provides construction arbitration rules, most construction arbitrations use similar practices as in commercial or ad hoc arbitrations, such as rules for the taking of evidence or document exchanges (see, for example, the IBA Rules on the Taking of Evidence in International Arbitration; AAA Discovery Best Practices for Construction Arbitration).

For more information on JAMS construction arbitration, see Practice Note, JAMS Construction Arbitration: A Step-by-Step Guide. For more information on AAA construction arbitration, see Practice Note, AAA Construction Arbitration: A Step-by-Step Guide.

Construction Arbitrators

Among the most valuable features of arbitration is that arbitration allows the parties to select their arbitrator. An arbitrator's level of construction expertise is usually a critical factor in deciding whether to appoint a particular arbitrator to a dispute.

Construction arbitrators are typically construction industry professionals, such as industry representatives, in-house or outside counsel, or technical experts. They have experience overseeing or managing complex construction disputes. The arbitrator's ability to understand construction-specific concepts:

- Avoids the need for the parties to educate the arbitrator on:
  - industry practice;
  - jargon; and
  - construction law.
- Enables the arbitrator to more efficiently and confidently reach the right result.
- Affords the parties greater confidence in the arbitrator's decision-making abilities.

For more information on appointing construction arbitrators, see Practice Notes, AAA Construction Arbitration: A Step-by-Step Guide: Appointment of the Arbitrator and JAMS Construction Arbitration: A Step-by-Step Guide: Appointing the Arbitrator.

The Project

Nearly all construction arbitrations stem from the execution of a tangible piece of work, often referred to as the project. The project can involve anything from the construction or refurbishment of a single-family dwelling to a complex multi-billion dollar nuclear power plant. The complexities associated with the planning, organization, and ultimate execution of a complex construction project frequently give rise to a wide range of disputes. However, at their core, practically all construction disputes (and by extension construction arbitrations) involve a single underlying project.

Key Actors

Construction arbitration disputes usually involve many different actors with different interests in the project. The number and type of actors on any given project may vary but the project's key actors typically include:

- The principal participants, which are usually:
  - the owner, also sometimes referred to as the employer; and
  - the contractor, also sometimes referred to as the general or prime contractor.

  (See Owner and Contractor.)
- Design architects and engineers (see Architects and Engineers).
- Stakeholders to which the owner is answerable (see Stakeholders to Which the Owner is Answerable).
- Subcontractors and suppliers the contractor engages (see Subcontractors and Suppliers).

Owner and Contractor

The owner is the entity that wishes to develop or sponsor a construction project. The contractor is person or entity the owner engages to execute the work. Without the relationship between the owner and contractor, there would be no project.

The core of many construction disputes stem from the relationship between the owner and contractor. However, the ripple effects of the owner-contractor relationship commonly give rise to disputes between many of the ancillary entities associated with a project. The network of interrelated parties surrounding the project and the owner/contractor relationship means that many construction disputes result in multiparty arbitrations or parallel proceedings. For this reason, owners and contractors should ensure that there is consistency among the various contracts' dispute resolution provisions. Failing to have all affected parties involved in an arbitration proceeding can complicate the efficient and effective resolution of project disputes.

Architects and Engineers

Owners and contractors often engage architects and engineers to develop designs for a particular project. Although the arrangements may vary, architects and engineers are commonly responsible for the development of the physical design of a project along with the multitude of technical aspects required to execute the work. If the designs are incompatible, unworkable, or defective, architects and engineers may be subject to liability for any additional costs required to correct a deficient design.

Because of their deep knowledge of the project details, architects and engineers may also serve in an oversight role on behalf of the owner. They may manage certain project tasks and monitor the contractor's progress (see, for example, FIDIC, Conditions of Contract for EPC/Turnkey Projects, Section 3 (2017)). For disputes involving mega-projects, the architects and engineers sometimes serve as neutral third-parties responsible for resolving project disputes.

Stakeholders to Which the Owner is Answerable

Upstream of the owner are many different entities that are not in privity with the contractor but have a vested interest in the outcome of the project. These upstream entities include:

- Financing entities.
- Lenders.
- Lessees or other ultimate users of the project.

These upstream actors often exert significant control over the execution of a project because of their relationship with the owner.

Subcontractors and Suppliers

Downstream of the contractor are various subcontractors, vendors, and suppliers that specialize in particular trades or products necessary to complete the project. Although many contractors self-perform some portion of the work required to execute a project, they frequently lack the expertise required execute every element of a project on their own. As a result and often depending on the nature of a project, some subcontractors play outsized roles during the lifecycle of a particular project.

Complexity of Disputes

Although the size and scale of individual projects can vary dramatically, the disputes stemming from construction projects generally have at least one trait in common: they are typically more complex than most commercial disputes. Construction disputes tend to be complex because they usually involve:

- Complex technical engineering or design concepts.
- Complex logistical issues.
- Numerous individual claims.

Technical Concepts

Construction disputes often involve sophisticated engineering and design concepts that the parties use to execute the project. The task of explaining and understanding the (often abstract) concepts can be challenging to even the most sophisticated advocate or arbitrator.

Logistical Concepts

Constructions projects, especially mega-projects, present construction management challenges. They involve planning and coordination of many dozens of interrelated tasks that must be performed to execute the work. When unexpected events disrupt the contractor's original plan, the effect can:

- Delay the scheduled project completion.
- Add substantial costs for the owner or contractor.

Because of the logistical complexity of managing a numerous overlapping project tasks, it can be difficult for parties to isolate and quantify the impacts stemming from a single event.

Multiple Claims

One difficult and unique facet of construction arbitration is the challenge of presenting numerous individual claims as part of an overarching construction arbitration (see Queen Mary University of London & Pinsent Masons, International Arbitration Survey - Driving Efficiency in International Construction Disputes, 10-11 (2019) (outlining complexities associated with construction arbitration)).

It is not unusual for a construction dispute to involve dozens or even hundreds of discrete individual claims. Usually the claims individually represent a relatively small sum of money but collectively may represent a large sum. Each claim may also serve as the basis of a separate arbitration. The goal of a well-planned construction arbitration is to adequately and efficiently present each individual claim in the context of a single omnibus case.

Construction Industry Norms and Jargon

Like any other industry, the construction industry relies on specific practices and jargon. Practitioners arbitrating construction disputes rely heavily on these concepts to present claims and defenses. Arbitrators, counsel, experts, and witnesses all proceed with a shared understanding of this industry-specific terminology and a general assumption that all participants are equally familiar with the language. Conversely, those less familiar with basic construction industry norms and jargon may find it difficult to present, understand, or respond to points the participants raise in a construction arbitration.

Although an exhaustive list of these norms and terms is beyond the scope of this Note, some of the most important concepts a practitioner must understand include:

- **Project scheduling.** The practice of creating and maintaining a schedule the project participants use to plan a contractor's work and monitor progress during an ongoing project. Project scheduling is critical to claims involving delays (see Delays and Time-Related Costs).
- **Construction or project management.** The practice of overseeing and managing the work during the lifecycle of a project. The parties' ability to implement effective construction or project management practices often impacts the number of claims that arise on a project as well as the parties' ability to successfully prosecute or defend against individual claims.
- **Project accounting and cost management.** The practice of maintaining accounting records and monitoring costs incurred during a project. Project accounting and cost management practices are critical to documenting and proving damages in the course of a construction arbitration.

Common Construction Arbitration Disputes

Construction arbitrations regularly involve many claims that fall into a relatively small universe of common types of disputes (see, for example, Queen Mary University of London & Pinsent Masons, International Arbitration Survey - Driving Efficiency in International Construction Disputes, 7-8 (2019) (describing the most common causes of construction disputes)).

Performance Deficiencies

Performance deficiency claims most often refer to work that a supplier, contractor, or subcontractor must perform, repair, or otherwise rectify to satisfy the requirements of the construction agreement. These claims can involve, for example:

- The repair of damaged or improperly constructed work.
- The replacement of malfunctioning equipment.

Changes Orders

Change order claims (also sometimes referred to as variation claims) stem from work that the contractor performs on behalf of the owner that was not part of the contractor's original scope of work. As a result, the contractor submits a claim for additional compensation because the additional work was not included in the scope of work in the parties' contract.

If the contractor can establish that the disputed work was not part of the original scope of work for the project, the contractor can usually recover additional compensation and time to complete the project.

For more information on change orders, see Practice Note, Changes in the Work in Construction Contracts: Drafting Strategies: Types of Changes in the Work.

Delays and Time-Related Costs

If the contractor's work on the project is delayed, the owner and contractor may dispute which parties are:

- Contractually responsible for the delays.
- Entitled to recover compensation resulting from the delay.

A material term of most construction agreements is the time allotted for a contractor to execute the work. If the contractor fails to meet the deadlines set out in the contract, the owner often retains the right to assert a liquidated damages claim against the contractor.

Construction contracts also often contain provisions that entitle a contractor to extensions of time to the contracts' deadlines under certain circumstances. These provisions typically relieve the contractor of any exposure to liquidated damages if the contractor establishes the right to an extension of time. An extension of time may also entitle the contractor to recover damages from the owner to compensate the contractor for the contractor's costs resulting from the delays (usually referred to as delay damages).

Acceleration and Constructive Acceleration Claims

Acceleration and constructive acceleration claims are related to delay claims but involve a slightly different scenario.

Acceleration claims occur when an owner directs the contractor to speed up the progress on the project to ensure the contractor completes the work before the originally scheduled completion date. In this situation, the contractor may recover:

- The cost of:
  - supplementing the workforce; and
  - adding equipment.
- Any other quantifiable costs stemming from the contractor accelerating the schedule.

A constructive acceleration claim generally occurs when:

- The contractor is entitled to an extension of time under the terms of the construction contract.
- The owner refuses to grant the time extension.
- Without the time extension, the contractor accelerates the work to achieve the original project completion date (often to mitigate the risk of being assessed liquidated damages).

In this situation, if the contractor establishes an entitlement to a time extension, the contractor can typically recover the acceleration costs from the owner on the theory that the owner constructively directed the contractor to accelerate the work by refusing to acknowledge the contractor's entitlement to an extension of time.

Loss of Efficiency or Disruption Claims

Contractors often experience impediments that cause the project's labor force to work less efficiently and remain working on the project longer than expected. These impediments may be due to adverse site conditions, weather, or design changes. By having the labor force work longer than expected, the contractor incurs additional costs to accomplish the originally scheduled amount of work.

In these situations, if the risk of the impediment is not contractually allocated to the contractor, the contractor may submit a claim for the disruption or loss of efficiency. In these claims, the contractor seeks to recover the additional costs the contractor incurred resulting from the disruption, typically labor or equipment costs.

Termination

Construction agreements usually allow the owner to terminate a contractor for cause if the contractor fails to perform. Claims arising out of the termination of a contractor often:

- Turn on the question of whether the termination was improper.
- Incorporate other claims, such as delay and disruption claims, to establish whether the contractor was in default.

For more information on owners' and contractors' rights to terminate a construction contract, see Practice Note, Terminations and Suspensions in Construction Contracts: Drafting Strategies.

Notice

Although not a stand-alone claim, disputes often arise over whether a contractor provided timely notice of a claim. Construction agreements usually contain notice provisions that require a contractor to notify the owner within an agreed amount of time about a particular event that may give rise to costs or delay claims. These notice provisions typically provide that a contractor's failure to give notice to the owner within the requisite period is a waiver of the contractor's right to assert its claim.