Construction Arbitration

WRITTEN BY

Albert Bates Jr. | R. Zachary Torres-Fowler

Published in Practical Law The Journal on May 2, 2023.

Arbitration is the most widely used method of dispute resolution in the construction industry. Parties should understand the key concepts and common types of claims when deciding whether to arbitrate disputes involving construction contracts.

Arbitration is an important form of alternative dispute resolution used in the construction industry. Many construction disputes involve aspects that may make them challenging to litigate 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 in the construction sector. This article introduces core concepts and types of claims associated with construction arbitration and explains the issues parties should consider when deciding whether to select arbitration to resolve construction disputes. (For more on the steps and considerations involved in arbitrating a construction dispute, see Arbitrating Construction Disputes in the US on Practical Law.)

US Domestic Versus International Construction Arbitration

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

US Domestic Arbitration

Construction projects and parties that are 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 instead 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.

US domestic construction arbitrations do not normally follow the norms and procedures used in international arbitration proceedings. Rather, 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 than in litigation. As a result, US domestic construction arbitration represents a relatively unique practice distinct from both court litigation and international 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 Univ. of London & Pinsent Masons, Special Report: International Arbitration in Construction at 8-9, 23-24 (2019).) Some of the usual norms that govern international commercial arbitration also apply to international construction arbitration. (For a collection of resources published by the International Bar Association's (IBA's) Arbitration Committee to assist counsel with international arbitration practice and procedures, see IBA Arbitration Committee Resource Toolkit on Practical Law.)

Features of Construction Arbitration

Construction arbitration is a type of commercial arbitration. For example, as in commercial arbitration:

- One or more arbitrators preside over a construction arbitration.
- Construction arbitrators have in-depth knowledge and expertise in the relevant subject matter (see *Construction Arbitrators* below).

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

- A single, tangible project or a series of related projects.
- Multiple actors.
- Technical and logistical complexity.

- Industry jargon.

- One or more issues from a relatively short list of issues that typically arise in a construction project (see *Common Construction Arbitration Disputes* below).

Some arbitral institutions, such as the American Arbitration Association (AAA) and JAMS, provide arbitration rules specifically for the construction industry (see, for example, AAA, Construction Industry Arbitration Rules and Mediation Procedures and JAMS, Engineering and Construction Arbitration Rules and Procedures). However, 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, AAA, Discovery Best Practices for Construction Arbitration; for more information, see IBA Rules on the Taking of Evidence in International Arbitration 2020 on Practical Law).

(For more on the necessary steps for starting and conducting construction arbitration, see AAA Construction Arbitration: A Step-by-Step Guide and JAMS Construction Arbitration: A Step-by-Step Guide on Practical Law.)

Construction Arbitrators

Among the most valuable features of arbitration is that the parties can select their arbitrator. An arbitrator's level of construction expertise is usually a critical factor in deciding whether to appoint a particular arbitrator. 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 reach the right result more efficiently and confidently.
- Affords the parties greater confidence in the arbitrator's decision-making abilities.

(For more on appointing construction arbitrators, see AAA Construction Arbitration: A Step-by-Step Guide and JAMS Construction Arbitration: A Step-by-Step Guide on Practical Law.)

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 multibillion-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 separate 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.
- Design architects and engineers.
- Stakeholders that the owner must answer to.
- Subcontractors and suppliers that the contractor engages.

Owner and Contractor

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

Many construction disputes stem from the relationship between the owner and contractor. However, ripple effects from the owner-contractor relationship commonly give rise to disputes between many of the ancillary entities associated with the 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 there is consistency among the dispute resolution provisions of the various contracts. Failing to have all affected parties involved in an arbitration proceeding can complicate the efficient and effective resolution of a project dispute.

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 a 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. For example, they may:

- Manage certain project tasks.
- Monitor the contractor's progress (see, for example, FIDIC, Conditions of Contract for EPC/Turnkey Projects, Section 3 (2017)).
- Serve as neutral third parties responsible for resolving project disputes (for disputes involving mega-projects).

Upstream Stakeholders

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.

The 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 to 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 life cycle of a particular project.

Complexity of Disputes

Although the size and scale of individual projects can vary dramatically, disputes stemming from construction projects generally have at least one trait in common, namely that they are typically more complex than most commercial disputes. This is because construction disputes 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 even to 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 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 Univ. of London & Pinsent Masons, Special Report: International Arbitration in Construction at 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, each claim individually represents a relatively small sum of money, but collectively the claims may represent a large sum. Each claim may also serve as the basis for a separate arbitration. The goal of a well-planned construction arbitration is to present each individual claim adequately and efficiently in the context of a single omnibus matter.

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 article, some of the most important concepts a practitioner must understand include:

- **Project scheduling.** This is the practice of creating and maintaining a schedule that 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* below).

- **Construction or project management.** This is the practice of overseeing and managing the work during the life cycle 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 these claims.

- **Project accounting and cost management.** This is 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 during 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 Univ. of London & Pinsent Masons, Special Report: International Arbitration in Construction at 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.

Change Orders

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

in Construction Contracts: Drafting Strategies on Practical Law.)

Delays and Time-Related Costs

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

- Contractually responsible for the delay.
- 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.

Additionally, a construction contract often contains provisions that entitle a contractor to extensions of time to modify contract 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 costs 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. The basis for this claim is 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 was not contractually allocated to the contractor, the contractor may submit a claim for the loss of efficiency or disruption. If the claim is successful, the contractor could recover the additional costs that it incurred resulting from the disruption, which are 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 on owners' and contractors' rights to terminate a construction contract, see Terminations and Suspensions in Construction Contracts: Drafting Strategies on Practical Law.)

Notice

Although not a stand-alone claim, disputes often arise over whether a contractor provided timely notice of a claim. A construction agreement usually contains a notice provision that requires 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. The notice provision typically provides 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 that claim.

RELATED INDUSTRIES + PRACTICES

- Construction