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Arbitration Overhyped?
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Bid Protests

# Plumb LAW

## WE'VE MOVED!

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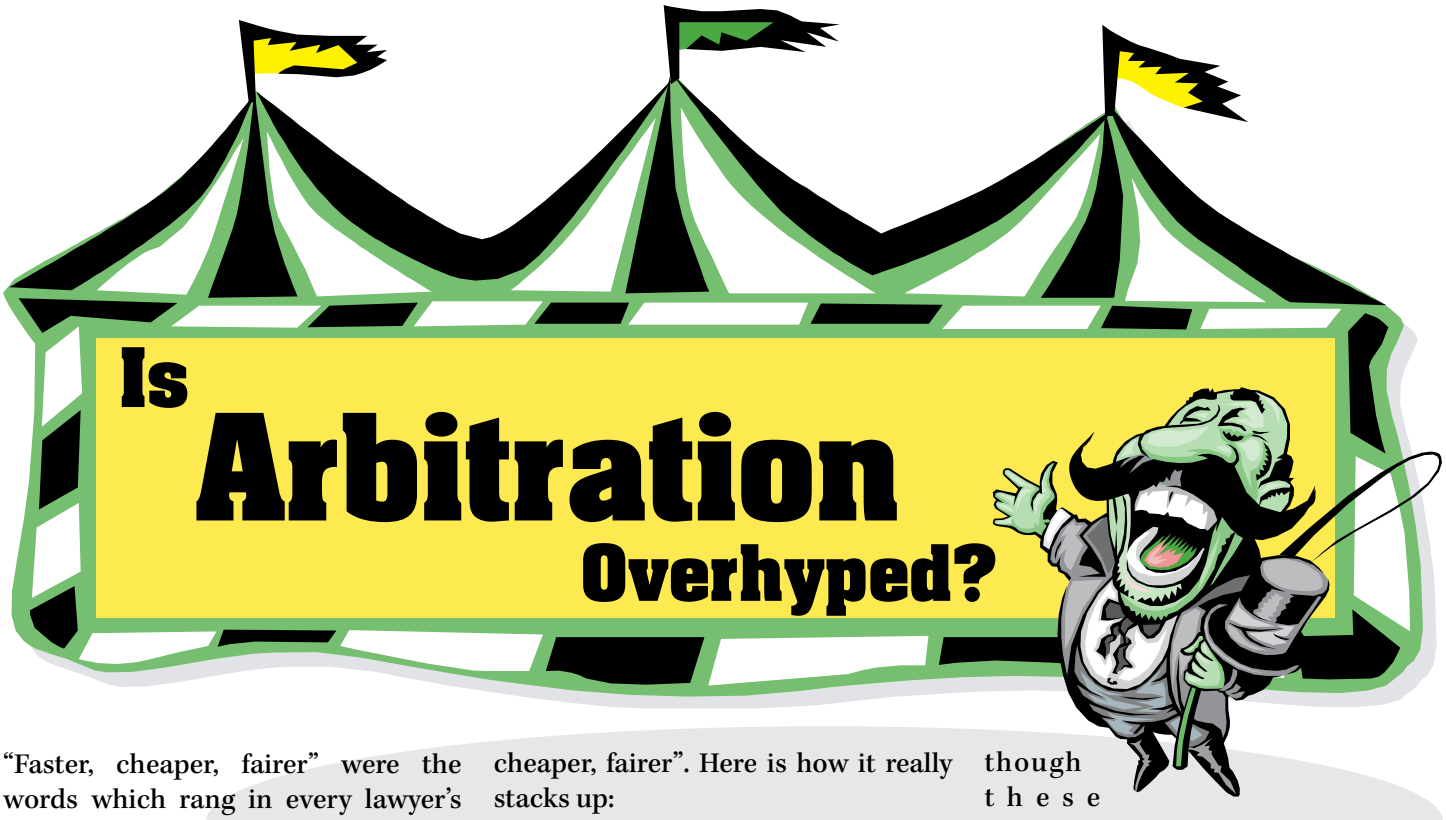
**Construction Law: That's All**




"Faster, cheaper, fairer" were the words which rang in every lawyer's and contractor's ears when arbitration was first ballyhooed as a great alternative to lawsuits. But after some contractors suffered from seemingly endless arbitration delays, high fees and insane results, they now avoid arbitration like the plague. That's an overreaction, but when "picking your poison" between arbitration and litigation, remember that the wrong choice can be expensive.

Sophisticated construction lawyers often agree about the cases which are best decided in arbitration or litigation. But if they do not agree, the construction contract will provide the answer. If a contract does not contain an arbitration clause, then arbitration cannot be required unless the parties separately agree to it. Either party can still start a lawsuit if the contract does contain an arbitration clause, but the opposing party must promptly apply to a judge to "compel" arbitration if it does not want to "litigate". Otherwise, the right to arbitrate is "waived".

Arbitration "hype" can be better understood by a closer look at "faster, cheaper, fairer". Here is how it really stacks up:

*Is arbitration faster?* Not necessarily. Arbitration has its own rules, and the required steps still take time to complete: the selection of arbitrators; a preliminary conference; document exchanges; expert witness reports; "pre-hearing" submissions; and in rare cases, depositions. The biggest time-killer, however, involves the agreed scheduling of arbitration dates for the parties, their lawyers, and the arbitrators. Even agreed dates are cancelled for reasons which a court would not allow, like business scheduling conflicts. Judges can also undercut agreed arbitration schedules by placing their own trial schedules ahead. The worst cases are three arbitrator panels: they can take years.

*Is arbitration cheaper?* Another mixed bag. First, out-of-pocket costs are far higher in arbitration. Courts charge small filing fees and judges are available "on the house". In arbitration, filing fees typically cost thousands of dollars and arbitrator's fees can easily add $1,500 per day to the bill. Even though these costs are usually split, and the prevailing party is supposed to be reimbursed by the loser, this does not always happen and you can lose. The bigger expense is that a well prepared arbitration may cost as much in counsel fees, or more, than a lawsuit. While lawsuits do cost money for "discovery" preparation, that whittles down the potential number of issues for trial. This whittling process does not exist in arbitration, so an experienced practitioner has more to prepare in order to avoid surprises. The actual time for the hearings can be longer, as well, because arbitrators will permit the presentation of more irrelevant information.

*Is arbitration fairer?* Arbitration is certainly less predictable than litigation, so in that sense, it is not fairer at all. Arbitrators are not bound by the rules of evidence. They can accept claims and evaluate information which no judge would consider in a court case. They can also ignore a contract's terms, as well as

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# Payment Bonds

In keeping with our practice of highlighting decisions from distant courts which may later be followed by our own judges, a Maryland court has now "tightened the screws" on sureties who have ignored their own payment bond's procedures. Here, the Court decided that when the surety missed a time limit to respond to a payment bond claim, the surety could not challenge it later.

Under an AIA form of payment bond, an unpaid contractor's payment demand to the surety is supposed to state the claim amount with "substantial accuracy". The surety then has 45 days to identify the amount which is not disputed and pay it. The surety is also supposed to identify the basis for disputing the balance.

Here, two subs sued the surety after their bond claims were ignored. Each sub completed the surety's "Proof of Claim" form. The surety responded under a "reservation of rights". The surety told one sub that it would be in contact when the GC responded to the claim, but, no response was offered until after the sub sued. The surety told the other sub that the claim should be reduced to a lesser amount, but, the surety did not pay the unchallenged balance.

The Court reasoned that the construction payment process depended on the surety's role of assuring payment to subs and suppliers. Since the surety did not dispute the claims within the time or manner required by the bond, the surety was responsible to each one for the whole amount.

Many bond forms besides the AIA have specific time limits and procedures. For example, New Jersey's law governing public works contracts requires a surety's response within 90 days after claim submittal. *National Union Fire Insurance Co. v. David A. Bramble, Inc.*


**Arbitration over Litigation**

The one area where arbitration shines is when a dispute involves technical "construction" problems. Arbitrators understand construction: they know that "bank run" has nothing to do with a "run on the bank" and initial CPM schedules are just planning tools. Arbitrators likewise know what standard contract clauses mean and how the construction industry interprets them. This saves on expert witness costs and keeps out some idiocy. Arbitration also tends to produce a better result when the parties have a "good faith" disagreement about the facts because they can skip some things which are required in court proceedings. Finally, resolving a dispute with arbitration can allow the parties to maintain a business relationship because it tends to be less adversarial.

**Litigation over Arbitration**

Cases which require an interpretation of law should always go to court because this is what judges do best. When technical issues control the outcome, arbitration is better. As an illustration, the correct interpretation of a contract's "pay when paid" clause belongs in court. But if the reasons for non-payment involve questionable workmanship, then that is better suited for arbitration.

Cost considerations should send "little cases" to litigation. In New Jersey, a "little case" is brought in a separate court where recovery will not exceed $15,000. Those cases move quickly and can easily be completed before a comparable arbitration.

No matter what the place, a really complex case is always expensive, slow and unfair. Litigation usually enjoys a slight advantage because discovery can limit the number of disputed issues. Sometimes, parties can "hybridize" the two by conducting discovery but using arbitration for final decision-making.

When deciding upon arbitration or litigation, make sure you correctly communicate all the relevant facts to counsel for an informed recommendation. Picking one or the other may be the most important decision in the case to make.

## Public Bidding

The New Jersey appeals court nicely squashed Fairfield's attempt to manipulate a bid result when Fairfield sought to favor a particular bidder. For those who believe that the courts always side with the government, this decision's answer is a resounding no.

While the courts will ordinarily follow the government's interpretation of their bid specifications, the government cannot ignore the plain language of a bid. One bidder, Waste Management, had submitted a price for basic service, together with a "No Bid" response to one alternate. Suburban offered a higher price for the basic service, but wrote "Included in Base Service" for the alternate. Fairfield wanted the alternate, but it also wanted to use Waste Management. So, Fairfield and Waste Management argued that the phrase "No Bid" meant that the alternate was included.

Having none of this, the Court wrote that the phrase "No Bid" meant what it said—Waste Management was not willing to bid the alternate. Settled principles of law dictate that no material element of a bid may be changed after bid opening. If a bidder could so freely reinterpret its own bid, then the bidder could change its position after bid opening about whether it would furnish the alternate. Plainly, that is not permitted. Thus, once Fairfield decided to accept the alternate, it could not accept the Waste Management bid.

A more eye-popping issue, which explained the favoritism, arose during the court proceedings. Waste Management was in the process of "working off" the settlement of a double-billing claim by performing "free" pick-up of school trash. As part of its bid, and in response to another alternate, Waste Management offered to continue with this work at no cost. The Court found, however, that school trash pick-up should have been publicly advertised. Allowing Waste Management to continue was still another "subterfuge to further manipulate the contract award after all bids were opened". So, the Court ordered Suburban to be given the contract for the remainder of the term with both aforementioned alternates.

Other court cases have deferred to the government's interpretation of bid specifications in technical areas. The absence of any technical issue, the plain language of the bid, and the obvious favoritism undoubtedly led the Court to be more aggressive. Furthermore, the decision not only undercut the legality of the settlement, but may have spelled "the end" for settlements based on the performance of other services. *Suburban Disposal, Inc. v. Township of Fairfield.*

## Insurance Coverage

Everyone loves to find insurance coverage for a claim: the carrier pays the claim as well as the legal fees to fight it. But, insurance policies invariably exclude coverage for "your work" as compared to the physical losses caused by "your work". For example, the claim that a beam was incorrectly installed and must be replaced is not covered because it is "your work". If the beam causes a wall to collapse, the resultant damage is a physical loss which should be covered.

A few court decisions had found coverage where a sub's work was incorporated into a general contractor's work, and the sub's work was defective, but did not result in physical loss.

Here, a higher court rejected this theory. In its analysis, the Court stated that standard insurance clauses provide for coverage when there is an "occurrence" causing "physical injury to or destruction of tangible property". Poor workmanship may be an occurrence, but it does not cause "physical injury" to "tangible property". Adopting language from another decision, the Court noted "the policy in question does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident". Thus, the incorporation of defective subcontract work into the work of the general contractor, without physical damage, is not covered.

While the decision is similar to the law in most states, its pragmatic lesson is straightforward: if you make a mistake, and hope for insurance coverage, make sure your mistake is a dangerous one. *Fireman's Insurance Co. v. National Union Fire Insurance Co.*