

MEDIATION AND THE CONSTRUCTION INDUSTRY: HAS ARBITRATION FAILED?

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The very nature of the construction industry — where time actually equals money, creative solutions to problems are welcomed and celebrated, and where unnecessary delays are demonized — encourages the development of stream-lined dispute resolution mechanisms that encourage efficiency and value rather than rigid procedural rules and adversarial litigation. In a world where arbitration was touted as the “be all/end all” to litigation it would seem counterintuitive to tout mediation as the better alternative dispute resolution tool. However, that is where the industry finds itself today.

I. Common Myths About Arbitration

When asked about the benefits of arbitration most law students would assuredly mention lower costs, shorter resolution times, and efficiency. These incorrectly held beliefs have helped perpetuate arbitration as the savior of the inefficient and expensive judicial system. Arbitration is often more expensive than a traditional trial. Let’s say Holly Homebuyer finds that the window above her sink is leaking. Ms. Homebuyer’s first action is to call the builder to demand satisfaction; when the builder refuses her repeat requests and will not repair the faulty window, Ms. Homebuyer could file in small claims court to have the window repaired. The relative simplicity of the case would ensure a swift decision. The homebuyer’s total costs: around \$250, depending on her jurisdiction. Now imagine Ms. Homebuyer was bound by an arbitration agreement and was forced to file a claim with the AAA. Her costs would quickly rise into the thousands making arbitration a more expensive alternative.

Now imagine a slightly more complex transaction, Ms. Homebuyer’s electrical system was wired with cheap non-insulated wire and her house burns down moments after she has signed her closing documents. Ms. Homebuyer’s insurance policy does not cover substandard construction and builder defects so she must seek satisfaction from her builder. Armed with reports from several different inspectors pointing to the wiring as the sole cause of the fire, a former employee’s testimony that the builder personally inspected and approved the faulty wire, and a videotape capturing the builder admitting to the faulty wiring, Ms. Homebuyer files suit against the builder. A swift judicial decision would inevitably follow. However, if the same case were submitted for arbitration there could be months or years of delays to decide upon an arbitrator, arrange meetings between the parties for hearings/depositions, and await the arbitrator’s award. As you can see, it is easy to imagine instances where arbitration can unnecessarily prolong the inevitable award. Arbitration was designed to be a flexible dispute resolution tool that was beneficial to both sides. The original purpose of

arbitration has suffered a slow decline into increased formality and an ever-increasing litigious influence. Now mediation waits in the wings for its day in the sun.

II. The Benefits of Mediation

Mediation is especially useful when applied to disputes between a general contractor and a subcontractor. Here you can imagine any number of situations where a subcontractor agrees to complete a portion of the project, by a certain date, for a certain price; let’s say the subcontractor agreed to excavate and build a basement foundation for a new home. The subcontractor shows up with his excavator and begins to dig the foundation when he uncovers an old septic tank. Under the contract it is not clear if the subcontractor or the general contractor is responsible for the tank’s removal. If the dispute were to proceed to trial or arbitration the project could be delayed for months or years while the parties await the court or tribunal’s resolution. In this case it would be in the interest of both parties to sit down at the table in the presence of a neutral third-party mediator who has significant legal and construction experience, and work the problem out. The mediator would be there to resolve any impasses in the discussion by referring to both contract law principles and norms within the construction industry. Inevitably each side would make some concessions, the problem would be solved, and the work could resume. Each party would save a significant amount of money and avoid time-consuming hearings.

Mediation opens the door to creative awards. Using the septic tank example, the usual path toward litigation will assure that no matter the outcome the general contractor and the subcontractor will not do business together in the future. However, a creative mediator may suggest that the subcontractor remove the septic tank and request that the general contractor will reuse the same subcontractor on another current project or one in the near future. The subcontractor may have to bear some of the removal costs in the current instance, but he will undoubtedly benefit from his future relationship with the general contractor.

The unpredictability of the legal system is greatly reduced in mediation. Inconsistencies in judge’s opinions and jury selection can lead to unimagined results. Cases where a contractor felt he might be liable for a few thousand dollars in damages suddenly is forced to pay hundreds of thousands to the homeowner. More recently, mortgagees who made a few technical mistakes in their paperwork processing are finding that their mortgagors are being awarded the security property. These dramatic awards can largely be attributed to the current backlash against banks following the foreclosure crisis of the early twenty-first century.

Mediation may be the answer to the current backlash against mandatory arbitration clauses in builder contracts. Currently the

Supreme Court is reviewing the Constitutionality of mandatory arbitration clauses in contracts of adhesion, although there is some question as to whether contracts between builders and homebuyers are actually contracts of adhesion. Beyond the enforceability of arbitration clauses in contracts of adhesion is the emergence of several consumer groups dedicated to removing arbitration clauses from residential purchase contracts. These groups are amassing a laundry list of cases where an arbitration clause was used to deprive a homebuyer of judicial satisfaction.

III. Choosing the Best Dispute Resolution Mechanism for Your Business

The first thing any contractor should do before choosing a resolution mechanism is to contact an attorney. A qualified attorney will not only be able to recommend a strategy tailored to meet your needs, they would also be able to create the legal documents necessary to memorialize the agreements with your

subcontractors and home buyers. Do not limit your contact with an attorney to that first meeting. Each project is different and may require a different set of safeguards to ensure that you will be covered in each separate instance.

The best approach is dispute avoidance. A contractor who is dedicated to conflict avoidance will take care to memorialize conversations, change orders, and all extras in a written memo signed by all parties. Consistency in contractual terms, contract administration, payment processes, permit obligations, and pre-dispute resolution procedures is also key to conflict avoidance. Upon completion of any project, subcontractors and general contractors should create detailed punch lists with remediation recommendations signed off by all parties. As arbitration loses favor throughout the legal world the construction industry can be a proving ground for new and innovative ways to resolve conflicts through traditionally disfavored areas, such as mediation.