nyrej
CELEBRATING 30 YEARS

Arbitration in construction and development contracts: Prudence or pitfall? - by Vincent Pallaci

September 05, 2017 - Long Island

Vincent Pallaci,
Kushnick | Pallaci PLLC

Once upon a time, there was a frame of thinking that said arbitration was better than litigation because it was both “cheaper” and “faster” than litigation. Removing a bloated and backlogged court system from the equation made sense, especially in the world of construction and development where the parties did not necessarily have the time or money to wait for the slow wheels of justice to turn. However, as arbitration is becoming more expensive, it’s worth looking at the equation again to determine whether arbitration should still reign supreme in construction and development contracts.

Arbitration in construction and development is entirely voluntary and entirely a creature of contract. That means the parties are free to craft an arbitration provision that works for them. In evaluating arbitration there are a few important considerations, among them: 1) the costs of arbitration; 2) who will arbitrate; 3) what discovery, if any, will there be during the arbitration; and 4) can the arbitration award be challenged?

To commence a lawsuit there is a fixed filing fee: $210 for an index number in the New York supreme court. The most commonly used arbitration provision in New York requires arbitration before the American Arbitration Association (AAA). In 2017, the lowest AAA filing fee (covering claims up to $75,000) was $750 with a case service fee of $800. The fees go up from there.

Beyond the filing fees, there are two main components of costs: attorneys’ fees and arbitrator’s fees. When commencing a lawsuit, you have to pay an attorney to draft a complaint, draft discovery, conduct depositions, file motions and, ultimately, try the case before a judge or jury. All attorneys are different, but most experienced commercial litigators in the New York metropolitan area will charge between $300 and $600 per hour.

Attorneys’ fees are where people usually think arbitration has the big advantage over litigation, but the conventional wisdom may need a fresh look. While drafting a complaint will often be more expensive than drafting a demand for arbitration, the attorneys’ fees during the trial-phase of a litigation will closely resemble those during the arbitration hearing. However, keep in mind that you also have to pay the arbitrator or arbitrators (in addition to the AAA fees). An experienced construction arbitrator can easily cost $4,000+ per day. Some cases can have up to three arbitrators. The tradeoff here is that you can get an arbitrator who is knowledgeable in the construction world. As a result, most arbitration hearings will be more expensive than a trial

Discovery is often the great unknown in litigation because even the most experienced litigator cannot predict how the other side will respond to discovery, how much documentation will be provided, how many depositions will be needed or how many motions will need to be filed. They might be able to provide a general ballpark, and an experienced litigator often will, but nobody can entirely predict the discovery future. In arbitration, that unknown world is drastically reduced.

Most construction/development arbitrations include some provision for exchange of documents, but few arbitrations, absent special circumstances, will allow for depositions of parties. Motion practice in an arbitration is the rare exception rather than the rule. Discovery is also the most time consuming

element of litigation. By reducing its scope during arbitration, you are naturally reducing the time the arbitration will take to reach a conclusion. But the real question is whether limited discovery is a good thing? Yes, in all likelihood you will save money on attorneys' fees for discovery in arbitration, but at what cost? Do you really want to go into the arbitration hearings not knowing what the other witnesses are going to say? If you have a multi-million-dollar dispute, is saving a few thousand dollars in discovery worth the added risk of the unknown during arbitration?

This brings us to our final consideration: the finality of the arbitration decision. In all but the rarest of situations, an arbitrator's award is final and binding. In litigation you have an absolute right to at least one appeal. On the one hand this lack of an appeal helps bring finality, limit costs and keep the time compact. On the other hand, for the party that feels the arbitrator was out of his or her mind, there is often no recourse.

The next time you are negotiating a construction contract, and the time comes to discuss arbitration, at a minimum you should consider: 1) Do you want to limit the number of arbitrators? 2) Do you want to specify the qualifications of the arbitrators? 3) Do you want to define the scope of discovery? 4) Do you want to allow appeals? Above all else, think about it before you decide whether arbitration is right for your next project.

Vincent Pallaci, Esq., is a managing member of Kushnick | Pallaci PLLC, Bohemia, N.Y.