Arbitration vs. Litigation: The Great Debate
By David K. Taylor

Many of the “form” commercial construction contracts (e.g., AIA forms) contain “dispute resolution” clauses proposing binding arbitration as opposed to courtroom litigation. Most U.S. courts, faced with the number of cases flooding the legal system, regularly enforce arbitration clauses. However, the decision to arbitrate should not be taken lightly. There are pros and cons, and one size does not fit all. This brief article is intended to help decision-makers make a well-informed decision regarding arbitration in the context of a construction dispute, involving a U.S. project with U.S. based parties.

Please note: The introduction in the 90s of arbitration in consumer and lending contracts has introduced an entirely different set of factors in evaluating arbitration. We are focused, however, on its use for construction contracts, which, along with union contracts, were the principal early users of arbitration in the ’50s and ’60s. While Bradley Arant frequently advises clients regarding various dispute resolution choices for international projects, that advice involves some different considerations than apply to U.S. projects, so it is not addressed here.

Problems with Courtroom Litigation

The primary reason many in the construction industry prefer arbitration is the perception of problems with the existing legal system. Any business that has been through a lawsuit, even if resolved in its favor, does not wish to go through the process again. Some of these problems include:

Cost of Litigation. Courtroom litigation is expensive and time consuming. More importantly, while 95 percent of civil cases settle before trial, settlement usually takes place on the courthouse steps after the parties have incurred the majority of the litigation costs. The out-of-pocket costs of attorneys, expert witnesses, electronic discovery consultants and other discovery expenses are often considerable. In most U.S. jurisdictions, unless there is an attorneys’ fees provision in the contract, fees are not recoverable—even for the winning party. One contractor client said it best: “While only 1 percent of my projects have ended up in a lawsuit, that one project cost me 75 percent of the profit I made on the other 99 percent.” In addition, a company may win in court only to realize that after subtracting the attorneys’ fees, discovery costs and other litigation expenses, the bottom line is a net zero recovery. In some cases, the attorneys’ fees and expenses may exceed the amount at stake. Even when a party wins, it faces the question of whether the judgment is collectible. Holding a paper judgment against a bankrupt or marginally solvent contractor (or a single use LLC developer after a foreclosure) may not be worth the paper on which it is written. There are also substantial soft costs of litigation. Time is money. In any lawsuit, management and other key employees must devote considerable time to the dispute; the attention to a past job detracts from management of on-going jobs, bidding on future work, and affects morale of personnel who feel “tainted” by the litigation process.

Publicity and Public Filings. Lawsuits can damage reputations and sometimes help competitors. Court filings are public records. While the filing of a lawsuit, even if frivolous, may make the front page of the local news, a trade journal, an email chain or industry blog, the dismissal or successful defense of that claim a year later may not get reported at all. Court filings and trial testimony are open to any competitor. In a case involving a claim for lost profits, for instance, the business making the claim may be required to open up its tax records to prevail. The parties can agree on “Protective Orders,” but the reality is that even with such orders, once produced, those documents are out there for someone to discover.
Time. Lawsuits can take years to get to trial. After a trial, the losing party has a right to appeal…which may take another two to three years. The right to an appeal, of course, is also a reason in favor of litigation, and that right, while time-consuming, makes litigation more predictable. Any smart lawyer, if he or she wants, can make the other side wait a considerable amount of time before paying—which may be exactly what your adversary intended. An otherwise solvent defendant may be able to delay a final hearing for frivolous reasons, and by the time a judgment has been rendered, that company’s assets are gone or a bankruptcy has been filed. While there are ways in which to trace the assets, that process can mean more lawsuits and more legal fees.

Unpredictable Results. There is no way to guarantee what a judge or jury may do in a civil case. More importantly, if the case involves complicated facts, expert testimony, or industry-specific issues, there is potential for the jury, or even the judge, to get confused and render an unfair judgment. Neither the judge nor the jury cares about either of the party’s business. It is very difficult during a trial to educate the jury and judge about the particular subject matter of a construction dispute. When a business places a substantial legal dispute (especially where the outcome of the business may be at stake) in the hands of a judge or jury, it may be engaging in something akin to legalized gambling—rolling the dice.

Pros and Cons of Binding Arbitration

Predictability. A frequent complaint of courtroom litigation is that judges and juries do not understand complicated construction disputes, often leading to unpredictable and unsatisfactory results. Ideally, an arbitration is heard by a third-party neutral or neutrals with experience and knowledge in the area of dispute (e.g., commercial construction). Arbitrators do not have to be lawyers and many times can be engineers, architects, contractors or developers. This characteristic of arbitration can eliminate the substantial problems and time involved in educating a judge or jury in the nuances of construction. Properly selected arbitrators understand and focus on the most material issues in the dispute and are not easily swayed by lawyers’ emotional arguments or some expert witness. Because arbitrators are paid, each tends to pay more attention to the proceedings, and may be deemed to care more about reaching the appropriate outcome. Also, there is often less formality in an arbitration hearing. For instance, the formal rules of evidence and procedure may not be strictly followed. Instead, the focus is on the facts and testimony.

Time. Because there is no crowded court docket, an arbitration hearing can often be scheduled in a matter of months, not years. Even when millions of dollars are at stake, generally hearings can be scheduled more quickly than a court hearing. In addition, there are fewer and more restrictive grounds for appealing an arbitration award, so finality is the rule rather than the exception. In the original view of arbitration, prompt, efficient, and final decisions were viewed as more important than whether it was legally correct.

Costs. In most cases, the costs and expenses of arbitration are less than litigation. Because litigation is often criticized for the time and expense of pretrial discovery, it is significant that, with a few exceptions, discovery is limited in arbitration. The absence of prehearing motions and multiple depositions, as well as the finality of the decision, can reduce attorneys’ fees and costs. While for some companies prehearing motions—and possible disposition—of a case “on the law” is of major significance, many arbitration administrative bodies do allow for prehearing dispositive motions in more contemporary rules. And lastly, the cost of prolonged personal involvement by key company employees can be at least minimized.

Privacy. Unlike courtroom litigation, arbitration is private and confidential. The proceedings are not public records. Arbitrators maintain the privacy of the hearings unless some law provides to the contrary.
Conclusion

Arbitration is not a panacea, nor is it always the right choice. In some instances, parties are better off in court. However, any construction business should discuss with its lawyers whether arbitration might be a better choice. This discussion is important when deciding whether to choose arbitration (or accept it) in a form contract at the beginning of a project. It may also be important after a dispute has arisen, where the contract does not mandate arbitration. One should not charge blindly into litigation after a dispute has arisen; rather, one should examine all alternatives available to resolve a dispute. Going through an expensive trial may not be in the best interests of a business. If the dispute can be resolved through arbitration or some other alternative dispute resolution procedure, including non-binding mediation, a construction company can be assured of proceedings that will, in many instances, be faster, confidential, more predictable, and less expensive than courtroom litigation.