Legal Pipeline

www.phcppros.com/articles/15211-arbitrate-with-care-to-avoid-flimsy-post-hoc-excuses

dorotaseweryn@aol.com

|

Getty Images/iStockphoto

Arbitrate with Care to Avoid ‘Flimsy Post-Hoc Excuses’

Parties should read and be familiar with contract dispute resolution mechanisms to help avoid surprises and heavy-handed arbitration clauses.

Steven Nudelman (/authors/13-steven-nudelman)

April 1, 2022

p.p1 {margin: 0.0px 0.0px 0.0px 0.0px; line-height: 12.0px; font: 43.5px Helvetica; color: #ce4d2e} p.p2 {margin: 0.0px 0.0px 0.0px 0.0px; line-height: 12.0px; font: 10.0px Helvetica} p.p3 {margin: 0.0px 0.0px 0.0px 0.0px; text-indent: 9.0px; line-height: 12.0px; font: 10.0px Helvetica} p.p4 {margin: 9.5px 0.0px 2.5px 0.0px; line-height: 12.0px; font: 12.0px 'Museo Sans'} p.p5 {margin: 0.0px 0.0px 0.0px 0.0px; text-indent: 9.0px; line-height: 12.0px; font: 10.0px Helvetica; min-height: 12.0px} span.s1 {letter-spacing: -0.1px} span.s2 {letter-spacing: 0.1px} span.s3 {font: 10.0px 'Zapf Dingbats'; letter-spacing: 0.1px} span.Apple-tab-span {white-space:pre}
Recent case law is chock full of arbitration-related disputes. More and more construction contracts include alternative dispute resolution clauses, providing for mediation, arbitration or even a hybrid of both, known as med-arb. Parties to a construction contract include such clauses to avoid litigation — often including a jury trial — because lawsuits, complete with discovery and appeals, are long and expensive.

The problem with this approach is that these parties often agree to arbitrate without understanding precisely what they are agreeing to. The result is a great deal of “satellite litigation” involving the enforceability of arbitration clauses.

In this column, we explore a good example of satellite litigation involving a med-arb dispute resolution clause,
Clayco, Inc. v. Food Safety Group, Inc
., No. 4:20-mc-00739-MTS, 2021 WL 859557 (E.D. Mo. March 8, 2021).

Background

Contractor Clayco Inc. (Clayco) entered into a subcontract with Food Safety Group Inc. (FSG), pursuant to which FSG would furnish and install metal wall panels for a commercial construction project at a cost, including change orders, of just over $4.4 million. At some point, Clayco alleged that FSG did not meet its obligations under the subcontract and associated progress schedule.

Clayco served FSG with a notice of default and demanded that FSG cure the default. Since FSG was not responsive and its work remained incomplete, Clayco terminated the subcontract.

The parties' subcontract contained an interesting dispute resolution clause. Under Article XXVI, Sections A through M, the parties were required to mediate their dispute and, if unsuccessful, proceed to arbitration. This is a standard, common process.

However, Section N included a twist. Under Section N, Clayco — and only Clayco — could invoked an alternative procedure in writing. Under the Section N alternative, the parties were required to mediate their dispute through the American Arbitration Association (AAA). The mediation commenced by Clayco's written demand to the AAA and it had to be completed within 60 days thereafter.

Following initiation of the mediation, the parties would exchange mediation position statements and attend a mediation session that had to be conducted in eight hours on a single day. If the matter did not get resolved in that time, the mediator would automatically become an arbitrator and the proceedings would shift from mediation to "baseball arbitration."

Under baseball arbitration, each side provides the arbitrator with a last, best and final offer and demand in writing. The arbitrator then discloses the parties' offer and demand. Within five days after the disclosure, the arbitrator issues an award, adopting either the offer or demand, without modification or amendment. This award is considered final, binding and enforceable by a court of competent jurisdiction.

Here, counsel for Clayco filed a request for mediation with the AAA. Its transmittal letter, which was copied to FSG's attorney, indicated that Clayco was invoking Section XXVI.N of the parties' subcontract. The mediator selected for the case issued a scheduling order that followed the process set forth in the Section N alternative. Clayco brought suit seeking to compel FSG to participate in arbitration.

Nine months later, the parties mediated for eight hours and were unable to resolve their dispute. The mediator then became an arbitrator. He accepted the parties' best and final offers, and ultimately selected one of the offers (Clayco's). This award was for $1,684,108. Clayco went to court to move to confirm the arbitration award. FSG filed its own motion to vacate the arbitration award.

Avoid med-arb clauses

Before discussing how the district court addressed the parties' motions, a brief interlude is required.

If you are ever presented with a choice, stay away from the Section N alternative or any other kind of med-arb clause for that matter. The "hat" and mindset of a mediator differ greatly from that of an arbitrator. Mediators are facilitators; arbitrators are decisionmakers. Mediators learn confidential information from the parties during the mediation process. This information is seldom usable during arbitration proceedings.

However, just because information cannot be overtly used does not mean that it plays no role in the mediator-turned-arbitrator's thinking and perception. In short, the procedure is flawed from the outset since the parties may very well be prejudiced in the eyes of their arbitrator based on conduct that occurred in the mediation.

The parties are better off using different people as mediator and arbitrator. That having been said, a court is going to enforce the parties' lawful agreement to arbitrate — even if Steven Nudelman thinks that the methodology may be wacky. And the Section N alternative is lawful — at least in the eyes of the district court hearing Clayco's case.

Federal Arbitration Act

The district court here began its analysis by referencing the applicable statute that sets forth the bases to vacate an arbitration award — the
Federal Arbitration Act
, 9 U.S.C. § 10(a) (FAA). Under the FAA, an arbitration award may be vacated where: it was procured by corruption, fraud or undue means; there was evident partiality or corruption in the arbitrators; the arbitrators were guilty of misconduct in refusing to postpone the hearing, or in refusing to hear relevant evidence, or of any other misbehavior that prejudices the parties; or the arbitrators exceeded their powers.

FSG attempted to argue that the arbitrator exceeded his powers because Clayco failed to invoke the Section N alternative. FSG argued that it never received Clayco's written intention to invoke the Section N alternative and it never received Clayco's written request for mediation. The district court disagreed, giving short shrift to FSG's arguments.

The court found that Clayco sent the AAA a letter expressly invoking the Section N alternative and formally requesting mediation. Moreover,
counsel for FSG was copied on the transmittal letter
as a courtesy. Under the AAA rules, a request for mediation is initially filed with the AAA alone. There was no requirement under the AAA rules or the subcontract for Clayco to give FSG written notice that Clayco was invoking the Section N alternative, and requesting mediation through the AAA (even though Clayco did, in fact, provide such notice to FSG's counsel).

As the court concluded: "Arbitration is a matter of contract. The FAA does not prevent the enforcement of agreements to arbitrate using different rules than those set forth in the FAA itself because such a result 'would be quite inimical to the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms.'" Clayco, 2021 WL 859557, at *4 (citation omitted).

The court noted that FSG participated in the baseball arbitration process after mediation failed — precisely the procedure set forth in the Section N alternative. Yet, at no time did FSG object to the procedure until after it lost. As the district court said: “FSG made no formal objection [to the procedure]. Instead, it chose to assert flimsy
post hoc
excuses only after the outcome displeased it.”
Clayco
, 2021 WL 859557, at *4.

The court found that the arbitration process took place as the parties agreed, and FSG waived any procedural defects through its participation. Even if it did not waive such defects, FSG failed to demonstrate any of the four bases to vacate an arbitration award under the FAA.

Takeaways

The Clayco case does not present any earth-shattering legal principles. Rather, it enforces the notion that parties should read and be intimately familiar with the dispute resolution mechanism in their contracts.

Here, FSG should have known that under the parties’ subcontract, Clayco could invoke the Section N alternative by written demand to the AAA. Furthermore, FSG should have been aware that under the AAA rules, a party commences the mediation process by serving a request to the AAA.

Finally, FSG should not have sat on its rights; if it felt that the med-arb process under Section N was objectionable, it should have chimed in sooner and not waited until after it received an adverse award.

Again, none of these lessons is particularly complex. However, parties to construction contracts tend to gloss over the dispute resolution clause during the contract negotiation. Instead, they would be better served by having their construction attorney review the dispute resolution mechanism ahead of time. Such a review would help avoid surprises and heavy-handed or lopsided arbitration clauses.