"Dispute Resolution"

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by

James R. Keller

I. Traditional Dispute Resolution

A. When the Contract is Silent

Lawsuits in a traditional court of law occur when the construction contract has no provision about how disputes will be resolved. They also occur when the agreement expressly calls for lawsuits to be filed in a specified court or place, such as the Circuit Court of the City of St. Louis, Missouri.

Many disputes are still resolved in traditional courts with a judge or jury making the ultimate decision. Missouri has established general jury instructions to cover disputes over the interpretation of a contract and whether the contractor substantially performed, a necessary element to recover the contract price. *See* M.A.I. 26.07.

B. Traditional Litigation

Sometimes a traditional court is not the best forum for dispute resolution. The recent case of *Massman Const. Co. v. Missouri Highways and Transportation Comm.*, 31 S.W.3d 109 (Mo.App. W.D. 2000) provides a dramatic, albeit extreme example

of what can happen when a construction dispute is resolved through traditional litigation.[1]

It shows just how time-consuming, unpredictable and expensive construction litigation can be, not to mention the emotional toll it exacts on the parties.

After three trials, four appeals and twelve years, Massman Construction Company received in 2000 a judgment that it could keep for $850,000. The problem with this result is that Massman had been fighting the Commission since the late 1980s over substructure work it did on the Highway 40 bridge across the Missouri River near St. Charles and Chesterfield.

The Missouri Court of Appeals for the Western District (located in Kansas City) decided that the trial court correctly entered a judgment in favor of Massman after a jury verdict for $850,000. Massman had sued the Commission for breach of warranty ex contractu.

This particular claim is brought against the government, such as the Highway Commission. Massman had to prove that the Commission made a false representation of material fact, that Massman did not know that it was false, that Massman relied on

[1] The following originally appeared in a substantially similar form in an article by James R. Keller, entitled "Missouri River Spawns Big Judgment for Massman Construction," *St. Louis Construction News & Review,* p. 22-27, November – December 2000.

the representation and, as a direct result of such reliance, Massman incurred damage.

The dispute began after Massman had submitted a bid to the Commission to do the bridge's substructure work on this high-profile project. When Massman prepared its bid, the Commission's plan did not show that there was a rock revetment in the river that may affect construction and thus, Massman's bid. A revetment typically is a built-up area of stone, concrete or similar material used to create an embankment.

Ironically, it was Massman that had built the revetment in question some ten years earlier. In fact, Massman had participated in more than 40 contracts with the United States Army Corps of Engineers to build more than 2,000 structures in the river, including revetments.

Massman's role in building the revetment in dispute may have hampered Massman's case, but it did not prevent ultimate victory. Here is why.

The evidence showed that Massman knew that the revetment was close to the bridge, but not that it necessarily would interfere with construction of a new bridge pier. Further, none of the Corps of Engineers' documents showed a conflict between the new bridge and the existing revetment.

The Commission offered contrary evidence, but as the appellate court noted, the jury was free to disregard such evidence and award Massman the $850,000. The $850,000 judgment differs greatly from the results in the prior trials. The first trial netted Massman a hefty $1,922,821.28. The second trial yielded far less, only $250,000. Each trial had a different jury.

While it is always difficult to compare jury verdicts, the first trial did not include evidence that Massman had put in the revetment. This evidence alone may explain the significant size of the first verdict compared to the next two trials.

After the first trial, the appeals court sent the case back to the trial court for a second trial. The appeals court believed that the jury needed to know about Massman's prior role in the revetment. After the jury's verdict, the appellate court held that the trial court properly denied the Commission's post-jury motion for a judgment in its favor. The court noted that "reasonable minds could differ as to whether Massman knew that the revetment would interfere with the construction of Pier 6 of the bridge." Thus, Massman had enough evidence to merit letting the jury determine who should win.

After the jury verdict in the second trial yielded only $250,000, the trial court agreed with Massman that the verdict was too small. The trial court declined Massman's request to

increase the jury's award to $1,922,821.28. It did, however, order a new trial on the question of damages only.

The Commission appealed this decision. The Supreme Court then transferred the case to itself and reversed the trial court's decision to have a new trial only on damages. The Supreme Court ordered the trial court to enter a proper response to Massman's previous request to increase the verdict beyond $250,000.

The trial court obliged by tripling the judgment to $750,000. Then, administering what may have seemed like a form of Russian roulette, the trial court offered the Commission the option of accepting the new verdict of $750,000 or retrying the case but only on the issue of damages.

The Commission declined both options, and instead, asked the appellate court for help, once again. This time the appellate court instructed the trial court to offer the Commission the choice of accepting the $750,000 or retrying the case on all issues. The Commission chose a new trial on all issues.

The next trial produced the present judgment of $850,000. Obviously, given this final result, the Commission would have been better off taking the offer of $750,000. There is no way, however, that either party could have predicted this result.

Would there have been a different result through alternative dispute resolution such as arbitration? Perhaps the ultimate

result might have been the same, but the path to get there would not have taken so many twists and turns, cost as much money or lasted that long.

Here is why.

II. Alternative Dispute Resolution (ADR)

A. Arbitration

Arbitration is the "submission for determination of disputed matter to private unofficial persons selected in a manner provided by law or agreement." *Black's Law Dictionary*. This makes the arbitrator or panel of arbitrators the decision-makers. Their role is to reach without bias or compromise a "just and equitable" result within the scope of the parties' agreement. *See* R-46 of AAA's Construction Industry Dispute Resolution Procedures, as revised and in effect on July 1, 2001.

Simply speaking, arbitration occurs when the parties to a dispute agree that they will have an arbitrator they select hear and decide the case. They also agree that the arbitrator's decision will be binding and pursuant to state and when appropriate federal law it can be converted into a judgment in a traditional court of law, thereby vesting the parties with all the rights and liabilities associated with a "regular" judgment. *See* Missouri's Arbitration Act, Chapter 435 R.S.Mo.

B. Where Do You Arbitrate?

1. Private Arbitration

Private arbitration occurs when the parties hire the arbitrator and he or she handles the dispute directly with the parties. This typically occurs when a court orders arbitration or when the parties have the flexibility to hire the arbitrator on their own.

2. Dispute Resolution Services

Most arbitrations occur through the use of a dispute resolution service spelled out in the agreement to arbitrate or selected by the parties after the dispute arises. The world's largest is the American Arbitration Association ("AAA"), and it also is the most cited and used in construction contracts. There are many other services, however, including national organizations like USA&M and JAMS, and local groups like Pinnacle.

Any service has a panel of approved arbitrators from whom the parties select their arbitrator. Smaller cases generally require one arbitrator and the larger cases (typically those exceeding $1 million) more often use a panel of three arbitrators. AAA also has formal established rules and procedures that the parties will follow throughout the process. You can visit AAA's web site to review all of its rules at WWW.ADR.ORG.

C. The AIA Provisions on Arbitration

The American Institute of Architects ("AIA")[2] has produced the contract recognized nationwide as the industry standard for construction. It is AIA Document A201-1997, General Conditions of the Contract for Construction. This contract, 40 single-spaced pages long, requires mandatory mediation and arbitration with the American Arbitration Association. Virtually every major construction contract starts with this form (or a form close to it) as the legal foundation for what the parties agree to do, especially in how to resolve disputes through alternative dispute resolution instead of traditional litigation.

Since the AIA provisions are so prevalent, they are worth citing in detail, as follows:

4.4 RESOLUTION OF CLAIMS AND DISPUTES

4.4.1 Decision of Architect. Claims, including those alleging an error or omission by the Architect but excluding those arising under Paragraphs 10.3 through 10.5, shall be referred initially to the Architect for decision. An initial decision by the Architect shall be required as a condition precedent to mediation, arbitration or litigation of all Claims between the Contractor and Owner arising prior to the date final payment is due, unless 30 days have passed after the Claim has been referred to the Architect with no decision having been rendered by the Architect. The Architect will not decide disputes between the Contractor and persons or entities other than the Owner.

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4.4.2 The Architect will review Claims and within ten days of the receipt of the Claim take one or more of the following actions: (1) request additional supporting data from the claimant or a response with supporting data from the other party, (2) reject the Claim in whole or in part, (3) approve the Claim, (4) suggest a compromise, or (5) advise the parties that the Architect is unable to resolve the Claim if the Architect lacks sufficient information to evaluate the merits of the Claim or if the Architect concludes that, in the Architect's sole discretion, it would be inappropriate for the Architect to resolve the Claim.

4.4.3 In evaluating Claims, the Architect may, but shall not be obligated to, consult with or seek information from either party or from persons with special knowledge or expertise that may assist the Architect in rendering a decision. The Architect may request the Owner to authorize retention of such persons at the Owner's expense.

4.4.4 If the Architect requests a party to provide a response to a Claim or to furnish additional supporting data, such party shall respond, within ten days after receipt of such request, and shall either provide a response on the requested supporting data, advise the Architect when the response or supporting data will be furnished or advise the Architect that no supporting data will be furnished. Upon receipt of the response or supporting data, if any, the Architect will either reject or approve the Claim in whole or in part.

4.4.5 The Architect will approve or reject Claims by written decision, which shall state the reasons therefore and which shall notify the parties of any change in the Contract Sum or Contract Time or both. The approval or rejection of a Claim by the Architect shall be final and binding on the parties but subject to mediation and arbitration.

4.4.6 When a written decision of the Architect states that (1) the decision is final but subject to mediation and arbitration and (2) a demand for arbitration of a Claim covered by such decision must be made within 30 days after the date on which the party making the demand receives the final written decision, then failure to demand arbitration within said 30 days' period shall result in the Architect's decision becoming final and binding upon the Owner and Contractor. If the Architect renders a decision after arbitration proceedings have been initiated, such decision may be entered as evidence, but shall not supersede arbitration proceeding sunless the decision is acceptable to all parties concerned.

4.4.7 Upon receipt of a Claim against the Contractor or at any time thereafter, the Architect or the Owner may, but is not obligated to, notify the surety, if any, of the nature and amount of the Claim. If the claim relates to a possibility of a Contractor's default, the Architect or the Owner may, but is not obligated to, notify the surety and request the surety's assistance in resolving the controversy.

4.4.8 If a Claim relates to or is the subject of a mechanic's lien, the party asserting such Claim may proceed in accordance with applicable law to comply with the lien notice or filing deadlines prior to resolution of the Claim by the Architect, by mediation or arbitration.

4.6 ARBITRATION

4.6.1 Any Claim arising out of or related to the Contract, except Claims relating to aesthetic effect and except those waived as provided for in Subparagraphs 4.3.10, 9.10.4 and 9.10.5, shall, after decision by the Architect or 30 days after submission of the Claim to the Architect, be subject to arbitration. Prior to arbitration, the parties shall endeavor to resolve disputes by mediation in accordance with the provisions of Paragraph 4.5.

4.6.2 Claims not resolved by mediation shall be decided by arbitration which, unless the parties mutually agree otherwise, shall be in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association currently in effect. The demand for arbitration shall be filed in writing with the other party to the Contract and with the American Arbitration Association, and a copy shall be filed with the Architect.

4.6.3 A demand for arbitration shall be made within the time limits specified in Subparagraphs 4.4.6 and 4.6.1 as applicable, and in other cases within a reasonable time after the Claim has arisen, and in no event shall it be made after the date when institution of legal or equitable proceedings based on such Claim would be barred by the applicable statute of limitations as determined pursuant to Paragraph 13.7.

4.6.4 Limitation on Consolidation or Joinder. No arbitration arising out of or relating to the Contract shall include, by consolidation or joinder or in any other manner, the Architect, the Architect's employees or consultants, except by written consent

containing specific reference to the Agreement and signed by the Architect, Owner, Contractor and any other person or entity sought to be joined. No arbitration shall include, by consolidation or joinder or in any other manner, parties other than the Owner, Contractor, a separate contractor as described in Article 6 and other persons substantially involved in a common question of fact or law whose presence is required if complete relief is to be accorded in arbitration. No person or entity other than the Owner, Contractor or a separate contractor as described in Article 6 shall be included as an original third party or additional third party to an arbitration whose interest or responsibility is insubstantial. Consent to arbitration involving an additional person or entity shall not constitute consent to arbitration of a Claim not described therein or with a person or entity not named or described therein. The foregoing agreement to arbitrate and other agreements to arbitrate with an additional person or entity duly consented to by parties to the Agreement shall be specifically enforceable under applicable law in any court having jurisdiction thereof.

4.6.5 Claims and Timely Assertion of Claims. The party filing a notice of demand for arbitration must assert in the demand all Claims then known to that party on which arbitration is permitted to be demanded.

4.6.6 Judgment on Final Award. The award rendered by the arbitrator or arbitrators shall be final, and judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof.

D. What Missouri Contracts Must Include

Under Missouri law, every contract that includes a binding arbitration clause must also contain the following language in ten point capital letters adjacent to or above the place provided for the parties to execute the contract: THIS CONTRACT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES. Section 435.460 R.S.Mo.

E. Additions/Modifications to the Standard Agreement

The standard contract can and inevitably should include additions and modifications to suit the unique circumstances of the construction project and the particular parties involved. Items to consider include:

- Location for dispute
- Type of arbitration
- Type of arbitrator and qualifications
- Discovery before the hearing
- Is the arbitrator bound by the law?
- Arbitrator power for emergency relief
- Type of award
- Type of decision
- Rules to apply
- Timeliness of hearing and decision
- Attorney fees and other monetary compensation
- By agreement, the sky's the limit

F. Advantages of Arbitration

- Speed (for claims of $75,000 and less, trial in 30 days)
- "Trial by your Peers"
- Confidential Proceedings

- Expense: "I can't afford to go to trial" (Discovery is more limited)
- Finality: Rarely do you hear, "The trial is over; the appeal begins"
- "Picking your Arbitrator"
- Attorney fees (it can be a win, win)
- More flexible and creative awards are possible
- The goal is to achieve a fair result that is just and equitable

G. Arbitration Can Make a Difference

Do these advantages really yield a viable difference from traditional litigation? Yes, they can. Consider what happened in a recent Missouri construction lawsuit tried in a traditional court. The case is *Environmental Protection, Inspection and Consulting, Inc. v. City of Kansas City, Mo.*, 37 S.W.3d 360 (Mo.App. W.D. 2000).[3]

The decision involved a contractor's lawsuit against an owner where Missouri's appellate court in Kansas City upheld a trial judge's decision to take away a jury verdict of $454,572 under Missouri's Prompt Payment Act. The case is a good example of how important it is for a contractor to properly document its claim if it expects to recover interest for late payments and a better example of how the outcome may have been different through

arbitration. The appellate court also reversed a judgment in favor of the contractor for breach of contract for $561,200 and sent this part back for another trial.

In 1992, Environmental Protection, Inspection, and Consulting, Inc. (EPIC) contracted for $400,000 with the City of Kansas City (KCMo) to build a replacement spillway at the Kansas City Zoo. This was part of a $50,000,000 Zoo renovation.

In 1998, a Kansas City jury awarded EPIC the $454,572, plus another $40,000 for negligent maintenance of property and $561,200 for breach of contract. KCMo, the defendant, was looking at an adverse judgement of $1,055,772.

This is when things started going bad, lawsuit wise, for EPIC. First, the trial judge set aside the jury's interest award of $454,572. Then on December 26, 2000, Missouri's Court of Appeals in Kansas City threw out the contract damage award of $561,200 based on an error in the instruction to the jury and ordered another trial. The appellate court upheld the trial judge's decision to deny the interest award. EPIC will not get another chance at this claim.

This left EPIC, after nine years, with a $40,000 recovery. EPIC and KCMo were faced with another potentially long trial--the first one went

[3] The following originally appeared in large part as an article by James R. Keller, entitled "Contractor Loses $450, 000 Due to Lack of Documentation," *St. Louis Construction News & Review*, p. 13, March – April 2001.

six weeks--to determine if EPIC can recover more on its claim for breach of contract.

EPIC's claims arise from an agreement with KCMo to build a new spillway, diverting water for the first time to the Blue River. A prior spillway channeled water to a lagoon. The specifications called for building the spillway without draining the lagoon.

To do this, EPIC built a cofferdam, a temporary structure using sheet pilling and concrete forms, to dam the water and thus permit excavations for the spillway. Water seeped under the cofferdam. EPIC used pumps to remove the water but eventually the water backed up so far that work on the inlet excavation had to stop.

EPIC determined that the water flowed through a specific layer of porous rock under the cofferdam. KCMo ordered the rock's removal. After the lawsuit was filed, EPIC learned that KCMo and its engineers knew of the rock's existence but did not disclose it in the bid documents or the contract.

Also, a KCMo work crew filled a ditch near the existing spillway with dirt, causing the water from a big rainfall to rise over the cofferdam and flood the new spillway work site. The flood created the need for extensive repairs and cleanup. EPIC lost equipment and materials. (This is where the jury awarded EPIC $40,000 for loss of its business concern due to these problems.)

KCMo urged EPIC to timely complete the project, which required extra work. EPIC submitted change orders to cover what happened, but KCMo only approved about $12,500 of them.

EPIC's bad luck continued. The relationship between EPIC and KCMo broke down. A material supplier sued EPIC. The losses on the project forced EPIC to go out of business in 1994, the same year it filed this lawsuit.

EPIC sued under Missouri's Public Works Prompt Payment Statute, which applies to contracts with the government. It promotes timely payment to contractors, subcontractors and suppliers and allows them to recover 1.5% interest per month for late payments made in bad faith, plus reasonable attorney fees. The statute sets out many reasons an owner can withhold payment and not face this interest charge, such as unsatisfactory work progress, defective work or materials that are not corrected and disputed work.

The statute requires the owner to pay the retainage to the contractor within 30 days after the contract work is substantially complete and the public owner accepts. However, the contractor must submit its invoice and all other appropriate documentation and certificates in complete and acceptable form as required in the contract. Before final payment is due, the contractor also must file with the owner all the documents and certificates required by the contract.

The trial judge decided, and the appellate court agreed, that EPIC did not present any evidence that it submitted to the owner the required invoice or the other appropriate documentation and certificates as required in the contract and the statute. Thus, the trial judge properly took away the jury's damage award on this issue.

EPIC argued that its change order requests, a certificate of completion and a payment request were enough to comply with the statute's requirements. The appellate court decided, however, that these facts may help EPIC on its breach of contract claim for extra work but they were no substitute for what is required to trigger a prompt payment claim under the original contract.

Even the jury's finding that KCMo withheld payment in bad faith could not save this claim. Compliance with the threshold requirements of documentation is mandatory.

In arbitration, the result may have been different because the arbitration agreement often does not expressly require that the arbitrator follow the law. This leaves the arbitrator with the opportunity to reach a "just and equitable" result by taking into consideration factors other than simply "the law."

III. Mediation

Mediation is "the act of a third person who interferes between two contending parties with a view to reconcile them or

persuade them to adjust or settle their dispute." *Blacks Law Dictionary*.

The Mediator is the peacemaker whose goal is to resolve conflict through compromised agreement. Mediation is a mandatory first step in AIA contracts before arbitration can occur. The process is non-binding. If the parties cannot reach an agreement on how to compromise their dispute, they then can proceed to arbitration. (It is strongly recommended that the parties use a different person from the mediator to be the arbitrator.)

The AIA provisions on mediation in a construction contract are as follows:

4.5 MEDIATION

4.5.1 Any Claim arising out of or related to the Contract, except Claims relating to aesthetic effect and except those waived as provided for in Subparagraphs 4.3.10, 9.10.4 and 9.10.5 shall, after initial decision by the Architect or 30 days after submission of the Claim to the Architect, be subject to mediation as a condition precedent to arbitration or the institution of legal or equitable proceedings by either party.

4.5.2 The parties shall endeavor to resolve their Claims by mediation which, unless the parties mutually agree otherwise, shall be in accordance with the Construction Industry Mediation Rules of the American Arbitration Association currently in effect. Request for mediation shall be filed in writing with the other party to the contract and with the American Arbitration Association. The request may be made concurrently with the filing of a demand for arbitration but, in such event, mediation shall proceed in advance of arbitration or legal or equitable proceedings, which shall be stayed pending mediation for a period of 60 days from the date of filing, unless stayed for a longer period by agreement of the parties or court order.

4.5.3 The parties shall share the mediator's fee and any filing fees equally. The mediation shall be held in the place where the Project is located, unless another location is mutually agreed upon. Agreements reached in mediation shall be enforceable as settlement agreements in any court having jurisdiction thereof.

Mediation now requires "good faith" participation. Local Rule 16-6.05 of the U.S. District Court, Eastern District of Missouri provides:

> (A) Failure to Participate in ADR Process in Good Faith
>
> The neutral shall report any willful or negligent failure to attend any ADR conference, to *substantially* comply with the order referring case to Alternative Dispute Resolution, or otherwise participate in the ADR process *in good faith*. The judge may impose any sanctions deemed appropriate.

Applying this Rule a federal court judge recently sanctioned a lawyer and his client for failing to participate in "good faith" in court-ordered non binding mediation. The case was unanimously upheld late last year on appeal by the Eighth Circuit. *Nick v. Morgan's Food, Inc.*, 270 F.3d 590 (8th Cir. 2001).

Mediation is highly successful. It is far less expensive than litigation (either through a traditional court or arbitration). With few exceptions, mediation offers a no to low risk opportunity to settle a dispute for far less than otherwise would be spent.

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