Understanding Mediation and Arbitration

This article provided courtesy of XL Catlin's Design Professional unit

Design professionals often are asked to agree to contracts that call for arbitration or mediation as mechanisms for resolving project disputes. To the untrained eye, these may seem like the same thing: random forms of dispute resolution that architects or engineers never need to think about unless there is a problem. However, these two concepts are vastly different, and do not necessarily lend themselves to a side-by-side comparison. This article takes a closer look at both processes and offers recommendations to help the contract negotiator select the appropriate approach to dispute resolution.

What are they?

Mediation is a form of dispute resolution in which two or more parties to a dispute sit down with a mediator—often referred to as a neutral third party—to hammer out a settlement. There are several forms of mediation, but the most familiar is *voluntary non-binding mediation*. The process is always confidential; nothing that is said or done during a mediation can be used against the other party later in litigation should the dispute not resolve. This *mediation privilege* is intended to facilitate settlement by fostering open communication.

Anyone can agree to mediate a dispute at any time and it doesn't matter if your contract fails to specify mediation; the option is always available to the parties should they choose to attempt to resolve their differences short of trial. Parties can mediate a dispute regardless of whether that dispute is the subject of a lawsuit or a demand for arbitration. In fact, if a lawsuit is filed, most courts will require the parties to the lawsuit to mediate the case as a condition to having a court-room available to try the case. (This is known as *court-ordered mediation*.) Judges look with favor on this type of resolution since the vast majority of cases resolve at mediation and the fewer cases cluttering their dockets, the better.

A different animal altogether, *arbitration* is a more formal and binding procedure that occurs in lieu of a trial. Generally, when folks have a dispute that they can't resolve, the recourse is a lawsuit that is filed either in state or federal court. However, parties can agree by contract to use arbitration to resolve their differences. (While parties can always agree to arbitrate a dispute, this generally does not happen absent a contractual agreement to do so.)

Arbitration involves one or more arbitrators, whose roles function as triers of fact. They are judge and jury rolled into one.

Professional Association Standard Agreements

Standard agreements published by professional associations also require you to make choices about dispute resolution. For example, the American Institute of Architects (AIA) agreements call for mediation before arbitration or litigation (which you and your client decide before you sign the contract). The Engineers Joint Contract Documents Committee (EJCDC) documents offer parties a choice of mediation or arbitration, which they must agree on during contract negotiation.

Pros and Cons

The differences between mediation and arbitration are significant and they can greatly impact how a dispute is handled and ultimately resolved. Below is a brief summary of the pros and cons of each.

Benefits of Mediation

- Mediation is typically a *non-binding* process. If the parties don't like the mediator's recommendations or feel that they cannot reach a settlement, they can continue their dispute in court or using another dispute resolution process. If they do agree on a solution, it's generally memorialized in a written settlement agreement.
- Parties who agree to mediate a case are allowed to *choose the mediator*. This allows parties to select a mediator with the requisite skill and background experience as well as a particular style that may be suitable for a specific case, given the personalities and facts involved.
- The process is *informal* in that "evidence" can be presented by way of argument, discussion or via expert testimony. The standard rules of evidence that apply in court don't apply in mediation as the whole point of mediation is to encourage folks to tell their side of the story and how they intend to prevail at trial.
- All communication is *privileged*. While you can glean a lot by what is said or not said in mediation, you cannot use statements that someone made outside of the mediation. For example, if one party admits that its liability is 25% of the amount claimed, this admission cannot be used outside of the mediation process.
- Mediation provides a *preview* of the other side's case. While parties typically attend mediation with the intention of reaching a settlement, they also use the process as a way to learn more about the facts of a dispute and how the other party views its case. Sometimes, even if a mediation does not resolve a dispute, you can obtain a snapshot of where the other side sees the strengths and weaknesses of its case, which helps you further evaluate the strengths and weaknesses of your own case. Mediation might provide new aspects that the parties had not considered, or it might reinforce the fact that the initial analysis of liability and damages is accurate. Mediation also can give parties insight into who the relevant decision makers are and how they might be influenced.

Potential Downsides of Mediation

- Some regard the willingness to mediate as a *sign of weakness*. While it nearly always makes sense for parties to sit down early on and see if they can resolve their disputes, some see this as the other party's lack of confidence in its own case. In such instances, it may be best to rely on a court-ordered mediation, but this often doesn't occur until the parties have spent a considerable amount of money litigating their dispute. (This is one good reason to call for mediation in all your agreements.)
- If the dispute involves multiple parties, it can be *difficult to motivate all parties to participate* meaningfully in mediation, especially if there is no lawsuit pending. Some insurance companies refuse to participate in mediation until a lawsuit has been filed. In addition, some parties (or their attorneys) are just not interested in the early resolution of a dispute.
- A very few cynical parties use mediation as a *fishing expedition*. With no intention of resolving the dispute, these folks attend a mediation hoping to leave with information about the other party that will give them an advantage in a lawsuit.

Benefits of Arbitration

- Arbitration may be a better choice than litigation for *complex* cases where a jury would likely be confused by the issues or would not understand the issues at all. We all know that a jury of your peers doesn't mean a jury full of architects and engineers, but rather a random sampling of folks from the community in which your case will be tried.
- Arbitration can mitigate against the *uncertainty of a runaway jury verdict*, especially in some notorious jurisdictions, or a verdict that just doesn't make sense—a finding of no liability with an award of damages, for example. By weeding out the folks that won't understand the issues, or

don't want to sit on a jury, the hope is that you can get a result that makes more sense.

- Arbitration is often a good choice when dealing with a foreign project when there is little confidence in the judicial system where the case is located. (International arbitration is not the same as domestic arbitration and involves different rules.) For example, if there is a dispute that arises out of a pipeline project in Kazakhstan, US companies might feel uncomfortable litigating in that country due to a lack of familiarity with the courts or a perception that the courts are biased or unfair. However, don't discount all foreign courts. For example, the judicial system in Singapore has a sophisticated judiciary with skilled judges who can preside over complex cases. These courts are also free.
- Parties to the dispute generally get to *pick the arbitrator*. This is important in that the parties can sift through resumes and look for arbitrators with experience in a particular field: an arbitrator with an engineering background, for example, or an arbitrator who has many years' experience representing design professionals.
- *Arbitrations are private*. The proceedings are not open to the public and, because the standard for appealing an arbitrator's decision is so high, there is almost no chance of an appellate court issuing a written opinion about your case. For companies who are concerned about public relations issues and perhaps deal with a high volume of disputes, arbitration is an appealing method of keeping their dirty laundry out of the public eye.

Potential Downsides of Arbitration

Arbitrations are *very expensive*, and this is the biggest drawback and deterrent. Arbitrations are costly for the following reasons:

- Arbitrators tend to err on the side of caution when it comes to evidence and typically let all evidence in—including evidence that would never be admissible in a court of law. This adds time to the process and can result in an unfair result.
- Arbitrators get paid by the hour and have no incentive to expedite the process. Contrast this to the court system where most judges are overworked and do all they can to limit the length of a trial so other folks can have their day in court. (Federal courts tend to set extremely aggressive trial schedules.) The difference between arbitration and a court case can be stark: what might be a three-week trial in federal court could take three, four or more months in arbitration.
- According to certain arbitration rules, if a claim is for over $1 million (not uncommon these days), the dispute must be heard by a three-arbitrator panel. This means the costs are tripled. Just imagine a three-arbitrator panel where each arbitrator charges $500 an hour—that's $1,500 an hour. At eight hours a day, the arbitrators alone will cost $12,000 a day. Compare this to a judge and jury who are free!
- When your arbitration proceeding drags along at a snail's pace, you incur additional legal and expert costs and the cost of attending the arbitration is compounded. Just do the math: two attorneys attending a 15-day (three week) trial versus a 60-day (three month) arbitration. Then, consider what your time is worth, as well as the time of those in your firm who have to prepare for and attend the arbitration. This can quadruple the cost.
- Arbitration awards are binding and very difficult to overturn on appeal, even if the arbitrator clearly failed to apply the facts and follow the law. While the American Arbitration Association recently developed an optional appellate review process, these optional rules rarely show up in contracts, leaving the parties stuck with a potentially bad result that would never hold up in court. While judges and juries (and arbitrators) can make egregious mistakes, our system of jurisprudence provides a right to appeal, a right often given up in an arbitration proceeding.

Choose Mediation

For all the reasons mentioned above, XL Catlin suggests that you choose mediation as a first step in dispute resolution, and recommends that you provide for it in your contracts. Our claims adjusters have first-hand knowledge of and experience with many of the well-known mediators. They know that it makes the most sense to find common ground early in a dispute and settle a case if possible.

Why is early resolution important? For one thing, professional liability policies have eroding limits, which means that all of the costs incurred in defending a case, like attorneys' fees and expert costs, reduce the amount of available insurance. For example, if XL Catlin spends $500,000 defending a case, and the policy limit is $1,000,000, then there is only $500,000 left to pay for any loss. The process of litigating a case is typically very costly, so it makes sense to try to find out as much information informally as possible. Finally, resolving a dispute early minimizes the disruption to your company and your staff.

XL Catlin Recommends Mediation

XL Catlin knows that mediation frequently resolves disputes amicably, without litigation and without destroying business relationships—resolve a claim through mediation and receive:

- 75% deductible credit for claims resolved within one year—up to $25,000
- 50% deductible credit for claims resolved after one year—up to $25,000

As a general rule, XL Catlin doesn't favor arbitration—primarily because of the excessive costs and the difficulty in correcting a situation where the arbitrator fails to apply the facts and law properly.

If mediation isn't successful or isn't an option, parties who are worried about the potential for a runaway jury can always waive a jury trial and proceed with a bench trial, which is a trial with only a judge who acts as the trier of fact. Most large counties where the majority of state court actions are filed have specifically designated complex courts that specialize in hearing cases that are deemed "complex" due to the nature of the legal and factual issues involved and the number of parties. Complex courts are generally well versed in the issues that confront design professionals and the judges generally understand construction and design concepts.