Arbitration Rules Reconstructed

The American Arbitration Association (AAA) released revised construction industry rules for mediation and arbitration effective Oct. 1, 2009. The changes range from technical revisions to important substantive additions. Since the AAA arbitration rules are the most frequently used mediation and arbitration rules for construction disputes, these changes warrant careful consideration by owners, contractors, subcontractors, design professionals and their attorneys.

Determining whether the new AAA rules or a prior version applies to a dispute can be tricky. Unless the parties agree otherwise, the new rules apply to any arbitration filed after Oct. 1, 2009. Consistent with this approach, many construction contracts specify that the rules in effect at the time of filing an arbitration demand govern. However, many other contracts, like the 2007 edition of the form contracts published by the American Institute of Architects, provide that arbitration proceedings "shall be administered by the [AAA] in accordance with its Construction Industry Arbitration Rules *in effect on the date of the Agreement*." This underscores the need to review contract language to determine whether the new rules apply to disputes arising under contracts executed prior to Oct. 1, 2009.

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AAA has made changes to its mediation rules (M-1 to M-18) and the existing three sets of arbitration rules: regular track rules (R-1 to R-56); fast track rules (F-1 to F-14), which apply to disputes that do not exceed $75,000; and rules for large, complex construction disputes (L-1 to L-6), which are meant to supplement the regular rules. The changes increase the threshold for the large case rules from disputes in excess of $500,000 to those in excess of $1,000,000. The rules now expressly state that attorneys' fees are not to be considered in determining whether these thresholds are exceeded.

AAA also added a new fourth track of arbitration rules (D-1 to D-4) for resolution of disputes by a single arbitrator through document submission without a "face-to-face" hearing. Where the parties agree, this expedited and simplified process is available regardless of the size of the dispute. Additionally, unless a hearing is requested by the parties or by the arbitrator, these rules apply to disputes that do not exceed $10,000.

The changes to the mediation rules are relatively minor. The prior mediation rules did not specify how to determine the locale of the mediation in the absence of an agreement between the parties. In this situation, the new rule (M-3) provides that locale shall be preliminarily set at the city nearest to the construction project and that the mediator shall have final authority to fix the locale of the mediation. This prevents extended delay caused by a party refusing to agree on a location. Arbitrators have been given similar authority to determine the locale of an arbitration and a deadline is imposed for raising locale disputes (R-12).

The other notable change to the mediation rules (M-14) precludes parties from calling a mediator to testify in legal proceedings related to the mediation. A similar change to the arbitration rules (R-51) protects arbitrators. This is not a dramatic change for California practitioners because California law already establishes that mediators and arbitrators, with limited exceptions, are not competent to testify in subsequent civil proceedings. (Evidence Code Section 703.5.)

A number of technical revisions were made to the regular arbitration rules. For example, deadlines for various actions have been changed from "[15] days" to "[14] calendar days" to avoid the problem of responses falling due on a weekend. But there are numerous substantive changes and a few of the more significant changes are highlighted below.

A new rule (R-50) was added to preclude a party from unilaterally withdrawing a duly filed claim or counterclaim and permits withdrawal only upon agreement of the parties or with consent of the arbitrator(s). Disputes over whether withdrawal is "with or without prejudice may be decided by the arbitrator." This should deter parties from filing and withdrawing claims and counterclaims to harass a party.

On a somewhat related point, parties have been free under the AAA rules to increase or decrease the amount of their claim or counterclaim prior to the close of the hearing. The revised rule (R-6) now requires that written notice of such change be given to the AAA and to all parties and that the arbitrator may set a cutoff for any increase or decrease. And, if a party believes that any such change in the amount of the claim or counterclaim warrants a change in the number of arbitrators, such a request must be made to AAA no later than seven days after receipt of the notice of change in the claimed amount. This revision is meant to ensure that any change to the size of the panel is promptly addressed so as to minimize disruption to the arbitration process.

Arbitrator disclosures and conflicts of interest have received increasing legislative and judicial attention. The changes to the AAA rules add a seemingly innocuous clause to the disclosure requirement. The old rule dictated that "[a]ny person appointed or to be appointed as an arbitrator shall disclose to the AAA any circumstances likely to give rise to a justifiable doubt as to the arbitrator's impartiality or independence...." The new rule requires such disclosure to be made by the arbitrator *"as well as the parties and their representatives"*. California law (Code Civil Procedure Section 1281.9(a)) imposes certain disclosure obligations on a proposed neutral arbitrator and the failure to satisfy those obligations may justify vacating or setting aside an arbitration award. The change to the AAA rule aims to surface all potential conflicts at the outset so that they can be addressed up front rather than being raised after the proceedings commence or after an award has been issued. How AAA and the courts will respond to the failure of a party to comply with its disclosure obligations under the new rule remains to be seen.

The rule regarding consolidation of arbitrations and joinder of parties (R-7) was substantially revised. The new rule applies when the parties cannot agree upon consolidation of related cases or joinder of parties. A single arbitrator is specially appointed by AAA to decide such issues. This so-called "R-7 arbitrator" is ineligible to serve as a "merits" arbitrator unless the parties agree otherwise. The R-7 arbitrator is empowered to establish a process for selecting arbitrators for the resulting case as well as allocation of arbitrator compensation - a cost that can be quite substantial - subject to reallocation by the merits arbitrators in any newly constituted case. Quixotically, the rule states that to request consolidation of arbitrations "the requesting party must have filed a Demand for Arbitration." As written, only a claimant and not a respondent may seek to consolidate arbitrations, which makes no sense. AAA probably meant to indicate that a claimant or respondent may request consolidation provided at least one arbitration demand has been filed with AAA. AAA will need to fix this.

When parties agree to a three person panel but cannot agree upon the professional background of the arbitrators, the new rules (R-14) state that the AAA shall decide the professional composition of the panel in light of the preferences expressed by the parties.

A small number of changes were made to the rules for large, complex disputes in addition to increasing the threshold to $1,000,000. The rules regarding administrative conferences and the preliminary management hearing have been reorganized. Additionally, the arbitration panel is required to promptly issue a written order setting forth decisions on the matters discussed at the preliminary case management hearing. Finally, unless the parties agree otherwise, the arbitrator in a case governed by the rules for large, complex disputes must issue a reasoned award.

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The fast track rules contain a number of detailed rule changes that make the fast track proceedings move faster. To expedite appointment of an arbitrator, the parties are provided with a list of five arbitrators and may strike no more than two names in the event that they cannot agree upon the arbitrator. AAA then selects the arbitrator from the remaining candidates who were not struck by either side.

The new AAA construction industry rules contain a number of significant changes. Those changes can influence the outcome of a case and should be carefully considered when formulating a case plan and strategy for a dispute subject to these rules.