Construction Contracts

Arbitration as a Means of Dispute Resolution in New Jersey

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A look at the practical considerations in utilizing arbitration when drafting construction contracts.

This article will discuss several practical considerations in electing arbitration as a method of dispute resolution when drafting and negotiating construction contracts in New Jersey. Certainly, one important consideration is the finality of arbitration versus the very limited likelihood of successfully appealing an arbitrator's decision. Another factor to be considered is the limited right to join parties and issues related to the arbitration. Finally, the parties must consider the precise language chosen in the arbitration clause, as that language will govern which disputes are arbitrable. An important first step is to review the history that has led to today's current construction arbitration landscape.

Arbitration, generally, is a method of dispute resolution involving one or more neutral third parties, usually agreed upon by the disputing parties, whose decision is binding.[1] Of course, in New Jersey arbitration may be either binding or non-binding, depending on what has been contractually bargained for, or is required statutorily.[2] Our courts have long encouraged the use of arbitration as an alternative means of dispute resolution.[3] As early as 1794, New Jersey enacted a statute, codifying English common law.[4] That arbitration statute was reformed in 1923, and is still in existence today.[5] New Jersey's Arbitration Act was modeled on similar legislation passed in New York in 1920.[6] The act was based upon the premise that arbitration was contractually based and provided for resolution of disputes through contractually bargained for provisions.[7] In construction dispute resolution, arbitration is a fact of life. As public

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and private parties typically utilize American Institute of Architects (AIA) form documents, most disputes are governed by the Construction Arbitration Rules of the American Arbitration Association (AAA).

The AAA Construction Arbitration Rules permit a matter to proceed along one of three tracks. The fast track shall be applied in any case where no party's disclosed claim or counterclaim exceeds $75,000, exclusive of claimed interest, arbitration fees and costs. Parties are encouraged to agree to the fast track procedures in cases involving more than $75,000. The procedures will not be applied, absent agreement by the parties, in cases in which there is no disclosed monetary claim, or in any multi-party case. Unless all parties agree otherwise, the procedures for large, complex construction cases shall apply to all cases in which the claim or counterclaim of any party is at least $1,000,000 exclusive of claimed interest and arbitration costs and fees. Parties may also agree to use these procedures in cases involving claims of less than $1,000,000, or in cases with undetermined or non-monetary claims. All other cases shall be considered under the regular track.

The New Jersey Arbitration Act restricted grounds for vacating an award to four instances: where the award was procured by corruption, fraud or undue means; where there was evident partiality or corruption in the arbitrators; where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence, pertinent and material to the controversy, or of any other misbehavior, by which the rights of any party have been prejudiced; or where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final and definite award, upon the subject matter submitted, was not made.[8] The act specified three situations in which a court could modify an arbitration award: evident miscalculation of figures; an award upon a matter not submitted to the arbitrator, unless it affected the merits of the decision upon the matter submitted; and where the award was imperfect in a matter of form, not affecting the merits of the controversy.[9] Interestingly, these grounds have remained virtually unchanged, as no major revisions to the act have been made.[10]

Today, the grounds for vacating an arbitration award are set forth in N.J.S.A. 2A:24-8. That statute provides:

> The court shall vacate the award in any of the following cases:
>
> a. Where the award was procured by corruption, fraud or undue means;
>
> b. Where there was either evident partiality or corruption in the arbitrators or any thereof;
>
> c. Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause being shown therefore, or in refusing to hear evidence, pertinent and material to the controversy, or of any other misbehavior prejudicial to the rights of the parties;
>
> d. Where the arbitrators exceeded or so imperfectly executed their powers that a mutual, final and definite award upon the subject matter as submitted was not made...

The grounds for modifying or correcting an arbitration award are set forth in N.J.S.A. 2A:24-9. That statute provides:

> The court shall modify or correct an award in any of the following cases:
>
> a. Where there was an evident miscalculation of figures or an evident mistake in the description of a person, thing or property referred to therein;
>
> b. Where the arbitrators awarded upon a matter not submitted to them unless it affects the merit of the decision upon the matter submitted; and
>
> c. Where the award is imperfect in a matter of form not affecting the merits of the controversy...

Additionally, it should be noted that the New Jersey Supreme Court has stated, "in rare circumstances a court may vacate an Arbitration Award for public policy reasons."[11] It is unlikely however, that a court would exercise its power in this area, except in cases dealing with child support or public sector arbitrations.[12]

In a widely cited construction case, the New Jersey Supreme Court in 1992 held, in *Perini*,[13] that the judiciary could vacate an arbitrator's decisions for a number of reasons, among them, a mistake in the interpretation of law.[14] The Court, however, changed that standard a mere two years later, deciding that a court could no longer vacate an award in a voluntary arbitration proceeding because of the arbitrator's mistaken interpretation of the law.[15] In *Perini*, the Court concluded in a plurality opinion that a court could vacate an arbitration award based upon a mistake of law which was "gross, unmistakable or in the manifest disregard of the applicable law," because of the "undue means" and "exceeded their powers" provisions of the arbitration act. It should be noted, however, that Chief Justice Robert Wilentz, in a concurring opinion, agreed with the outcome, yet asserted that a mistake of law, regardless of how gross, should not be grounds for vacating an arbitration award.

Less than two years later, the Court revisited the mistake of law exception and overruled *Perini* in *Tretina Printing*.[16] In that opinion, the Court adopted Chief Justice Wilentz's concurrence in *Perini* as the prevailing standard of review for the vacation of arbitration awards. The *Tretina* Court stated, "the essential question [is] the extent to which, and the standard under which, an arbitrator's award can tolerate judicial review."[17] The Court then flatly rejected the *Perini* standard and adopted

the standard set forth by Chief Justice Wilentz's concurring opinion in *Perini*.[18]

The *Perini* plurality had concluded that "undue means" and "exceeded their powers" provisions of the statute included egregious mistakes of law.[19] Rejecting *Perini*, the *Trentina* Court held that an error of law was no longer a valid basis for vacating an award. Thus, the correct standard was stated by Chief Justice Wilentz in *Perini* as:

> Basically, arbitration awards may be vacated only for fraud, corruption, or similar wrongdoing on the part of the arbitrators. [They] can be corrected or modified only for very specifically defined mistakes as set forth in [N.J.S.A. 2A:24-9]. If the arbitrators decide a matter not even submitted to them, that matter can be excluded from the award. For those who think the parties are entitled to a greater share of justice, and that such justice exists only in the care of the court, I would hold that the parties are free to expand the scope of judicial review by providing for such expansion in their contract; that they may, for example, specifically provide that the arbitrators shall render their decision only in conformance with New Jersey law, and that such awards may be reversed either for mere errors of New Jersey law, substantial errors, or gross errors of New Jersey law and define therein what they mean by that. I doubt if many will. And if they do, they should abandon arbitration and go directly to the law courts.

In that light, what steps can be taken in advance of a dispute, to insure that the parties are not faced with an unexpected set of circumstances? Initially, careful drafting of the contract is of paramount importance. Further, understanding by all parties of exactly what they are contracting for is manifest. The parties should discuss in advance of the contract drafting, how they wish to allocate risks, and what their intentions are in selecting arbitration as the means of dispute resolution.

It is clear that an award will not be set aside except for actual misconduct by the arbitrators. However, if the parties wish further review of a decision, the time to opt for it is during contract negotiations. Certainly, parties are free to elect that the award may be modified or vacated by the courts, upon a mistake of law. Similarly, parties may elect to delineate the extent of discovery that will be permitted. This may be in the form of specifically stating what types of discovery will be allowed and under whose rules (AAA, state court rules or federal rules).

These choices, however, must be made in the context of why arbitration was selected in the first instance. As the Chief Justice stated,

> [i]n most cases ... all the parties want from the arbitrators is honesty and an attempt to reach a fair and just result, and what they rely on is not only the arbitrators' honesty but ... the depth of their experience with the kinds of problems put before them. I am not suggesting that that is their intent in *every* case, but that it is most probably their intent in practically all cases.[20]

The more provisions allow for extensive discovery, judicial review, and courtroom type procedures, the farther the parties are moving from the apparent goal of arbitration; a faster, less time consuming, less expensive alternative to litigation. Parties selecting arbitration most often recognize that sometimes a just and fair result is a result that may not have been reachable through litigation. Again borrowing words from the Chief Justice,

> if nothing is said in the agreement [regarding choice or review of laws], the arbitrators may use any standards they want to reach a just and equitable result, unrestricted by any law or laws, required only to be honest and to attempt to the best of their ability, based on their knowledge and experience, to achieve a just and equitable result.[21]

Considering the difficulty in altering or vacating an arbitrator's decision highlights the importance of being sure that the arbitration proceeds in a manner that ensures the understanding of the parties. Furtherance of that process suggests an intention to include all parties and issues involved in the dispute in the arbitration agreement. Without mutual agreement of the parties, it is nearly impossible to compel arbitration.[22] Importantly, however, the parties may consent to arbitration in the absence of a written agreement.[23]

The Appellate Division, in *Wasserstein v. Kovatch*,[24] addressed the issue of extending the reach of an arbitration agreement beyond the signatories to that agreement.[25] In that matter, the Wassersteins entered into a contract for construction of an

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addition to their home with general contractor Guild. That contract did contain an arbitration clause. Other actions were brought relating to the construction by Lodewyck, a subcontractor naming Guild, the Wassersteins, and Guild's principals for the value of goods delivered and services rendered, and by Conklin and Strong, Inc., a sub-subcontractor against Lodewyck. Notably, the Wassersteins were not a signatory on any contract with the subcontractor, Lodewyck, or the sub-subcontractor, Conklin. Lodewyck and Conklin consented to submit the matter to arbitration. The *Wasserstein* court held that defendants Lodewyck and Conklin were entitled to arbitration as agents of Guild, even though they had not individually signed an arbitration agreement.[26] The court held that "non-signatories of an arbitration agreement may be bound by the agreement under contract and agency principals."[27] The court held that arbitration between all the parties was proper, despite an article of the contract with Guild upon which the Wassersteins relied stating:

> The contract document shall not be construed to create a contractual relationship of any kind (1) between the architect, contractor, (2) between the owner, subcontractor or sub-subcontractor or (3) between any persons or entities other than the owner and contractor.

The court relied on a different article between Wasserstein and Guild, which provided in part:

> Contracts between contractors and subcontractors shall (1) require each subcontractor, to the extent of the work to be performed by the subcontractor, to be bound by the terms of the contract documents and to assume to the contractor all obligations and responsibilities which a contractor, by the contract documents, assumes towards the owner and architect and (2) *allow to the subcontractor the benefits of all rights, remedies and redress afforded to the contractor by these contract documents.* [Emphasis supplied in the original].

This highlights the necessity of careful consideration of contract provisions to insure, if that is the goal, the reach of arbitration to parties not signatories to the contract.

Another consideration which bears attention in drafting a contract is the desirability of consolidation of multiple arbitrations arising out of the identical facts and circumstances, and how a court may integrate clauses that seem to prevent joinder of parties in one consolidated proceeding. In *Sparwick*,[28] a general contractor, Carl Walker Construction Group, was retained for a construction project in Jersey City and, in turn, contracted with Tomasco Corporation to perform as a subcontractor on the project. The contract contained an arbitration agreement which covered all disputes between them arising from the contract. The agreement further stated the arbitration would be held in accordance with construction industry arbitration rules of the American Arbitration Association and "shall take place in Pittsburgh, Pennsylvania," and that Pennsylvania law would apply.

Sparwick Contracting, Inc., a sub-subcontractor, also filed a complaint against Tomasco, Walker, and LeFrak Organization, Inc., the owner of the property. The agreement between Sparwick and Tomasco did not contain any arbitration provision; however, Sparwick agreed to arbitrate the matter provided the arbitration was conducted in New Jersey.[29]

The court was faced, in consolidating the arbitrations, with conflicting venue provisions. The court noted that New Jersey recognizes the validity of forum selection clauses, but allows the court to decline to enforce such a provision in a particular instance if enforcement would seriously inconvenience trial.[30] The court reasoned that such a decision was a discretionary decision that lay within the power of the trial court. The court held that because the project was located in Hudson County, and access to witnesses and other evidence would be easier to achieve in New Jersey, and that there was no valuable reason to conduct the arbitration in Pittsburgh, Pennsylvania, it was in the interest of all parties to conduct the arbitration in New Jersey.[31]

When handling a dispute involving parties in various forums, consider asking a court to compel their separate arbitrations involving the same issues, to be conducted before the same panel of arbitrators *seriatim*, notwithstanding a non-joinder provision in one or more contracts. The AIA form architect/owner contract contains such a non-joinder provision, yet the involvement of the architect in arbitration with the owner/contractor is usually essential for a complete resolution of claims.

Finally, where specific claims are beyond an agreement to arbitrate, such as statutory claims for relief, the claims must be explicitly spelled out. While not a construction case, the New Jersey Supreme Court in *Garfinkel* held that an arbitration provision which seeks to include such claims must clearly and unmistakably establish a party's intent to waive judicial remedies.[32]

In *Garfinkel*, the plaintiff employee entered into an employment agreement setting forth the plaintiff's work obligations, salary, eligibility for stock ownership, and other terms. The contract of employment also contained an arbitration clause stating "any controversy or claim arising out of, or relating to, this agreement, or a breach thereof, shall be settled by arbitration in Morristown, New Jersey, in accordance with the rules of the American Arbitration Association."

In January 1998, the defendant

employer informed the plaintiff employee that he would not be permitted to exercise his option to become a shareholder. In March 1998, the defendant informed the plaintiff that he was being terminated. In September 1998, the plaintiff filed an action in the Law Division alleging, among other things, violations of the Law Against Discrimination (LAD).

The Court enunciated the well-settled principle that parties to an agreement may waive statutory remedies in favor of arbitration, and affirmed that the principle applied to the LAD.[33] The Court went on to state that because of the favored status of arbitration, agreements to arbitrate should be read liberally in favor of arbitration.[34] The Court noted, however, that a party's waiver of statutory rights "must be clearly and unmistakably established, and the contractual language alleged to constitute a waiver will not be read expansively."[35] The Court concluded that the arbitration clause in question, which stated "any controversy or claim" that arises from the agreement or its breach should be settled by arbitration, was insufficient to constitute a waiver of plaintiff's remedies under the LAD.[36] The Court advised that a waiver of rights provision should at least provide that the parties agree to arbitrate all statutory claims arising out of the relationship or its termination.[37] The Court mandated the use of language reflecting that the parties in fact know that other options such as federal and state administrative remedies and judicial remedies exist and that the parties know by signing the contract those remedies are forever precluded and that the parties acknowledged that those claims can only be solved by arbitration.[38]

The Court's reasoning in *Garfinkel* serves to highlight the importance of carefully choosing contract language that explicitly delineates the parties' intent as it relates to waiving other remedies in other forums. The contracting parties must also carefully select language that will, to the extent possible, allow the arbitration agreement to include all potential parties and issues to a dispute in the forum of the dispute. These steps are even more critical in light of the limited judicial review of arbitration awards. ⚖

Endnotes

1. *Black's Law Dictionary* 100 (7th Ed. 1999).
2. *See, Peters v. Marriot*, 278 N.J. Super. 327 (Law Div. 1994).
3. *Perini Corp. v. Greate Bay Hotel and Casino, Inc.*, 129 N.J. 479, 496 (1992) *citing* James B. Boskey, A History of Commercial Arbitration in New Jersey Part 1, 8 *Rut.-Cam.L.J.* 1, 2 (1976).
4. *Id.*
5. *See* N.J.S.A. 2A:24-1 to -11.
6. James B. Boskey, A History of Commercial Arbitration in New Jersey Part I, 8 *Rut.-Cam.L.J.* 1 (1976).
7. *Id.*
8. *Id.*
9. Act of Mar. 21, 1923, Ch. 134, S 10(a), 1923 N.J. Laws 291, 294.
10. Cf. N.J.S.A. 2A:24-8, N.J.S.A. 2A:24-9.
11. *Tretina Printing, Inc. v. Fitzpatrick and Associates, Inc.*, 135 N.J. 349, 364 (1994).
12. *See, Tretina, supra*, 135 N.J. at 364-65.
13. *Perini, supra*, 129 N.J. 479.
14. *Id.* at 496.
15. *Tretina, supra*, 135 N.J. at 357-58.
16. *Id.* at 349.
17. *Id.* at 356.
18. *Id.*
19. *Id.*
20. *Perini, supra*, 129 N.J. at 543.
21. *Id.*
22. *United Steel Workers v. Warriro & Gulf Nav. Co.*, 363 U.S. 574, 582, 80 S. Ct. 1347, 1353, 4 L. Ed. 2d 1409, 1417 (1960).
23. *Wasserstein v. Kovatch*, 261 N.J. Super. 277, 285 (App. Div. 1993).
24. *Id.*
25. *Supra.*
26. *Id.* at 286.
27. *Id.*
28. *Sparwick Contracting Inc., v. Tomasco Corp.*, 335 N.J. Super. 73 (App. Div. 2000).
29. *Id.*
30. *Id.* at 81-82.
31. *Id.* at 82.
32. *Garfinkle v. Morristown Obstetrics & Gynecology Assoc.*, 168 N.J. 124 (2001).
33. *Id.* at 131.
34. *Id.*
35. *Id.* at 132.
36. *Id.* at 134.
37. *Id.* at 135.
38. *Id.*

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