MEDIATION-ARBITRATION: A NEW APPROACH TO CONFLICT RESOLUTION IN THE CONSTRUCTION INDUSTRY

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The rational economic man stands as the first citizen of our free-enterprise economy. He promotes economic growth and efficiency — and hence prosperity — by intelligently grasping the economic consequences of his behavior. The rational man weighs the costs and benefits of an enterprise before he embarks upon it. When the probability of his success times his possible rewards sufficiently exceeds the probability of his failure times his possible costs, the rational economic man pursues his venture. A rational system of justice aids the rational economic man's economic calculus by helping him predict the risks of incurring a cost. A rational system of justice promotes enterprise planning by remaining predictable, by acting as a constant in the cost-benefit equation.

Unfortunately, our system of justice has become in many respects irrational. Rather than behaving predictably, our system seems often to assign costs randomly. Where the rational economic man once relied on a roadmap he now faces a roulette wheel. The roulette game of the legal system proves an expensive pastime, for even the rational man needs a high-priced specialist, his attorney, to place his bets for him. Moreover, the randomness of the game strikes the rational man as unfair. But since he is a *rational* economic man in a free economy, our first citizen may devise means of avoiding the legal system's costly and unpleasant roulette game. This essay offers him one escape: "mediation-arbitration."

To put both the problem and the suggested solution in perspective, consider conflicts arising on a construction project. The parties involved in such an undertaking range from owner, architect, and general contractor to sub- and sub-subcontractors and their suppliers. Moreover, behind each party stands his "alter ego," his insurer or guarantor. The chances of disagreement, delay, litigation, and increased costs on a construction project of any size are staggering. No doubt many worthwhile projects never begin — and our economy consequently suffers — because the parties cannot risk the increased costs a protracted dispute could entail.

Conflicts, by definition, arise out of unforeseen events: "acts of God," accidents, changes in plans, or knowing breaches of duty. Whatever their source, all disputes soon resolve into a basic issue: who must pick up the tab? When the rational economic man calls upon the judicial system to answer that question, its unpredictability, costs, and delay subvert his rational plan-

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ning, raise his cost of construction, and leave him feeling unjustly treated. "Mediation-arbitration," as an alternative, promotes his planning, lowers his costs, and offers him fairness by pursuing the rational man's primary values: economy, speed, and predictability.

When conflicts arise on a construction project, experience and human nature lead the parties to seek as quick and as amicable resolution as possible. The first instinct of rational economic men leads them to seek a reasonable agreement among themselves as to who should bear the costs. This first instinct is a wholesome one: a rational system of dispute-resolution would preserve it. Ours does not. If one party does not readily agree to absorb the costs, perhaps the parties compromise. Familiar with the construction process and each other, expert in their particular fields, and considerate of their associates' stakes in the enterprise, the parties exhibit respect and restraint in their compromise negotiations. Elusive virtues, respect and restraint, merit safekeeping. Our system of justice squanders them, only to place contention and excess in their stead. If the parties still balk at compromise, they may invite an expert and distinterested third party to mediate their dispute. The mediator's expertise spurs the parties to make their demands reasonable, and the chances of accord increase. Our system of justice wastes when it ignores such expertise. The informal means through which parties resolve their disputes demonstrate their intelligence and better instincts. The formal means to which parties must turn when the informal means fall not only ignore those virtues but also import new vices.

Litigation provides a good example of the effects of the darker side of human nature on conflict resolution. As the most familiar avenue of conflict resolution, litigation remains remarkably insensitive to complex problems which arise in commercial and industrial contexts. The method of collecting evidence and presenting it to the trier of fact —judge or jury — constitutes a costly, haphazard, and generally ineffective exercise. Complex conflicts require numerous affidavits, depositions, exhibits, and other documents — the collection of which comprises a process surprisingly called "discovery." Discovery is costly, not only in terms of legal fees, but also in terms of time. Deposition sessions, for example, distract busy individuals from their profitable activities. The mere discovery process often sours any present or future professional relations contending parties might have. Once the discovery process ends, the use to which the judicial system puts its product often alarms the parties.

Discovery produces the raw evidence: the lawyers then digest it and regurgitate it through the mouths of witnesses at trial. With their statements mangled out of context at trial, parties understandably worry about the effect upon the judge or jury. Expert testimony, often crucial in commercial litigation, enters the considerations only indirectly. The rules of evidence bar the expert from offering his expertise to the judge or jury in the manner he knows best, for instance a lecture or discussion. Rather, the expert testifies, his testimony effectively directed by one party's attorney and obscured by the other's. The fact that judges and juries should come to irrational deci-

sions on the basis of such a jumble of evidence should not surprise us. What they say of computers applies equally well to juries: "garbage in, garbage out."

The legal system itself recognizes that litigation does not provide quick, equitable, or economical solutions to some conflicts. Recently Chief Justice Warren Burger urged lawyers, legislators, and laymen to devise new methods of dispute resolution. The Chief Justice noted crowded court dockets, time, and expense as the principle reasons for eschewing litigation, though he could have added growing displeasure with some of the substantive results judges and juries have reached. Mr. Burger's remarks underscore a trend away from sole reliance upon litigation for the resolution of private conflicts. The old common-law disfavor of arbitration as "in derogation of the court's jurisdiction" has given way to judicial willingness to enforce arbitration agreements. In passing the United States Arbitration Act, Congress granted its imprimatur to private-tribunal resolution of disputes arising in interstate commerce. Many state legislatures have enacted the Uniform Arbitration Act, the provisions of which allow parties broad latitude in framing their own methods for resolving controversies. But private citizens in commerce and industry should not wait for judges, lawyers, and legislators to devise new avenues for conflict resolution. As "rational economic men" they should seize upon the Chief Justice's invitation and take the lead — by arranging their own commercial relations to provide for the type of dispute-resolution process which best aids their enterprise planning.

When one thinks of the use of private tribunals to resolve disputes, arbitration naturally comes first to mind. Indeed arbitration is the most common method for resolving specialized commercial, industrial, and labor conflicts. The foundation of the arbitration process is a written contract whereby the parties agree to submit present or future disputes to a mutually-acceptable third party for his decision. Through their contract the parties can choose or provide for choosing an individual or individuals who have experience and expertise in their business. The parties' agreement provides that the arbiter's decision will be final and binding upon them, subject only to the limited appeal provided by law. Should the losing party resist the arbiter's decision, the United States Arbitration Act and the Uniform Arbitration Act authorize courts to reduce the decision to a judgment that the winning party can enforce as he would any other court decision. In effect, through their agreement the parties have created a private, specialized court to hear their dispute and have bound themselves to respect its decision.

Arbitration has become a familiar procedure in the construction industry. The American Institute of Architect's "General Conditions of the Contract for Construction" includes clauses providing for arbitration of disputes. The "Construction Industry Arbitration Rules" of the American Arbitration Association provide an orderly procedure for engaging the arbitration process in the resolution of controversies which arise on the project. Though the procedures work well within their limitations, the limitations have come to convert arbitration into a modified form of litigation.

The infirmities of litigation in the process of collecting and presenting evidence also plague arbitration. Like litigation, arbitration generally provides for the selection of the trier of fact substantially after the conflict arises. In a construction dispute, for example, the project may have long been completed when the parties choose the arbiter. At that point, the arbiter cannot view the problem himself, nor can he collect testimony from witnesses while the facts remain fresh in their minds. Like judges, the arbiters receive evidence only after the attorneys resurrect it through the discovery process. And like litigation, arbitration requires an adversary hearing at which the arbiter receives the evidence. The unavailability of the trier of fact at the time of the controversy requires such a lawyer-directed method of collecting and presenting evidence. Moreover, although the rules of evidence for arbitration hearings are far broader than those of courts — they permit for introduction of much hearsay evidence, for example — they effectively retard the arbiters from making a quick decision on what evidence is relevant. In short, arbitration, like litigation, requires a costly and cumbersome procedure for dealing with evidence.

The weaknesses of arbitration become even more alarming if we consider the following controversy, one which might arise on any sizable construction project. During construction, the architect authorizes changes which prove costly to the contractor. The owner disputes the contractor's claims and simultaneously charges that the contractor installed components which were not suitable for the use for which they were intended. Moreover, the owner charges the architect with acting outside the scope of his authority in approving the changes. The contractor, to counter the owner's charges against him, accuses the architect of defective design.

If that sort of dispute sounds familiar, the news that arbitration cannot adequately handle it will be shocking. The fact remains, however, that arbitration cannot deal with such a dispute quickly and economically. Since arbitration depends upon a contractual relationship between parties, the owner, architect, and contractor could not be required to submit to one arbitration proceeding. Although the agreements between the owner and architect and the owner and contractor might each require arbitration of disputes, no contract governs the relationship between the architect and the contractor. The anomaly becomes sharper when we consider that two separate arbitration proceedings might yield inconsistent results.

Arbitration assumes two contending parties, and unless the underlying contract provides otherwise, it cannot deal with third parties. Yet such "third parties" abound in the construction process. One needs little imagination to conjure up a dispute involving the owner, architect, general contractor, subcontractors, and sub-subcontractors and their suppliers. One needs even less imagination to envision the same situation but in which some parties become involved only through the specious allegations of others. The expertise arbitration imports into the considerations could reduce such conflicts to the genuinely interested parties, but the limited third party practice of arbitration invariably dooms such controversies to litigation. Third-party con-

flicts thus result either in multiple arbitration proceedings or in a single court case. Neither alternative seems particularly appealing when time, expense and justice are the principle considerations.

The weaknesses of arbitration need not color all attempts to construct private dispute-resolution procedures. Indeed the same legal flexibility which licenses parties to frame arbitration procedures also provides them the freedom to construct a better or certainly alternative procedure: "mediation-arbitration".

"Mediation-arbitration" is an admittedly clumsy name for this alternative process. "Med-Arb," as we will call it, embraces several principles: comprehensiveness, continuity, technical expertise, and timeliness. Upon these principles rests a system of dispute resolution which imports the virtues of private negotiation and compromise, mediation, and arbitration.

To insure its success, Med-Arb requires care in creating a comprehensive contractual relationship among the parties to a project. As in arbitration, the contract between parties both sets out the method for dispute resolution and guarantees, in most States, the enforceability of its results, through Arbitration Statutes. In a construction project, for example, the owner generally first deals with an architect. The owner-architect contract, therefore, should contain three key provisions: first, a detailed description of the mediation-arbitration procedures; second a requirement that the parties submit all disputes arising on the project to the med-arb procedure; and third, a requirement that the parties bind *all other parties* with whom they deal to submit disputes to the med-arb process. Concern for these important details at the beginning of the project can alleviate unpleasant disputes as the project progresses. This offers opportunities for lawyers to participate in minimizing conflicts, rather than devoting much greater energies to resolving conflicts through the litigation process.

The provision setting out the med-arb procedures includes the heart of the whole process. Unlike arbitration, med-arb requires the appointment of a disinterested third party — the *med-arbiter* — *before* any conflicts arise. In their contract, the owner, architect and general contractor select an individual who has agreed to act as the center of the dispute-resolution process. A panel of med-arbiters may be provided for. Provision can be made to permit later participants to request a change in med-arb selection as a condition prerequisite to their signing a contract. When a conflict arises on the project the immediate availability of the med-arbiter brings striking benefits. The parties themselves remain free to negotiate among themselves without the med-arbiter. Their instincts toward amicable settlement are not foreclosed by the availability of med-arb. On the contrary, the presence of med-arb forecloses threats of litigation and facilitates mitigating losses and costs related to solving the problem. Med-arb thus nurtures the natural instinct of the parties to try to reach accord.

If the parties should fail to reach an agreement on their own, they may invite the med-arbiter to wear his first hat — that is, to *mediate* their dispute. Like the traditional expert mediator, the med-arbiter acts as a buffer

between the parties, persuading them to temper their more extreme demands and informing them of possible grounds of agreement. But since he is more than a traditional mediator, the med-arbiter can act as a more effective spur to agreement. In the first place, he himself knows many of the facts which gave rise to the dispute. The med-arbiter is sensitive to the complexities of the issues due to his knowledge of technical aspects and construction processes. Should he personally be unfamiliar with a particular technical issue, he would call in additional expertise. Moreover, his knowledge leads the parties to give his opinions more weight. In the second place, the fact that the med-arbiter will become an arbiter if the parties fail to agree leads the parties to restrain themselves and to respect the positions of their associates in the enterprise. By remaining honest with the med-arbiter, the parties remain honest with each other and increase the chances of agreement.

If agreement efforts fail, the med-arbiter puts on his second hat, that of arbiter. He becomes, however, an arbiter with a difference. His familiarity with the project from its beginnings, his familiarity with the construction process itself, and his previous experience as a mediator abbreviates the need for the cumbersome presentations of evidence typical in arbitration and litigation hearings. Moreover, in their agreements the parties agree to waive the right to be present when the med-arbiter collects evidence they think relevant. Since he is cognizant of the complexities of the construction process, the med-arbiter knows which parties properly belong in the hearings and those which do not. The fact that all the necessary parties come before him allows the med-arbiter to exercise the expertise for which the parties engaged him: unlike a judge or lay jury, he can reach a substantive decision likelier to strike the parties as fair and equitable. When he does that, the med-arbiter justifies the efforts involved in constructing the system.

The second element of the underlying owner-architect contract requires the parties to submit all disputes which arise on the project to med-arb. This provision creates the jurisdiction of the med-arbiter and is essential to the integrity of the entire process. As in arbitration, courts will "specifically enforce" a med-arb agreement — that is, issue an order directing a party to submit to med-arb — only when the party is an actual signatory to a written med-arb agreement which explicitly covers the controversy in question. While this problem may seem a picky point, courts regard such considerations seriously before they order someone to submit to a private tribunal. In many states a simple statement that the parties agree "to submit any controversy arising on the project" to med-arb will fail to protect the integrity of the process. Suppose a question arises as to whether the parties agreed to submit a peculiar issue to med-arb. Is that itself subject to med-arb? Many courts have said "no", reserving such issues for judicial determination. Obviously such a loophole could undermine the entire med-arb procedure. Fortunately, the insertion of simple language in the underlying contract eliminates the problem altogether. The operative jurisdictional language in the agreement becomes: "the parties agree to submit all controversies arising on the project to mediation-arbitration, including but not limited to, disputes as to

issues properly subject to mediation-arbitration under this agreement." The magic words work, and all conflicts arising on the project *do* remain subject to med-arb.

The third aspect of the owner-architect agreement assures to med-arb what simple arbitration agreements frequently lack: complete third-party practice. The parties to the underlying contract agree to bind all *other* parties with whom they deal on the project to the mediation-arbitration procedures. The owner, for example, would bind the general contractor to the procedures in their individual contract. Similarly, the general contractor would bind subcontractors, subcontractors their sub-subcontractors, and so on. In this respect the insistence upon a written agreement to submit to med-arb by all participants in the project will constitute a departure from traditional industry practice. Subcontractors, for example, may not usually require written contracts of their materialmen. The underlying med-arb agreement could limit third-party practice to sub-subcontractors, however, without seriously limiting the procedure. Alternatively, and indeed preferably, a broad third-party practice including materialmen could educate the industry to the values of med-arb by exposing everyone in the industry to it. The most important consideration, however, remains securing a written agreement to submit to med-arb from those most directly involved in the project. Such an agreement makes the procedure complete, comprehensive, and binding.

Like litigation and arbitration, when mediation-arbitration runs its course, it produces a judgment enforceable at law. But unlike litigation and arbitration, med-arb engages every gradation of conflict resolution: negotiation, mediation, and arbitration. At the first stage is the opportunity to mitigate the losses. Until the very last stage the parties remain the masters of the outcome; they govern the result. Even in the last stage they contribute to the substantive determination, for in choosing an expert as the med-arbiter they have selected a person sensitive to their roles in the project. Vastly different from the roulette wheel of litigation, mediation-arbitration gives parties assistance in planning their enterprise by giving parties some control over the allocation of the costs of some risks. Mediation-arbitration affords a system of conflict resolution the rational economic man can use.