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**ALTERNATIVE DISPUTE RESOLUTION:
NEW APPROACHES FOR THE SURETY**

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Alternative Dispute Resolution: New Approaches for the Surety

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The concept of Alternative Dispute Resolution (ADR) is relatively new to the construction litigation arena. Mediation first appeared with regularity in the construction industry in 1980. By the mid-1980s, construction mediation was endorsed by the Design Professionals Insurance Company (DPIC) and other insurance companies. However, it was not until 1997 that the American Institute of Architects (AIA) finally put a mediation clause in its standard form construction contracts. Since that time, mediation has spawned a cottage industry of private ADR firms around the country. Mediation and arbitration have become an integral part of both the federal and state court systems. The majority of cases in all jurisdictions are referred to mandatory court ordered mediation regardless of the intentions of the parties. This is particularly true with complex construction cases, which are generally avoided by trial judges and become prime candidates for court ordered mediation. Mediation, whether voluntary or court-ordered, is fast becoming, and soon will be, the primary method of resolving construction disputes in the new millennium.¹

The formal ADR process, being a relatively new concept, continues to develop and evolve. ADR has become a topic of particular interest in the last few years, resulting in the development of completely new ADR methods and new approaches to the established techniques. Of course, ADR is a valuable tool for the surety. A hallmark of the ADR process is that the parties retain control over resolution of the dispute—resulting in greater predictability and control over outcomes. Furthermore, any ADR process will ideally increase the efficiency of resolving the dispute and result in cost savings. This paper will address a few of the alternatives currently available to the surety to maximize the benefits of the ADR process.

Contractual ADR Procedures for Completion or Take-Over Agreements

At the time the surety on a construction project is negotiating and entering into a completion agreement or a take-over agreement, the surety has an opportunity to insert additional ADR provisions in an attempt to avoid further claims and streamline the completion of the project. In the usual situation, the project is already in, or very close to, a liquidated damages scenario, with each day of delay adding hundreds of dollars of exposure for the surety. Any actions the surety can take to minimize the commonplace daily disputes that arise on the job site will result in more efficiency and less potential exposure.

One method to deal with such issues is to institute a contractual on-site dispute resolution process. Although there is no particular form required for such a process, a model provision has been reproduced below as an example:

Alternative Dispute Resolution. In an effort to resolve and expedite the resolution of any disputes or issues which may arise regarding the interpretation or application of this Agreement or other matters related thereto, the parties desire to establish a procedure for alternate dispute resolution as set forth herein. All Issues (which are defined as all disputes, differences, issues or questions arising between the parties relating to the construction, price, meaning

or effect of any clause or thing contained in this Agreement, or the rights or liabilities of the parties respectively) shall be subject to resolution as set forth herein between the parties hereto. If the Owner, Surety or Completion Contractor have a dispute regarding any aspect of the other's performance under this Agreement, the parties shall first endeavor to settle any dispute or issue through direct discussions between themselves or between their professional advisors. If the Issue cannot be resolved through direct discussions, within five (5) business days of the date said Issue is raised, the party initiating the Issue (hereinafter referred to as the "Initiating Party") shall refer the Issue to the contract referee (hereinafter referred to as a "Contract Referee") for prompt and timely resolution of the Issue. The initial Contract Referee's name, address and telephone number is _____.

If the initial Contract Referee resigns or subsequently refuses to act as referee as intended, then the Initiating Party shall suggest a replacement referee. A Contract Referee must be a state licensed building inspector, contractor or attorney knowledgeable with regards to commercial construction. No one shall be nominated or act as a Contract Referee who is in any way financially interested in this Agreement or the business affairs of either party. If the other parties are satisfied with the Initiating Party's selection of a replacement Contract Referee, then the parties shall submit their positions to the Contract Referee selected by the Initiating Party for resolution. If the other parties are not satisfied to have the Issue resolved solely by the Contract Referee selected by the Initiating Party, then in such event each other party shall, within 10 days after the appointment of the Contract Referee by the Initiating Party, select its own Contract Referee and shall give notice to the Initiating Party of the proposed Contract Referee's name, address and telephone number. The three Contract Referees shall thereafter proceed with a prompt determination of the Issue. In the event the three Contract Referees so chosen are unable to unanimously agree on the Issue within 10 days after their appointment, then the decision in writing signed by any two of them shall be final and binding on the parties hereto. If the three Contract Referees cannot agree on any Issue requiring a dollar or numerical valuation, then in such event the average of all three Contract Referees' valuations shall be used. If both of the non-Initiating Parties shall refuse or neglect to appoint a Contract Referee within 10 days after the Initiating Party shall have appointed a replacement Contract Referee and served written notice thereof upon the others, then the Contract Referee so appointed by the Initiating Party shall have power to proceed to resolve and determine the Issue as if the Contract Referee were a Contract Referee appointed by all sides hereto for that purpose, and the Contract Referee's decision in writing shall be final and binding upon the parties. If only one of the non-Initiating Parties shall appoint a replacement Contract Referee, then the two replacement Contract Referees shall proceed to resolve and determine the Issues and their decision in writing shall be final and binding upon the parties. The Contract Referee(s) shall also decide the responsibility of the parties hereto for his fees or other actual costs incurred by them in conjunction with the resolution of an Issue. The Contract Referee's decision on the validity or invalidity of such Issue and all Issues associated therewith, including the amount involved, shall be binding on the parties hereto.

The above described clause calls for a comprehensive dispute resolution process that provides for resolution of disputes by a neutral “Contract Referee” who is knowledgeable in the construction industry. The time frames are intentionally designed to be short, in order to expedite the process. Furthermore, there is a comprehensive system for resolving any disputes over the selection of a replacement referee, if necessary. Of course, the exact mechanics of any such procedure are open to negotiation and can be customized to any particular situation.

The potential drawbacks are readily apparent. First, the contractual dispute resolution process must provide for a fast, definite and certain resolution in order to be effective and efficient. Furthermore, any attempt to include such a provision could be intimidating to the contractor at the time of negotiating the agreement, particularly if the contractor has not been previously exposed to such provisions. However, the parties can certainly negotiate the extent and complexity of any such contractual ADR procedure and modify the language accordingly if necessary.

Avoidance of AAA Arbitration Fees

The American Arbitration Association (“AAA”) is a private, non-profit organization that has developed the premier comprehensive, full-service system for administering and servicing commercial arbitration matters. The AAA has even developed special rules for mediation and arbitration in the construction industry.² The easy accessibility of AAA arbitration has led to the incorporation of the standard AAA arbitration clauses in the majority of contracts calling for binding arbitration.

Although the very structured AAA process can be extremely beneficial—i.e., the selection of arbitrators from their panel of neutrals, the scheduling and coordination of hearings, and such—the process has become increasingly expensive. AAA administrative fees are based upon the amount of the claim, and comprise both an initial filing fee (due immediately upon filing) and a case service fee (if the matter progresses to an arbitration hearing). A listing of the current fees, taken from the current AAA commercial arbitration rules,³ is as follows:

These fees will be billed in accordance with the following schedule:

Amount of Claim	Initial Filing Fee	Case Service Fee
Above \$0 to \$10,000	\$500	N/A
Above \$10,000 to \$75,000	\$750	N/A
Above \$75,000 to \$150,000	\$1,250	\$750
Above \$150,000 to \$300,000	\$2,750	\$1,000
Above \$300,000 to \$500,000	\$4,250	\$1,250
Above \$500,000 to \$1,000,000	\$6,000	\$2,000
Above \$1,000,000 to \$7,000,000	\$8,500	\$2,500
Above \$7,000,000 to \$10,000,000	\$13,000	\$3,000
Above \$10,000,000	*	*
No Amount Stated **	\$3,250	\$750

*Contact your local AAA office for fees for claims in excess of \$10 million.

Applying the AAA fee schedule, a claim of slightly over \$500,000 would call for a non-refundable initial filing fee of \$6,000 and a case service fee of \$2,000. These fees are in addition to all hourly or daily fees charged by the arbitrator or arbitrators, which can range from \$150 to over \$300 per hour, plus expenses. Payment of the administrative fees is required for any party asserting a claim, even counterclaimants or third party claimants. Thus, a \$500,001 case that proceeds to a hearing will result in a minimum of \$8,000 in fees, not including the arbitrators' fees and expenses. Even a relatively small \$100,000 case will require a minimum of \$2,000 in administrative fees.

Although the AAA fees may be cost-effective in certain circumstances, sureties and others drafting arbitration provisions should also consider the use of arbitration clauses that call for arbitration under the appropriate state arbitration code, but without invoking the AAA rules and procedures. The state law provisions invoke similar protections and procedures, while allowing the parties more flexibility at a potentially lower cost.

For example, the Florida Arbitration Code, Florida Statutes §682.01 *et. seq.*, provides a procedure for voluntary binding arbitration.⁴ The statute provides a procedural structure not unlike the AAA rules, although with admittedly less detail. The statute provides that a request for voluntary or contractual binding arbitration is filed with the Clerk of the Circuit Court, like civil complaints. The court has the authority to appoint the arbitrators pursuant to the contractually established procedure. The arbitrators are empowered to administer oaths and issue subpoenas. Evidence at the arbitration is specifically taken pursuant to the Florida Evidence Code. The statute further provides that appeal of any arbitration decision is made to the Circuit Court (the Florida trial court) for a review of the record to determine any procedural or evidentiary failures, any misconduct by the arbitrator, or any deprivation of Constitutional rights. However, the doctrine of harmless error does apply in all appeals, and no further review is permitted unless a constitutional issue is raised. A copy of the Florida Arbitration Code has been attached to this paper. However, other states in the northeastern United States have similar arbitration provisions.⁵

It is also worth noting that Florida has recently implemented a voluntary trial resolution procedure. The voluntary trial resolution procedure is set forth in Florida Statutes §44.104, together with the voluntary binding arbitration provisions. Voluntary trial resolution is similar to binding arbitration, but permits only a single private judge and not a panel. The private judge may be any person who has been a member of the Florida Bar for at least five years. Interestingly, however, the final decision may be reduced to a judgment of the Circuit Court and may thereafter be appealed directly to the District Court of Appeal. Factual findings made in the voluntary trial, however, are expressly not subject to review on appeal.

When drafting an arbitration provision, sureties and their counsel should consider the relative costs and advantages of the AAA arbitration process and the applicable state arbitration code, and contract for the most effective method for the given situation. Substantial costs can be saved by avoiding the standard AAA arbitration clauses, but the resulting arbitration will be subject to somewhat less structure. Choosing the appropriate forum for arbitration at the time of contracting is an important component of the overall effectiveness of the contractual ADR process.

Alternative ADR Processes

Everyone in the surety field is familiar with the standard fare of ADR: mediation and arbitration.⁶ Though traditional mediation is often successful, not every mediation results in a complete resolution of the disputed issues, resulting in a lack of finality. If mediation reaches an impasse, the parties usually proceed to arbitration or to trial at significant additional time and expense. Use of alternative mediation and arbitration processes can reduce costs as compared to trial or arbitration. Studies have found that the more resources invested by the parties in attorney fees and costs, the more the parties become convinced that their positions are right and just. As a result, the likelihood of a settlement in traditional mediation is greatly decreased.

However, many variations of mediation and arbitration have developed. Parties to a dispute have many options that enable them to design a dispute resolution process that is most appropriate to their needs on a case by case basis. If a party is involved in the creation of a customized dispute resolution process, it is more likely to settle. By so doing, the parties buy into, or “own” the process, and therefore want to see the process succeed. Designing an ADR process that results in finality of the dispute reduces attorney fees and costs, especially when an unsuccessful mediation results in an arbitration or trial.

The following section of this article will explain some of the more recently developed forms of mediation/ADR, along with their advantages, disadvantages, and ethical issues.⁷

Traditional Mediation

Anyone with litigation experience is familiar with the traditional mediation model. The mediation conference begins with a joint session in which all parties and counsel are present with the mediator. Each side states its public position. When no further progress can be made in the joint session, the mediator meets with each side in private caucus sessions. Documents may be exchanged between counsel and provided to the mediator prior to and during the mediation. Of course, all discussions during the mediation and all documents prepared especially for use during the mediation are protected as confidential settlement negotiations.⁸

During caucus sessions, the mediator meets with each side separately. The discussions are confidential. The mediator cannot reveal what was discussed without first obtaining permission from the other side. The caucus provides an opportunity for the party and its counsel to candidly discuss their view of the case with the mediator. The strengths and weaknesses of each party's position are analyzed, as well as risk factors and costs of going forward to trial. Ideally, the mediation results in the formulation of a settlement agreement that is documented and signed on the spot by all parties and counsel.

Unfortunately, traditional mediation can often lead to an impasse. There are several relatively innovative means of overcoming impasse when the parties do not wish to expend any further resources, or when they feel a need to bring the dispute to an immediate conclusion.

Mediation Variations (Impasse Breakers)

When traditional mediation methods reach an impasse, any of the following impasse breakers can be utilized to further the settlement process and promote a final result. Counsel frequently leave the decision to utilize an impasse breaker until an impasse is actually reached.

Baseball Mediation

In this impasse breaker, each side writes down its final position, how much it will agree to pay or accept, and submits it to the neutral. The neutral then decides for either one or the other position, but no compromise position. The neutral's decision, by prior agreement, takes the form of a binding award or judgment.

Advantages: Baseball mediation provides a strong incentive for both parties to present reasonable positions to the arbitrator. An unreasonable position is unlikely to be accepted by the neutral. This process encourages parties to narrow their positions, resulting in a greater likelihood of settlement even before the neutral actually makes the decision. The parties, through counsel, can exchange their final positions before the neutral makes a decision. This process avoids the potential of leaving the decision in the hands of an arbitrator who could possibly just "split the baby"—a common fear of arbitration participants.

Disadvantages: The parties have lost control of the settlement process and have left the decision in the hands of a third party, the antithesis of the mediation process.

Golf Mediation

On impasse, the neutral writes down what he or she believes to be the fairest, most reasonable, and realistic final result on all claims. The neutral keeps this decision confidential and asks each party to write down their final positions. The party's final position that is closest to that of the neutral becomes the award.

Advantages: The same as Baseball mediation. There is perhaps a greater likelihood of a more reasonable solution with Golf mediation because it is originated by the neutral and not by one of the parties, as in Baseball mediation.

Disadvantages: The same as Baseball mediation—the parties lose control over the process. Also, when the final result is more than just a monetary amount, determining whose position is closest to the neutral's can be a source of disagreement in itself.

Pocket Golf Mediation

On impasse, the neutral formulates a monetary or non-monetary recommendation on all claims. The neutral presents the recommendation to each side in private caucus sessions and explains why each party should accept this recommended final position. If both sides accept, there is a settlement. If only one side accepts, that side does not lose face because the party that does not accept does not know the decision of the other side—i.e., the party that does not accept does not know whether the other party accepted-- retaining a degree of confidentiality in the parties' settlement positions.

Advantages: Pocket Golf mediation is very effective, especially in cases where the parties are far apart in their final positions but want to settle the dispute. A significant advantage to Pocket Golf mediation is that the parties save face by accepting a final position proposed by someone other than the opposing party. For some litigants it is very difficult, if not impossible, to accept an offer proposed by the opposition, even if it makes good sense. In such cases, the party who made the final offer has gained the upper hand. Pocket Golf mediation avoids the interplay of this factor by employing the neutral as the source of the settlement offer.

Disadvantages: Though the parties still maintain control over the settlement process by keeping the option to accept or reject the neutral's recommendation, if all parties do not accept the recommendation, an impasse still results.

Binding Mediation/High-Low Mediation⁹

On impasse, the parties stipulate that the mediator will decide a monetary final position, which becomes an award. Typically, the parties agree in advance that the neutral's final award cannot be higher or lower than the final positions of the parties, or to some other range agreed to by the parties.

Advantages: Sometimes the parties do not wish have a neutral resolve their dispute unless a comfort level is reached for a floor and ceiling of risk. That is, the plaintiff may need to know that it will be awarded no less than the floor amount while the defendant may need to have the assurance that an award against it cannot exceed a pre-agreed ceiling. With this comfort level stipulated to by way of a high-low agreement, some parties are able to go forward with binding mediation.

Disadvantages: The parties have relinquished a large degree of control over the settlement process.

Mediation Combined with Arbitration

The mediation process can also be combined with an arbitration component, so that at some point the dispute resolution process involves the presentation of evidence in an arbitration setting.¹⁰ These processes combine arbitration and mediation conducted by the same neutral. Such alternatives usually require the parties to make some choices and agree to the parameters before the process begins.

Mediation/Arbitration (Med/Arb)

The process starts with traditional mediation. The parties decide in advance that if there is an impasse, the neutral concludes the mediation and begins an arbitration, either immediately or at a pre-determined future date. Once the presentation of evidence has concluded, the neutral, now acting as an arbitrator, renders a binding award. This process works well in conjunction with a high-low agreement, like in High-Low mediation.

Advantages: Med/Arb reduces the time and cost of having a second neutral hear the case in arbitration. The neutral in this process may be in a better position to address the needs

of the parties, thus allowing the neutral more flexibility in rendering an award compared to traditional arbitration or trial.

Disadvantages: There is a possibility that the award could be based partially upon what is told to the neutral during the confidential, private caucus sessions that occur during the mediation phase. Another disadvantage is that the opposition does not have an opportunity to cross-examine during a confidential caucus. Theoretically, both of these disadvantages can be overcome by the neutral issuing a warning at the outset of the Med/Arb. The neutral should state that the award will be based solely on evidence presented during the arbitration phase, during which parties have an opportunity to cross examine the opposition witnesses. Of course, the parties may be inhibited about being totally candid during the private caucus sessions of the mediation phase because they know the neutral could become the decision-making arbitrator. This risk, however, is known to the parties at the outset and can be handled accordingly.

Arbitration/Mediation (Arb/Med)

This form of dispute resolution is sometimes referred to as "Last Chance mediation." This process also combines arbitration and mediation conducted by the same neutral. In this setting, the arbitration is conducted first. The neutral prepares a confidential written award and seals it. The same neutral, now sitting as a mediator, conducts a traditional mediation. If the mediation is successful, the award is destroyed and never revealed. If the mediation is unsuccessful, the award is delivered to the parties.

Advantages: During the mediation phase there is significant pressure on the parties to settle because the neutral has already rendered an award. This pressure is often absent in the traditional mediation context, unless trial is imminent. The parties, however, still retain the power and opportunity to negotiate a settlement. The ethical dilemma of Med/Arb, wherein the award theoretically could be based in part on what is told to the neutral during a mediation private caucus session, is not present because the award in the Arb/Med is rendered before the mediation phase begins.

Disadvantages: Theoretically, the neutral can coerce a settlement, given the imminent ability to deliver an award against one party or the other. This coercion would reduce the parties' level of control and satisfaction in the process. The clear challenge to the neutral is to obtain a truly voluntary settlement, without the appearance of coercion.

This process can be very successful. Studies have shown that parties work much harder at resolving a dispute using Med/Arb or Arb/Med than during traditional mediation. The parties are much more motivated to settle. If there is no settlement, the consequences are immediate: the award is rendered against one party or another.

Mini-Trial

Arb/Med and Med/Arb are most efficiently used in conjunction with a Mini-Trial. There are different types of Mini-Trials, however, the type referred to here calls for the parties to stipulate, before commencement of the Arb/Med or Med/Arb process, to condense the arbitration phase. All aspects of an arbitration or trial can be condensed. Stipulations can be

reached with respect to the amount of time each party is permitted for its case and rebuttal. There can be stipulated limitations as to the number of witnesses, the time spent on direct and cross examination of witnesses, and the number of expert witnesses. Even if a traditional mediation does not result in settlement of all claims, it is possible for the mediator to assist counsel and parties in designing a Mini-Trial process in order to successfully cut litigation costs dramatically.

Cases are more easily and efficiently settled when the appropriate form of ADR is used. The settlement process starts with an agreement on the appropriate dispute resolution process. When the parties are involved in helping decide on the form of the dispute resolution process, they have an investment in its creation and wish to see the process succeed. A small amount of time spent designing an ADR procedure that is well suited to your dispute can be extremely beneficial to the process.

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¹ Gary Morgerman, *Construction Mediation: After 20 Years, Poised at the New Millennium*, available at <http://www.mediate.com/articles/morgerman.cfm>; Deborah S. Griffin, *Retrospective on Alternative Dispute Resolution*, *Construction Lawyer*, Fall 2001, at 46.

² American Arbitration Association Construction Industry Dispute Resolution Procedures (revised 7-1-01).

³ American Arbitration Association Commercial Dispute Resolution Procedures (Including Mediation and Arbitration Rules) as Amended and Effective on September 1, 2000.

⁴ For additional Florida procedure, see Florida Statutes §44.104.

⁵ Alabama: Ala. Code §§ 6-6-1 – 6-6-16 (2001); Georgia: Ga. Code Ann. § 9-9-1, *et seq.* (2001); Florida: § 682.01, *et seq.*, Fla. Stat. (2001); Louisiana: La. Civ. Code Ann. arts. 3099-3132 (West 2001); North Carolina: N.C. Gen. Stat. § 1-567.1, *et seq.* (2001); Tennessee: Tenn. Code Ann. § 29-5-101, *et seq.*

⁶ For a discussion of mediation in the context of complex surety or construction matters, see High E. Reynolds, Jr., *What An Arbiter May Expect of Counsel in a Complex Surety or Construction Arbitration*, TIPS Committee News, Winter 2000-01, at 1.

⁷ Adapted with permission from Paul R. Fisher, *Creative Mediation Design*, available at <http://www.mediate.com/articles/fisher.cfm>.

⁸ Connecticut: CONN. GEN. STAT. §§52-408 to 52-424 (2001); Illinois: 710 ILL. COMP. STAT. 5/1-23 (2001); Massachusetts: MASS. GEN. LAWS ch. 251, §§1-19 (2001); New Jersey: N.J. STAT. ANN. §§2A: 24-1 to 24-11 (West 2001); New York: N.Y. C.P.L.R. §§7501-14 (McKinney 2001); Pennsylvania: 42 PA. CONS. STAT. §§7301-20 (2001); Rhode Island: R.I. GEN. LAWS §§10-3-1 to 10-3-21 (2001).

⁹ Andrea M. Alonso and Kevin G. Faley, *High-Low Agreements: You Can Have Your Cake and Eat It, Too*, *The Brief (TIPS)*, Fall 1999 at 69.

¹⁰ Barry C. Bartel, *Med-Arb as a Distinct Method of Dispute Resolution: History, Analysis, and Potential*, *Willamette Law Review*, Summer 1991; Guittard, *Arbitration/Mediation, When Mediation is Not Enough*, *American Bar Association ADR Newsletter*, Summer 1993.