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LOCAL FINANCE NOTICE

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Alternative Dispute Resolution in Public Construction Contracts: It's Always Good to Talk

P.L. 1997, c. 371, (N.J.S.A. 40A:11-50) the Alternative Dispute Resolution (ADR) in Public Construction Contracts statute, was enacted to provide an alternative to litigation to resolve disputes involving public construction contracts. As of January 19, 1998, its effective date, all construction contract documents for public construction projects entered into in accordance with the Local Public Contracts Law (N.J.S.A. 40A:11-1 et seq.) must have provisions requiring contract disputes be submitted to ADR prior to being referred to a court for adjudication.

This Local Finance Notice adds to information that has been published in a number of different local government publications. It is intended to provide local unit officials with general guidance on implementing the provisions of the law. Careful consideration should be given to provisions that are selected and advice from legal, architectural, and engineering professionals should be obtained as well.

ADR Generally

The law defines a "construction contract" as "a contract involving construction, or a contract related thereto concerning architecture, engineering or construction management." However, the law is clear that the ADR provisions **do not** apply to disputes concerning bid solicitation or the award process, or to the formation of contracts or subcontracts entered into under the Local Public Contracts Law.

The law does not mandate the use of any particular form of ADR, and refers to mediation, nonbinding arbitration, or binding arbitration as examples. There is nothing in the statute to prevent a local contracting unit from specifying some other form of ADR, such as fact finding, if it so desires. The statute requires that **some** form of ADR be used before the local contracting unit has recourse to a lawsuit, except it may seek injunctive or declaratory relief in court **at any time**, before, during, or after an ADR proceeding.

ADR must be performed according to "industry standards." These "industry standards" are the rules and standard practices of ADR organizations, such as the American Arbitration Association (AAA), National Arbitration and Mediation (NAM), or the Judicial Arbitration and Mediation Service (JAMS). For example, the AAA has its *Construction Industry Dispute Resolution Procedures*, which contain AAA's rules for construction industry mediations and arbitrations. However, there is **no statutory requirement** that any particular organization of arbitrators (neutrals) be used to conduct the ADR procedure.

In some cases, local contracting units may consider using the American Institute of Architects' AIA Document A201-1997: *General Conditions of the Contract for Construction,* as an ADR alternative. This calls for contract disputes to first be submitted to the architect of record for a decision. After an initial decision by the architect or the passage of 30 days after the submission of a claim to the architect without a decision, the dispute is subject to mediation. Under the AIA document, a dispute can be submitted for binding arbitration or litigation only after it has been through mediation.

AIA Document A201-1997 is simply the American Institute of Architects' view of how construction contract disputes should be settled. However, the AIA's view **is not** binding on local contracting units. Local contracting units are not required to submit a contract dispute to the architect for a decision unless they agree to that step in the contract. The new law requires that there be some type of ADR process before the contract dispute is allowed to proceed to the courts.

Local contracting units may decide to include in their ADR provisions a requirement that neutrals demonstrate they have knowledge of New Jersey local government contracting laws. The reason for this is so that a neutral does not hand down an award that is contrary to New Jersey local government contracting laws. Unfortunately, for all forms of ADR there is a shortage of neutrals trained in public construction contract arbitrations and New Jersey local government contracting laws. Again, please remember, nothing in the statute prevents a contracting unit from seeking injunctive or declaratory relief in court **at any time**.

An important and innovative aspect of the ADR statute is that it allows, upon the demand of a contracting party, the joinder (i.e., the bringing into the ADR action) of third parties (such as an architect, engineer, or sub-contractor) who are not parties to the contract in dispute whenever that dispute involves more than one contract, or more than one dispute of a similar nature under a contract or related construction contracts. However, the neutral may rule that such joinder is inappropriate.

Types of ADR

The three primary forms of ADR suggested by the statute are discussed below. It is important to remember that while these are general definitions, it is always the terms of the construction contract ADR provisions which set definitions and govern the process.

Mediation is a voluntary procedure through which parties meet with one or more neutrals who attempt to facilitate a resolution of a dispute between the parties themselves. A mediator (neutral) has no power to impose a resolution upon the parties. The process simply brings in a mediator or a three member panel in an attempt to crystallize the issues and suggest a variety of solutions. Mediation can take place in a very formal proceeding under the auspices of any of a number of organizations (e.g., the AAA or JAMS), or through a more informal mechanism, if the local contracting unit so wishes. It has been said that mediation is all pros and no cons:

- Most people familiar with different dispute resolution techniques believe that there are no real drawbacks and only significant benefits to mediating disputes.
- Mediation has a high success rate (60 percent plus).
- Mediation allows an opportunity to have a mediator explore and develop ways of resolving a dispute without unnecessarily compromising either party's position.
- Mediation allows a mediator to engage in "shuttle diplomacy" between two parties, which is one of the greatest assets of this particular ADR method.

Nonbinding arbitration is a more formal process through which disputes are preliminarily resolved by an arbitrator or a panel of arbitrators who hear the presentations of each party, ask questions, obtain documents, elicit testimony, and arrive at conclusions for the disputes placed before them. Nonbinding arbitration has two advantages over binding arbitration:

- **The decision is not binding on the parties**, but gives the parties an idea of how a disinterested third party views their respective positions.
- Since neither party is bound by a decision, either party can pursue alternative remedies that are not prohibited by their contract.

Binding arbitration is a formal procedure which is similar to non-binding arbitration, except that the decision of an arbitrator(s) is binding on the parties. The binding arbitration provisions of a contract and the New Jersey Arbitration Act (N.J.S.A. 2A:24-1 et seq.) both generally prohibit appeals of the arbitration award. Appeals from binding arbitration **are not** permitted except in cases of fraud, misconduct, or other highly unusual circumstances. Appeals of binding arbitration decisions are usually unsuccessful. In no event, can an arbitrator hand down a binding award that is contrary to New Jersey governmental contracting law, anymore than a judge can.

In theory, binding arbitration has some advantages for the local contracting unit:

- Confidentiality can be maintained and publicity avoided where confidential or sensitive information may be involved.
- Arbitrators may be drawn from an industry pool and often possess specialized knowledge and expertise to help them understand a dispute and its underlying aspects.
- Proceedings can be streamlined and complex rules of evidence and procedure can be avoided. However, some observers contend that binding arbitration actually lends itself to the involved proceedings and complex rules it purports to avoid.
- Pre-hearing discovery, with its significant costs and delays, can be largely eliminated or limited.
- Disputes can usually (but not always) be resolved more quickly and economically than in litigation.
- Unlike litigation, the parties control the process and may accommodate their specific scheduling requirements.

But binding arbitration also has some disadvantages:

- Generally, an arbitration award is final and the right to appeal or challenge that decision is limited.
- Sometimes, it is perceived that arbitrators are inclined to "split the difference" and render compromise awards which may not fairly reflect the evidence presented.
- Unless specifically required by the parties or the contract, arbitrators typically do not make specific findings of fact or provide written opinions setting forth the reasons for their award.

Another form of ADR that can be used, but was not mentioned in N.J.S.A. 40A:11-50, is fact finding. There are three types of fact finding: 1) neutral fact finding, where a neutral party sets out to establish the facts of the dispute; 2) expert fact finding, where the facts are determined by a neutral who is an expert in the matter

in dispute; and 3) joint fact finding, where the parties to the dispute each appoint neutrals to determine the facts of the dispute.

To conclude, local contracting units must use an ADR process before considering a lawsuit. The hope is that ADR will prevent the need for a lawsuit. ADR can take the "talking" form of mediation or non-binding arbitration, and then proceed to a lawsuit, if the contracting unit is not satisfied with the results. So the rule

is: talk first, lawsuit second. And as one prominent attorney for local contracting units put it: "It's always good to talk."

Contracting units are urged to carefully discuss their ADR options with their attorney and construction professionals as to which option works best for them. Recipients of this Notice are asked to share it with the appropriate administrative, engineering, and procurement personnel in their organization.

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