

RECENT DEVELOPMENTS IN  
ARBITRATION LAW  
AND IMPACT ON CONSTRUCTION  
CASES

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# 1. General Trends

- In business cases both the US Supreme Court and California Supreme Court continue to articulate a strong policy favoring arbitration of disputes.
- In consumer cases, such as employment and securities cases, California appellate courts scrutinize the terms of the arbitration agreement to determine if it is enforceable.

## 2. The Broad And Pre-Emptive Effect of the Federal Arbitration Act

- In transactions involving interstate commerce, the Federal Arbitration Act (“FAA”) applies, and may preempt the California Statute (“State Act”).
- The scope of the FAA’s applicability is as broad as the Commerce Clause. *Citizens Bank v. Alafabco*, 539 U.S.52 (2003) (Restructuring of loan with construction company), *Allied Bruce Terminix Co. v. Dobson*, 513 U.S. 265 (1995) (extermination contract on home).

## 2. Federal Arbitration Act (cont'd)

- The FAA is substantive federal law and applies in both Federal and State Courts. *Marmet Health Care Center, Inc. v. Brown*, 132 SCt. 1201 (2012); *Buckeye Check Cashing, Inc. v. Cardegna*, 546 US 440 (2006).
- State Laws which conflict with the FAA, directly or indirectly, are pre-empted by the FAA. *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

### 3. FAA's Impact on Construction

- In General: Most construction contracts “affect commerce” in some respect, such as use of out-of-state vendors. If the contract has an arbitration provision it may be subject to the FAA.
- Construction Defects: FAA pre-empts a California Law allowing a purchaser of real property to file a lawsuit for construction and design defects, notwithstanding an agreement to arbitrate. *Shepard v. Edward Mackay Enterprises, Inc.*, 148 Cal.App.4<sup>th</sup> 1092 (2007) (FAA pre-empts CCP§1098.7).

### 3. FAA's Impact on Construction – Cont'd.

- Unlike the State Act (CCP§ 1281.3) the FAA makes no provision for consolidation of separate arbitration proceedings. Query whether such can be ordered in a case controlled by the FAA? See also AAA Construction Industry Rule R-7.

## 4. Arbitrability: Who decides – Court or Arbitrator?

- The U.S. Supreme Court seems to distinguish the issue of: 1) whether the parties have made an agreement to arbitrate; from 2) the issue of whether or not the arbitration agreement is valid or enforceable.
- If the issue is the existence of an agreement, then the Court must decide whether the parties have agreed to arbitrate unless there is a “clear and unmistakable intent” to submit that issue to the arbitrator. *First Options of Chicago Inc. v. Kaplan*, 514 U.S. 938 (1995) (Court must decide if individual owners of company which agreed to arbitrate are also bound to arbitrate).

## 4. Arbitrability (Cont'd.)

- Likewise if the issue is fraud in the inducement of the arbitration agreement itself (not the contract as a whole) the Court should decide the issue in the first instance. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (Arbitration clause is severable from other contract provisions and may be enforced by a Court);
- Compare with *Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440 (2006) (claim that contract is void in that alleged usurious interest rates violate state law is issue for the arbitrator, not Court).



## 4. Arbitrability (Cont'd).

- However if the parties expressly agreed to submit the issue of enforceability of the arbitration agreement to the arbitrator then the issue will be decided by the arbitrator. *Rent-A-Center West, Inc. v. Jackson*, 130 S. Ct. 2772 (2010) (5-4) (Delegation to arbitrator of enforceability issue in arbitration agreement is sustained despite claim that agreement is unconscionable under state law.)

## 5. Arbitrability – Impact on Construction

- EPC Contract: EPC Contractor's statute of limitations defense to Owner's breach and negligence claims must be decided by arbitrator, not court. Under the FAA a broad ICC arbitration clause trumped a state law which reserved the limitations issue for determination by the Court. *Bechtel Do Brasil, Etc. v. UEG, Araucaria Ltd.*, 638 Fed. 150 (2011).

## 5. Arbitrability – Impacts (Cont'd).

- Design Build Contract: Owner claimed that design build contract with AAA arbitration clause was illegal because contractor lacked an engineering license, and filed lawsuit in state court. Appellate court held that FAA applied and that AAA Construction Industry Rule R-9 showed a “clear and unmistakable intent” of parties to submit issues of legality and enforceability to arbitrator, not the Court. *HPD, LLC v. Tetra Technologies, Inc.*, 2012 Ark 408, 2012 WL 5360968 (2012) (Design-build contract for chemical plant)

## 5. Arbitrability – Impacts (Cont'd).

- Architect Contract: Architect's motion for preliminary injunction prohibiting arbitration and summary judgment on statute of limitations defense is denied where Owner claimed design defects and contract incorporated AAA Rules. Under AAA Construction Industry Rule R-9, the arbitrator has the power to determine issues of arbitrability. *Gwathmey Siegel Kaufman & Assoc. Architects, LLC v. Rales*, 898 F.Supp.2d 610 (S.D.N.Y. 2012) (citing *First Options*, supra.)

## 5. Arbitrability – Impacts (Cont'd).

- Homeowners Association: Where a condominium developer recorded CC&R's which required arbitration of construction defect claims and waived jury trial, and the CC&R's were incorporated in the unit owner's purchase contracts, the Homeowners' Association ("HOA") was bound to arbitration although it was not a signatory to the clause; and the clause was not unconscionable. *Pinnacle Museum Tower Ass'n v. Pinnacle Market Development (U.S.) LLC*, 55 Cal.4<sup>th</sup> 223 (2012) (6-1).

## 5. Arbitrability – Impacts (Cont'd).

- The California Supreme Court relied primarily on interpretation of the Davis Stirling Common Interest Development Act in reaching its conclusion. (Civil Code §1350 *et. seq.*)
- But the Court further stated, in distinguishing a prior appellate case, that the FAA would pre-empt state laws that discriminate against arbitration: “It stands to reason that the FAA would preempt state decisional law singling out an arbitration clause as the only term in a recorded declaration that may not be regarded as contractual in nature”.

## 6. Judicial Review of Award and Grounds for Vacature

- In general judicial review of an arbitration award is limited to the specific narrow grounds set forth in the FAA and State Act. 9 U.S. §§10-11; CCP §1286.2.
- The parties cannot enlarge the statutory grounds by contract. *Hall Street Assoc. v. Mattel, Inc.*, 552 U.S. 576 (2008) (Statutory grounds for vacature in FAA are exclusive).

## 6. Judicial Review of Award and Grounds for Vacature (Cont'd.)

- An arbitrator's authority includes resolution of all contested issues of law and fact. An award cannot ordinarily be vacated because an arbitrator made an erroneous conclusion of law or finding of fact. *Gueyffier v. Ann Summers Ltd.*, 43 Cal.4<sup>th</sup> 1179 (2008). *Revere Copper & Brass Inc. v. Overseas Private Investment Corp.*, 628 F.2d 81 (D.C.Cir.), *cert. denied* 446 U.S. 983 (1980).



# 7. Judicial Review and Vacature

## -- Construction Impacts

- Part of Contract is Illegal: Arbitrators may exceed their authority if the award violates an “explicit legislative expression of public policy”, even if that illegality is directed toward only a part of the contract, and not the contract as a whole. Business & Professions Code §7031(b) represents such a public policy. *Ahdout v. Hekmatjah*, 213 Cal.App.4<sup>th</sup> 21 (2013) (Provision in development contract required contractor to be licensed).

# 7. Judicial Review and Vacature

## -- Construction Impacts (Cont'd).

- Entire contract is illegal: The court can review and vacate an award in favor of the contractor because arbitrator exceeded his powers where the contractor was not properly licensed at all times during performance of the contract. The arbitrator exceeded his powers because the entire transaction, including the arbitration provision, was illegal and void. *Loving & Evans v. Blick*, 33 Cal.2d 603 (1949)(4-3) (One of the two contractors in partnership was licensed, but not partnership); Accord: *C- Sculptures, LLC v.*

# 7. Judicial Review and Vacature

## -- Construction Impacts (Cont'd).

*Brown*, 742 S.E.2d 359 (S.C. 2013); Contra: *Nussbaum v. Kimberly Timbers Ltd.*, 271 Conn. 65 (2004); *Erin Const. & Develop. Co. Inc. v. Meltzer*, 873 NYS 2d 315 (2009); *Davidson v. Hensen*, 135 Wash.2d 112 (1998).

- Query whether an objection to the arbitrator's authority based on non-licensure must be raised before the hearings commence in order to avoid an argument that the objection is waived?

# 7. Judicial Review and Vacature

## -- Construction Impacts (Cont'd).

- AAA Construction Industry Rule R-9(c) requires objections to jurisdiction to be made no later than the filing of an answer to the Claim or counterclaim giving rise to the objection.

# 8. Questions