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Featured Articles

The Changing Face of Arbitration

by Alexander G. Blue

I. Arbitration -- A Brief Overview

Arbitration as a dispute resolution alternative has existed for centuries. In its early days, arbitration was primarily limited to maritime and insurance disputes. In 1925 Congress passed the Federal Arbitration Act ("FAA") providing continuity and predictability for the structure and management of arbitration. The arbitration process became more prevalent throughout the twentieth century. In the past thirty years arbitration clauses have permeated contracts by product manufacturers, homebuilders, credit card companies, insurers, employers, car dealers, landlords and others that insist arbitration offers a lower cost, more rapid and less adversarial forum for conflict resolution than litigation. Additionally, proponents argue arbitration provides an environment in which complex and/or technical issues can be determined by well-qualified experts rather than by a panel of individuals who are generally laymen.

Many consumers and employees dislike the arbitration process because of the inherent, unequal bargaining power of the parties and a perceived arbitrator bias towards business. Other arbitration opponents complain about the bar of class-action suits, the potential usurpation of the roles of the judicial and legislative branches of government and society's inability to make good policy decisions going forward because of a lack of information regarding arbitration rulings and awards.

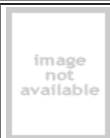
Over the last five years, as the membership of the Congress of the United States changed and became more populist, the call for reform of or relief from the arbitration process has intensified. Major reform initiatives in both houses of Congress seek to institute significant, substantive changes to the Federal Arbitration Act with the intent of limiting the scope and application of arbitration in favor of returning disputes to the courthouse for determination.

II. Proposed Changes to the Federal Arbitration

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Act

The Arbitration Fairness Act of 2009 is currently pending in House and Senate sub-committees of the Congress of the United States.^[1] These bills propose significant amendments to Section 2 of the FAA and would impact: (A) the validity of pre-dispute agreements to arbitrate; (B) whether a Court or Arbitrator decides the enforceability of an agreement to arbitrate; and, (C) what law applies to particular arbitration agreements.

A. Pre-Dispute Arbitration Agreements

Invalidated: If passed, pre-dispute arbitration agreements that required parties to arbitrate: 1) employment, consumer or franchise disputes, or 2) disputes arising under any statute intended to protect civil rights, would be invalidated.^[2] The scope of the Act is intended to be very broad as it seeks to restructure the dispute resolution landscape in favor of litigation.

The Act broadly defines **employment dispute** as "a dispute between an employer and employee arising out of the relationship of employer and employee as defined by the Fair Labor Standards Act."^[3] Similar in breadth, the definition of **consumer dispute** would encompass disputes between a person (other than an organization) who seeks or acquires real or personal property, services, money, or credit money, or credit for personal, family, or household purposes and the seller or provider of such property, services, money or credit.^[4] **Franchise dispute** is likewise broadly defined.^[5]

The intent and practical effect of the proposed legislation will be to eliminate arbitration as an alternative to litigation for employee claims and claims brought by clients or customers. Arbitration of these claims will only be allowed if the parties agree to arbitrate **after the dispute arises**.

B: Court Decides Enforceability: A Court, not the arbitrator, will decide the validity and enforceability of any agreement to arbitrate.^[6] This provision aims to eliminate any bias or perceived conflict of interest the arbitrator may have in determining which forum is appropriate for resolution of particular disputes. Many states, including Texas, have a similar provision in their respective arbitration acts.^[7] However, the Texas Act allows parties to agree to have an arbitrator decide questions regarding the validity and enforceability of an arbitration agreement.^[8] The proposed federal law would not provide the contracting parties such flexibility.

C: Federal Law Determines Applicability of FAA: The proposed law dictates that federal law

would determine whether the FAA applies to a particular arbitration agreement.^[9] This provision will ensure that the parties cannot defeat the newly proposed provisions by subjecting their arbitration agreements to state law.

These bills remain in Committee and probably will see little, if any, action the remainder of 2010. This is the third consecutive Congress in which these or substantially similar changes to the FAA have been proposed. As 2010 is an election year, it is unlikely any form of these changes will be codified before 2011. Regardless, the proposed changes are already influencing government and corporate policy decisions across the nation.

III. Effects of Proposed Changes and the Future of Arbitration

In the past year, the proposed changes to the FAA have impacted the actions and policies of State Attorneys General, multi-national corporations and major players in the dispute resolution field such as the American Arbitration Association (AAA) and the National Arbitration Forum (NAF). The following are examples of the broad impact of the proposed changes to the FAA.

A. State Attorneys General: In July 2009, the Attorney General for the State of Minnesota sued the NAF, alleging it unfairly favored credit card companies in the cases it handled, had conflicts of interest with the credit card industry and had financial ties to the debt-collection industry.^[10] A settlement was quickly reached. As part of the settlement, the NAF agreed to cease administering **ALL** consumer arbitration disputes.

B. Multi-National Corporations: Banks, insurers, home builders, product manufacturers and other large corporate interests have heard the drum beat of reform loud and clear. Seemingly overnight these entities have greatly reduced or ceased attempts to have consumers sign away their rights to litigate in favor of arbitration. As a matter of policy, J.P. Morgan Chase no longer submits credit card disputes to arbitration and is currently re-evaluating the inclusion of arbitration provisions in its consumer contracts.^[11]

Additionally, on August 14, 2009, Bank of America dropped its requirement that consumers settle disputes through arbitration.^[12] Bank of America also withdrew the mandatory arbitration language from the "Terms & Conditions" of its credit cardholder agreements. According to a company spokesman, this decision was at least partially due to the perception that such arbitration agreements are unfair to consumers.

C. AAA and NAF: On July 21, 2009 the AAA and NAF announced they will no longer participate in consumer disputes with credit card companies.^[13] Neither arbitration service provider is viewed by the public as a fair facilitator for the resolution of disputes. As a result, both institutions have launched internal reviews of their procedures for handling different types of disputes in an attempt to identify areas that can be improved in order to regain the confidence of the public at large.

IV. Conclusion:

The prospect of proposed changes to the FAA becoming law lingers. In response, corporations, the AAA, and the NAF have voluntarily revised policies concerning arbitration. These restrictions on the scope and enforceability of arbitration agreements will continue to result in fewer disputes being resolved through the arbitration process in the future. At a time when the courts are overburdened and increasingly underfunded, restricting or eliminating the use of arbitration may not prove as popular in practice as it seemingly has in theory.

Alexander G. Blue is a *2009 Texas Monthly Rising Star* who defends design professionals in complex construction disputes as a senior associate at Macdonald Devin, PC in Dallas, Texas.

[1] The Arbitration Fairness Act of 2009 is H.R. 1020 and S. 931.

[2] HR 1020, 111th Congress, Sections 4(4)(b)(1) & 4(4)(b)(2).

[3] H.R. 1020, 111th Congress

[4] *Id.*

[5] *Id.*

[6] HR 1020, 111th Congress, Sections 4(4)(b)(1) & 4(4)(b)(2).

[7] Chapter 171 of the Texas Civil Practice & Remedies Code.

[8] *Id.*

[9] H.R. 1020, 111th Congress, Section 4(c).

[10] Dallas Morning News, August 31, 2009: *Arbitration on the Ropes*, By Pamela Yip

[11] *Id.*

[12] *Id.*

[13] Pursuant to the NAF's settlement with the Minnesota Attorney General, the NAF will no longer arbitrate consumer-related disputes, of any nature.