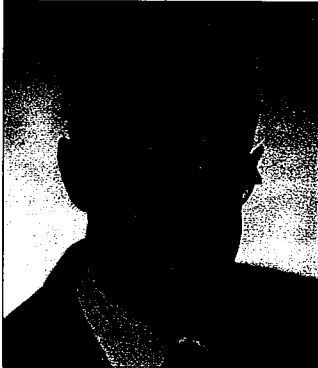


Arbitration—Waiver by Judicial Proceedings and the Effect of the Construction Industry Arbitration Rules of the American Arbitration Association

Robert M. Wright and Howard D. Venzie, Jr.†*



Robert M. Wright



Howard D. Venzie, Jr.

It is assumed by many lawyers that once a suit is filed, responded to on the merits, and discovery or other pre-trial proceedings are underway, any right to arbitrate under an existing arbitration agreement has been waived. In many cases an attorney for a party, after litigation has been instituted and some pre-trial proceedings have occurred, may decide that arbitration would be the better forum. He may also mistakenly assume that the right to arbitrate has been lost. This is not necessarily the case. In determining whether the right to arbitrate has been lost by participating in judicial proceedings, it is of extreme importance whether federal or state law is applicable and if the Construction Industry Rules of the American Arbitration Association have been incorporated into the agreement to arbitrate.

Applicability of State or Federal Law

Most of the cases holding that the commencement of a suit, the filing of answering papers or participation in pre-trial proceedings such as discovery without a demand for arbitration waives the right to arbitrate are cases decided under state law.¹ These cases follow the common law contract theory that participation in litigation is an intentional relinquishment of a known right because judicial proceedings are inconsistent with the right to arbitrate. Cases decided under the Federal Arbitration Act² represent the modern view that the mere commencement of a suit or responding to a suit or other participation in judicial proceedings short of trial on the merits does not waive the right to arbitrate absent prejudice to

the party resisting arbitration. Under Section 3 of the federal act, it is only where a party is "in default in proceeding with arbitration" that a stay of litigation will not be granted to allow arbitration. There is a strong federal policy in favor of arbitration and "default" is not lightly inferred. It is only where actual prejudice results from "substantially invoking the litigation machinery" that the federal courts will find a waiver.³ Therefore, the filing of a suit, answering a suit, filing counterclaims, third-party complaints, and participating in discovery does not necessarily waive the right to arbitration absent a showing of specific prejudice.⁴

Obviously, if you are in a jurisdiction where the state law is extremely strict on waiver, the first step is to see if federal law applies as there is an excellent chance in the average construction dispute that it does. Federal law applies whenever the contract involves interstate commerce.⁵ Section 1 of the Federal Arbitration Act defines "commerce" as commerce among the several states or with foreign nations. The Supreme Court has rejected any narrow construction of "commerce" as used in Section 1.⁶ Therefore, if the construction contract involves the payment of funds between states, transportation of goods between states or any other activity reasonably defined as interstate commerce the Federal Arbitration Act will apply.⁷ In this connection, the Supreme Court has made it clear that the Act evidences a strong federal policy favoring arbitration which creates a body of federal substantive law of arbitrability applicable to any arbitration agreement within the coverage of the act.⁸ The Court has further stated that the Act binds the state courts as well as federal courts requiring state courts to grant stays of litigation under the federal act.⁹ State courts are required to liberally read the arbitration agreement and to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible notwithstanding any state, statutory, substantive or procedural policies to the contrary.¹⁰ Therefore, even if the litigation is in state court in a jurisdiction where waiver is found by the mere filing or answering of a suit, counsel seeking arbitration is armed with the strongest possible mandate to the trial judge to apply federal law where the transaction involves interstate commerce as defined in Section 1 of the Federal Arbitration Act.

Ancillary Proceedings

Even if state law is applicable in a restrictive jurisdiction, waiver should not be found where the proceedings that have been instituted or responded to are ancillary to the right to arbitration. Examples of this are mechan-

*Partner, Whiteford, Taylor & Preston, Baltimore, Maryland. Member, American Arbitration Association's Panel of Arbitrators for Construction Industry Disputes.

†Partner, Venzie, Phillips & Warshawer, Philadelphia, Pennsylvania. Member, American Arbitration Association's Panel of Arbitrators for Construction Industry Disputes.

ic's lien actions, attachments before judgments, equitable lien actions, requests for preliminary injunctions, or actions to recover upon surety bonds. All of these actions are in reality ancillary to and in aid of the right to arbitrate the underlying claims and disputes and should not be viewed as a judicial waiver. While some courts have viewed participation in such ancillary proceedings as constituting a waiver,¹¹ these decisions are incorrect. There is no inconsistency between involving an ancillary remedy which is not available in arbitration and which is not inconsistent with arbitrating underlying claims and disputes on the merits. In all of these proceedings, the judicial action can be instituted with a stay of proceedings while the merits of the dispute are being arbitrated. The parties may return to court for a final order and enforcement of the ancillary remedy.

A good example of this is the accepted practice under the Maryland Mechanic's Lien Law. Maryland's law requires a preliminary hearing within thirty days after filing the request for a mechanic's lien. At this hearing, the trial judge determines whether there is probable cause for the institution of a lien. If he finds probable cause, an interlocutory lien is established upon the property. Trial must be held within six months to determine the merits of the controversy and the filing of a final lien order or, alternatively, dismissing the interlocutory lien and ruling in favor of the property owner. The practice in the trial courts where there is an arbitration agreement

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is for the lien petition to be filed and the preliminary hearing held. If an interlocutory lien is granted, then proceedings are stayed pending arbitration under the arbitration clause of the contract. The parties then return to court with the results of the arbitration submitted to the court for final action.¹² The same procedure can be used where suit is filed requesting injunctive relief.

After a hearing has been held and a court has made its decision on whether or not to grant a preliminary injunction, there is no reason why the matter cannot then be stayed and referred to arbitration on the merits. The parties can then return to court where the court, upon the basis of the arbitrator's decision, determines whether a permanent injunction is appropriate.¹³ Cases which

hold that the filing of ancillary proceedings, without more, waive the right to arbitrate are simply mindless applications of a rubric. Under what theory is the signing of a construction contract with an arbitration clause an implied waiver of a right to establish a mechanic's lien or to secure injunctive relief or to take any other action ancillary to an arbitrator's determination on the merits? Such remedies are available to preserve and protect a party's substantive rights which are being determined through arbitration of the underlying claim(s) or dispute(s). Obviously, if the situation is looked at in this light, few courts would hold that there is any such implied waiver since contractual waivers of that nature are normally required to be clear and explicit. It is therefore suggested that even in cases where the Federal Arbitration Act does not apply, and the jurisdiction strictly applies the waiver theory, counsel should be successful in being able to invoke ancillary remedies while still expressly preserving the right to arbitrate the dispute on the merits.

Effect of the Construction Industry Arbitration Rules of the American Arbitration Association

Even where non-ancillary judicial proceedings have been taken in a state with a restrictive view of arbitration waiver under circumstances where the federal act does not apply, waiver may not be found if the arbitration agreement incorporates or requires the parties to arbitrate in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association. Very few cases have examined the impact of these rules on the question of waiver or, for that matter, on other aspects of arbitration. Presumably, this is because counsel have either not been aware of the rules or have not been aware that they have impact upon the issues being determined by the court. On the issue of waiver, the rules provide a strong weapon for counsel seeking arbitration. The standard AAA arbitration clause provides that disputes shall be decided by arbitration "in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then obtaining unless the parties mutually agree otherwise." Rule 1 of the Construction Industry Rules provides as follows:

The parties shall be deemed to have made these Rules a part of their arbitration agreement whenever they have provided for arbitration under the Construction Industry Arbitration Rules. These Rules and any amendment thereof shall apply in the form obtaining at the time the arbitration is initiated.

More importantly, Rule 47 provides:

No judicial proceedings by a party relating to the subject matter of the arbitration shall be deemed a waiver of the party's right to arbitrate.¹⁴

As stated, very few courts have considered the effect of the rules on this issue.¹⁵ The jurisdiction with the most well developed case law under Rule 47 is Illinois. The

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26. J'Aire Corp. v. Gregory, 24 Cal. 3d 799, 598 P.2d 60 (1979).
27. Abner Corp. v. City Roofing and Sheetmetal Co., 73 N.C. App. 470, 326 S.E.2d 632 (1985).
28. Alley v. Courtney, 448 So. 2d 858 (La. App), *cert. denied*, 450 So.2d 360 (La. 1984).
29. Oates v. Jag, Inc., 314 N.C. 276, 333 S.E.2d 222 (1985).
30. Browning v. Maurice B. Levien & Co., P.C., 44 N.C. App. 701, 262 S.E.2d 355 (1980).
31. A.R. Moyer, Inc. v. Graham, 285 So. 2d 397 (Fla. 1973), *overruled*, 1984.
32. *Id.*
33. E.C. Ernst, Inc. v. Manhattan Constr. Co., 551 F.2d 1026 (5th Cir. 1977), *cert. denied sub nom.* Providence Hosp. v. Manhattan Constr. Co., 434 U.S. 1067 (1978) (applying Alabama law); United States v. Rogers & Rogers, 161 F. Supp. 132 (D. Cal. 1958); Gurtler, Hebert & Co. v. Weyland Mach. Shop, Inc., 405 So. 2d 660 (La. App. 1981), *cert. denied*, 410 So. 2d 1130; Conforti & Eisele, Inc. v. John C. Morris Assoc., 175 N.J. Super. 341, 418 A.2d 1290 (1980), *aff'd*, 489 A.2d 1233 (1985); Schoffner Indus., Inc. v. W.B. Lloyd Constr. Co., 42 N.C. App. 259, 257 S.E.2d 50 (La. 1982), *cert. denied*; A.E. Investment Corp. v. Link Builders, Inc., 62 Wisc. 2d 479, 214 N.W. 2d 764 (1974); Owen v. Dodd, 431 F. Supp. 1239 (N.D. Miss. 1977); Detweiler Bros. Inc. v. John Graham & Co., 412 F. Supp. 416 (E.D. Wash. 1976); Gilbane Bldg. Co. v. Nemours Foundation, 606 F. Supp. 995, 105 (D. Del. 1985); Berkel & Co. Contractors, Inc. v. Providence Hosp., 454 So.2d 496 (Ala. 1984); Donnelly Constr. Co. v. Oberg/Hunt/Gilleland, 139 Ariz. 194, 677 P.2d 1292 (1984); Quail Hollow East Condominium Assoc. v. Donald J. Scholz Co., 47 N.C. App. 518, 268 S.E.2d 12 (1980); Cosmopolitan Homes, Inc. v. Weller, 663 P.2d 1041, 1044 (Colo. 1983).
34. *E.g.*, Kellogg v. Pizza Oven, Inc., 157 Colo. 295, 402 P.2d 633 (1965); Jim Walters Homes, Inc. v. Reed, *aff'd in part, supra*, n.1; Hudgins v. Bacon, 171 Ga. App. 856, 321 S.E.2d 359 (1984).
35. 436 F. Supp. 262 (D. Me. 1977).
36. *Id.* at 273-74 n.10. *See also* Willard Van Dyke Productions, Inc. v. Eastman Kodak Co., 12 N.Y.2d 301, 239 N.Y.S.2d 337, 189 N.E.2d 693 (1983); Becker Pretzel Bakeries, Inc. v. Universal Oven Co., 279 F. Supp. 893, 900 (D. Md. 1968); Pan Am. World Airways, Inc. v. United Aircraft Corp., 53 Del. 7, 163 A.2d 582 (1960).
37. Threadgill v. Peabody Coal Co., 34 Colo. App. 203, 526 P.2d 676, 679 (1974).
38. Salt River Project Agricultural Improvement and Power Dist. v. Westinghouse Elec. Corp., 143 Ariz. 368, 694 P.2d 198 (1984).
39. Graham v. Chicago Rock Island & Pac. R.R. Co., 431 F. Supp. 444, 448 (W.D. Okla. 1976).
40. PROSSER, HANDBOOK OF THE LAW OF TORTS § 92 at 613 (1971).
41. Wright and Nicholas, *The Collision of Tort and Contract in the Construction Industry*, 21 U. RICH. L. REV. 457, 460 (1987).
42. PROSSER, HANDBOOK OF THE LAW OF TORTS § 92 at 613 (1971).
43. PROSSER, HANDBOOK OF THE LAW OF TORTS § 101 at 665 (1971).
44. 133 Ill. App. 3d 844, 479 N.E.2d 476 (1985), *aff'd*, 503 N.E.2d 246 (1982).
45. 479 N.E.2d at 478. *Accord*, Widett v. United States Fidelity & Guar. Co., 815 F.2d 885 (2d Cir. 1987); Bryant Elec. Co. v. City of Fredricksburg, 762 F.2d 1192 (4th Cir. 1985); Blake Constr. Co. v. Alley, 233 Va. 31, 353 S.E.2d 724, 727 (1987); Prichard Bros., Inc. v. Grady Co., 407 N.W.2d 423, *review granted* (Minn. App. 1987); Redarowicz v. Ohlendorf, 92 Ill. 2d 171, 441 N.E.2d 324 (1982); Crowder v. Vandendeale, 564 S.W.2d 879 (Mo. 1978); Ellis v. Robert C. Morris, Inc., 128 N.H. 358, 513 A.2d 951 (1986).
46. Espel, *Liability and Loss Allocation for Economic Losses in Construction Litigation Involving Design Professionals*, 13 WM. MITCHELL L. REV. 81 (1987); Wright and Nicholas, *supra* note 41. *See also* East River Steamship Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 106 S. Ct. 2295, 2303 n.8 (1986) (admiralty action where the court denied tort claims for a defective product, stating "the main currents of tort law run in different directions from those of contract and warranty, and the latter seem to us far more appropriate for the commercial disputes of the kind involved here").
47. Seely v. White Motor Co., 64 Cal. 2d 9, 45 Cal. Rptr. 17, 403 P.2d 145 (1965); Moorman Mfg. Co. v. Nat'l Tank Co., 91 Ill. 2d 69, 435 N.E.2d 443 (1982).
48. 92 Ill. 2d 171, 441 N.E.2d 324 (1984).
49. *Accord*, Tusch Enter. v. Coffin, 740 P.2d 1022 (Idaho 1987).
50. Prichard Bros., Inc. v. Grady Co., 407 N.W.2d 423, *review granted* (Minn. App. 1987).
51. Ellis v. Robert C. Morris, Inc., 128 N.H. 358, 513 A.2d 951 (1986).
52. *See* Ferentchak v. Village of Frankfort, 105 Ill. 2d 474, 475 N.E.2d 822 (1985); Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver, Inc., 312 A.2d 322 (Del. Super. 1973), *aff'd on other grounds*, 336 A.2d 211 (Del. 1975).

Arbitration

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Illinois decisions illustrate the impact of Rule 47 when it is properly brought before the court. These decisions are of particular interest because Illinois is one of the jurisdictions which had held that the filing of an answer to a suit without asserting the right to arbitrate constituted a waiver.¹⁶ In *Delici Construction Co., Inc. v. Board of Education*,¹⁷ suit was filed for damages for breach of contract. Defendant denied the existence of any contract and the parties agreed to a hearing without a jury on the issue of liability. The court found that a contractual relationship existed and that it had been breached. Later the same day the court had impaneled a jury to determine damages whereupon the defendant requested the damage issue be submitted to arbitration as required by the contract. A stay for purposes of arbitration was denied and an appeal taken. In an act of pure courage or foolishness—depending on your point of view—the defendant refused to participate in the jury proceedings and a verdict was taken. The plaintiff claimed waiver while the defendant contended that until a contract had

been found to be in existence by the court it could not invoke arbitration procedures and therefore there was no waiver. While the court was clearly inclined to hold that there was no waiver under the circumstances, the court pointed out that in view of Rule 46 of the 1973 Construction Industry Rules, which is identical to the current Rule 47, there was no waiver of the right to arbitrate the question of damages. In 1982, the court was again presented with a waiver issue in *Atlas v. 7101 Partnership*.¹⁸ In this case, plaintiff filed a complaint for injunctive and other relief including damages. The plaintiff had filed its initial complaint in 1980 which was subsequently amended. Plaintiff presented two motions for preliminary injunction which were denied. There were multiple defendants, only one of whom requested arbitration at the time of filing an answer. At that time, plaintiff also requested arbitration. The court granted the requests of both plaintiff and the one defendant and stayed the action pending resolution of the arbitration proceedings. The court noted that injunctive relief is ancillary and might not be available in arbitration, therefore viewing the request for injunctions as not being inconsistent with the right to arbitrate. However, the

court made it clear it did not have to reach that issue because of the impact of Rule 47 of the Commercial Arbitration Rules stating:

We are of the opinion that since this section of the American Arbitration Association's rules was incorporated into the arbitration clause, the limited legal maneuverings of the plaintiff in filing complaints and in obtaining rulings on his motions for preliminary injunctions were not inconsistent with that arbitration clause. Therefore, plaintiff has not waived his right to arbitrate.

In 1986, the Illinois court considered a case involving more substantial participation in litigation and the impact of the Construction Industry Arbitration Rules. In *Kastakis v. KSN Joint Venture*,¹⁹ plaintiff had filed an initial and amended complaint. Litigation proceeded for the next fifteen months with the plaintiff participating in discovery, filing various procedural motions including requests to admit facts, request to produce documents, motions for protective orders, demand for bill of particulars, and participation in depositions taken by the plaintiff. In April 1984, the defendants pled the arbitration agreement as an affirmative defense. Subsequently, an amended complaint was filed. Finally in July 1985, defendants moved to compel arbitration and stay proceedings. While discussing other reasons why there was no waiver, the court again focused upon Rule 47 of the American Arbitration Rules stating that it indicated the parties' intention to favor arbitration and that the court would not lightly waive this right. The court affirmed the trial court's stay of proceedings pending arbitration.

The arbitration rules obviously have great impact on the waiver issue. It is suggested that in any situation

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where counsel wishes to arbitrate and is faced with case law suggesting a waiver under the circumstance, it is very likely these cases can be validly and persuasively distinguished on the ground that they do not discuss Rule 47 and its impact on the waiver issue.

Circumstances Where a Waiver May Be Found

Notwithstanding the applicability of the Federal Arbitration Act or favorable case law in a jurisdiction which does not lightly find a waiver, a waiver may be found under the following circumstances:

1. *Undue Delay.* Here, the argument may be that arbitration is designed to be an inexpensive and speedy resolution of disputes. Undue delay in requesting ar-

bitration subjects the other party to substantial pre-trial expenses or other prejudice which would not otherwise have been incurred with prompt arbitration.²⁰

2. *Participation in Discovery.* Some courts have taken the view that making use of discovery procedures, particularly depositions, that are unavailable in arbitration is prejudicial and therefore waives the right to arbitrate.²¹ Others have examined the type of discovery taken as to whether it would be of equal benefit to both parties or in fact aid the party resisting arbitration.²²

3. *Submission of Arbitrable Issues for Judicial Determination.* Where this has happened it would probably be viewed as a waiver by most courts.²³ There would seem to be little basis for splitting arbitrable issues with some being resolved judicially and others by arbitration. Such issue splitting invades the province of the arbitrators and is probably inconsistent with the intent of the arbitration agreement.

Participation in Discovery as a Waiver and the Use of Rule 47

Those decisions which hold that discovery is a waiver are troublesome. First, it is erroneous to state that discovery by way of deposition is not allowed in arbitration. While the Construction Industry Arbitration Rules provide for production of documents and "other information,"²⁴ depositions are not mentioned. The Rules' silence on depositions, however, does not mean that depositions will not be allowed upon a request of one of the parties. It is a matter in the discretion of the arbitrators and in many arbitrations depositions have been allowed. Some state arbitration statutes allow the taking of depositions under designated circumstances.²⁵ If there is a strong policy in favor of arbitration in the jurisdiction, why should the taking of discovery, whether by deposition or otherwise, waive a right to arbitration? Presumably, judicial discovery is aimed at fairness and preventing trial by surprise. Moreover, a few cases have allowed limited discovery, including depositions, in aid of arbitration. A leading case considering these issues is *Bigge Crane & Rigging Co. v. Docutel Corp.*,²⁶ where a complaint was filed for \$70,000 balance due under a contract, \$120,000 for extra work and \$50,000 in damages. Plaintiff served notice to depose six officers of the defendant as well as related document inspection. Defendant moved to compel arbitration which was granted. The court then considered the question of discovery noting that, with a stay of the trial pending arbitration, it was still retaining jurisdiction over the matter and therefore had discretion to allow discovery in aid of arbitration. The court noted the problem of trial by surprise in arbitration and the resulting less than orderly proceedings including the necessity for continuances in arbitration hearings in order to respond to unanticipated evidence. The court also commented that court-ordered arbitration does not necessarily have to contribute to any delay in the arbitration

