Arbitration: Participation of the Surety as a Named Party

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Surety Sessions

Grace Winkler Cranley
DINSMORE & SHOHL LLP
227 West Monroe Street, Suite 3850
Chicago, Illinois 60606
(312) 775-1744

Tina M. Kocke
MERCHANTS BONDING COMPANY
6700 Westown Parkway
West Des Moines, IA 50266
(504) 417-5164

A surety's obligation to arbitrate typically arises as a result of the express terms of a payment or performance bond. Although those often do not contain express arbitration provisions, many contain language that incorporates the underlying bonded contract. That contract may require arbitration of disputes between the contractor (i.e. principal) and owner (i.e. obligee). As a result, the surety may be required to arbitrate disputes either because of the incorporation of the contract containing the mandatory arbitration provision or because the surety is obligated to do so by statute. In other instances, the surety may voluntarily agree to or seek to intervene in an arbitration as a means to resolve disputes.

A majority of jurisdictions require a surety to arbitrate when the bond incorporates a contract containing a mandatory arbitration clause. Courts, however, are divided on whether such incorporation also requires the surety to arbitrate its own disputes with the parties. The minority view finds that the incorporation of an arbitration clause in a contract only binds the surety to the result of the arbitration between the obligee and the surety's principal.[1] A surety's motion to compel arbitration is more likely to be denied in jurisdictions that deviate from the majority rule, and instead focus on the intent of the parties.

The surety's participation in an arbitration, either by requirement or consent, is a binding means towards resolution. Unlike traditional litigation, arbitrators have broad discretion in conducting the proceedings as well as fashioning awards. Courts are reluctant to vacate or modify an arbitrator's decision absent a showing of fraud, partiality, misconduct, or an overextension of the arbitrator's powers. As a result, the surety should enter the arbitration

[1] *See* James D. Ferrucci & R. Scott Cochrane, *Ch. 13, Effect of an Arbitration Provision in the Principal's Contract With the Obligee in* THE LAW OF PERFORMANCE BONDS 677, 678 (Lawrence R. Moelmann et al eds., Am. Bar Ass'n, 2d ed. 2009) for a comprehensive discussion.

forum cautiously and with an understanding of the advantages and potential consequences to its participation.

I. When is a Surety Required to Arbitrate? Mandatory requirement versus voluntary decision

A. Contractual Requirements

1. The Majority Rule Favors Incorporation by Reference

A surety's duty to arbitrate often arises out of language contained in the underlying contract or subcontract that is incorporated into the bond. The majority of federal jurisdictions—all but the Eighth, and Ninth[2]—generally require a surety to arbitrate when the surety bond incorporates a contract containing a mandatory arbitration provision.[3] A typical construction contract may include a provision such as:

> *Dispute Resolution.* All claims, disputes and other matters in question between the parties to this Agreement, arising out of or related to this Agreement or the breach thereof, shall be decided by arbitration or litigation, at the election of the owner....[4]

Often, a performance bond incorporates the provisions of the underlying construction contract by containing specific language referencing the contract and stating that contract by reference is made a part of the bond. The incorporation language in the bond is often generic and succinct, such as "the Subcontract [between certain parties] is hereby referred to and made a part hereof."[5]

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[2] *See AgGrow Oils, L.L.C. v. National Union Fire Ins. Co.*, 242 F.3d 777 (8th Cir. 2001); *Island Ins. Co. v. Noresco, LLC,* No. 12-00499, 2012 U.S. Dist. LEXIS 179468, *17 (D. Haw. Dec. 18, 2012). A more detailed analysis of the minority view is discussed below.

[3] Thomas H. Hayman, Patrick T. Uiterwyk and John A. McDevitt., *Incorporation by Reference: A Surety's Duty to Arbitrate*, 11 EASTERN BOND CLAIMS REV. 1, 2–3 (May 2008); *see also Tower Ins. Co. of N.Y. v. Davis/Gilford, A JV,* 967 F.Supp.2d 72, 82 (D.D.C. 2013) ("Indeed, a majority of federal circuit courts of appeals, including the First, Second, Fourth, Fifth, Sixth, Seventh, Tenth, and Eleventh Circuit Courts of Appeals, considering contractual language similar to that at issue . . . have concluded that a surety is bound by an arbitration provision in a prime- or subcontract that is incorporated by reference into a performance bond."); *Century Indem. Co. v. Certain Underwriters at Lloyd's,* 584 F.3d 513, 555 (3d Cir. 2009).

[4] *See Hoffman v. Fidelity and Deposit Co. of Maryland,* 734 F. Supp. 192 (D.N.J. 1990).

[5] *Tower Ins. Co. of N.Y v. Davis/Gilford, A JV.,* 967 F.Supp.2d at 72, 75 (D. D.C. 2013).

In construing arbitration provisions in the construction contract as being a part of and governing the surety bond, courts rely on varying rationales, the most common being (1) the breadth of the arbitration language and incorporation language; and (2) the favorability of arbitration agreements. In *Tower Insurance Company of New York v. Davis/Gilford a JV,* the sole issue before the Court was the applicability of the arbitration provision contained in the subcontract to the surety.[6] Before ever addressing the language of the contract, the court first noted Congress' intent and "preeminent concern" in enacting the Federal Arbitration Act was to enforce private agreements to arbitrate, "which requires that [courts] rigorously enforce agreements to arbitrate."[7] Accordingly, the "liberal federal policy favoring arbitration agreements" provided the framework in which the court analyzed the issue.[8]

The court then turned to the incorporation of the arbitration clause. In that case, the surety conceded that the subcontract was expressly incorporated into the performance bond.[9] However, the surety argued that the generic incorporation clause "[did] not evidence intent by the parties to incorporate the [arbitration clause] and that even if it [did], the plain language of the provision [did] not require it to arbitrate its personal surety defenses."[10] The court rejected the surety's argument that the subcontract was incorporated into the bond only for purposes of the surety's obligation to perform in the event of a default. The court reasoned that the language of the performance bond was clear and contained no exception of reservation, leaving no other option but to conclude that the language meant to "include the Subcontract's terms as provisions

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[6] *Id.* at 78.
[7] *Id.*
[8] *Id.*; *see also Exchange Mut. Ins. Co. v. Haskell Co.,* 742 F.2d 274, 275 (6th Cir. 1984) (relying on the United States Supreme Court's holding that "courts should give broad deference to the enforcement of arbitration clauses); *see also Great Am. Ins. Co. v. Hinkle Contr. Corp.,* 497 Fed. Appx. 348 (4th Cir. 2012).
[9] *Tower Ins. Co. of N.Y,* 967 F.Supp.2d at 79.
[10] *Id.*

of the Performance Bond in their entirety."[11] The court further reviewed the language of the subcontract, determining it contained no language limiting the arbitration clause to the signatories to the subcontract.[12] In doing so, it looked to other cases adopting the view that the language of the clause could limit the arbitration requirement to the signatories or to issues or problems arising out of the subcontract.[13] The court acknowledged that specific language in both the bond and the subcontract (or other construction contract) might eradicate this issue, but based on the majority view, "a surety is bound by an arbitration provision in a prime or subcontract that is incorporated by reference into a performance bond."[14]

However, not all courts view the incorporated language the same as illustrated by a recent dispute between a surety and contractor that resulted in opposite rulings on the same set of facts by two different federal district courts. In both cases, Developers Surety and Indemnity Company executed payment and performance bonds in favor of Carothers Construction, Inc. on several different projects.[15] When multiple subcontractors defaulted on various projects, Carothers asserted claims against the bonds. Carothers filed a demand for arbitration seeking approximately $4,000,000.00 against Developers regarding four unrelated projects in four states. Carothers claimed that Developers was required to participate in arbitration as the bonds incorporated by reference the subcontracts' mandatory arbitration clause.[16] Developers sought a declaration that it was not subject to the arbitration agreement.

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[11] *Id.*
[12] *Id.* at 82.
[13] *Id.; citing Fidelity & Deposit Co. of Maryland v. Parsons & Whittemore Contractors Corp.,* 397 N.E.2d 380, 381 (N.Y. 1979) (reasoning that disputes regarding the surety's obligations under the bond were not disputes arising out of the subcontract and thus not bound by the arbitration clause).
[14] *Tower Ins. Co. of N.Y v. Davis/Gilford, A JV.,* 967 F.Supp.2d at 72, 82 (D. D.C. 2013). Here, the court named the First, Second, Fourth, Fifth, Sixth, Seventh, Tenth, and Eleventh Circuit Courts of Appeals as standing for this proposition and specifically cited to cases from the same.
[15] *Developers Sur. & Indem. Co. v. Carothers Constr. Inc.,* No. 9:17-1419-RMG, 2017 U.S. Dist. LEXIS 111201, *2 (D.S.C. July 18, 2017).
[16] *Id.*

The South Carolina District Court considered the specific language of the arbitration clause, which stated, "all claims, disputes, and other matters in controversy between the Contractor and Subcontractor arising out of or relating to this Subcontract shall be decided by binding arbitration" and concluded that Carothers' claims against the bond arose as a result of the default and/or breach of the subcontractor.[17] The court rejected Developer's argument based on the language that disputes arising out of the subcontract between parties other than the contractor and subcontractor were not subject to binding arbitration. The court determined that "the liability of the surety is measured precisely by the liability of the principal"[18] and found that when the agreement to arbitration was incorporated into the bond, the "two are construed together as a whole to ascertain the intent of the parties."[19] Based on that reasoning the court found that the parties intended to submit disputes to arbitration and that the surety was bound by the subcontract's arbitration clause.

The Kansas District Court, only a month later, viewed the identical language and positions of Caruthers and Developers but found the exact opposite.[20] There, the court considered the same language but specifically focused on the wording that the dispute be between "the Contractor and Subcontractor," holding "by its terms, the arbitration provision does not apply to Carothers's claims on the bond, which is a dispute between Carothers and [Developers]."[21] The court also found that other provisions in the subcontract supported its reasoning.

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[17] *Id.* at *7.
[18] *Id.* at *10.
[19] *Id. citing Employers Ins. of Wausau v. Contr. Mgmt. Engineers of Florida, Inc.,* 377 S.E.2d 119, 121 (S.C. Ct. App. 1989).
[20] *Developers Sur. & Indem. Co. v. Carothers Constr., Inc,* No. 17-2292-JWL, 2017 U.S. Dist. LEXIS 135949, *7 (D. Kan. Aug. 24, 2017).
[21] *Id.* at *12.

While both courts applied a similar analysis considering the specific language of the arbitration clause, each court focused on separate and distinct words in the clause. The Kansas District Court, disagreeing with the earlier ruling, stated that the South Carolina District Court failed to address the relevant language.[22] The court rejected the notion that because "a surety's liability is coextensive with that of the principal as a general rule," it must be bound by the arbitration clause.[23] Despite recognizing this general rule, the court stated that Developers only assumed obligations per the terms of the bond and the subcontract, which did not provide for the arbitration of disputes with the surety.[24]

These cases illustrate that while the majority view requires a surety to arbitrate when a bond incorporates an underlying contractual obligation to do so, the language of the bond and contracts as well as applicable case law must be carefully considered. The vast majority of jurisdictions favors and applies a liberal policy towards arbitration.[25]

2. The Minority Rules for Surety Arbitration Focus on the Intent of the Parties and the Specificity of the Contract Language

Currently, the Eighth Circuit is the only Court of Appeals to explicitly require the incorporation clause to refer to a specific provision in the construction contract that has a "reasonably clear and ascertainable meaning."[26] This approach focuses on whether the incorporation clause reflects the surety's intent to arbitrate disputes under the bond. *Id.* In *AgGrow Oils LLC v. National Union Fire Insurance Company*, the surety sought to enforce a mandatory arbitration clause in a construction contract which was incorporated by reference into

[22] *Id.* at *18.
[23] *Id.*
[24] *Id.*
[25] *Developers Sur. & Indem. Co. v. Carothers Constr. Inc.,* No. 9:17-1419-RMG, 2017 U.S. Dist. LEXIS 111201, *3 (D.S.C. July 18, 2017).
[26] *AgGrow Oils, L.L.C. v. National Union Fire Ins. Co.*, 242 F.3d 777, 781 (8th Cir. 2001).

the surety bond.[27] The court assessed whether the incorporation clause adequately reflected the surety's intent to arbitrate disputes under the bond.[28] The surety bond required judicial resolution of disputes, and the construction contract contained a provision that it "not be construed to create a contractual relationship between any persons" other than the parties to the primary contract.[29] The court denied the surety's motion to stay the litigation proceeding, and held there was no arbitration agreement between the surety and the obligee.[30]

The Ninth Circuit Court of Appeals has never taken an explicit stance on this particular issue. The Ninth Circuit, when addressing the general question of incorporation of contracts, has required "clear and unequivocal" incorporation of the contract reflecting an intent to submit to arbitration.[31] Mere incorporation of a contract without specific reference to an arbitration provision is insufficient to bind the surety.[32] While the Ninth Circuit has not directly addressed whether a surety is bound by an arbitration clause incorporated into the bond, several district courts throughout the Ninth Circuit have, with differing approaches. For example, recently an Eastern District of California case acknowledged that "an abundance of case law provides that a surety may be bound by an arbitration clause in the underlying contract to which it is not a party where the contract is incorporated by reference in the Bond."[33] However, in determining that the surety was not obligated to arbitrate, the court looked to the specific language of the arbitration clause which provided it governed disputes "that arise if a party materially breaches any

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[27] *Id.* at 779-780.
[28] *Id.* at 782.
[29] *Id.* at 781.
[30] *Id.* at 783; *see also Dobson Bros. Constr. v. Ratliff, Inc.,* 4:08CV3103, 2009 U.S. Dist. LEXIS 53876 (D. Neb. Feb. 27, 2009) (following *AgGrow Oils* reasoning that there was no provision purporting to require arbitration of claims against the surety).
[31] *Cariaga v. Local No. 1184 Laborers Int'l Union of N. Am.,* 154 F.3d 1072, 1074 (9th Cir. 1998).
[32] *Id.* at 1075 (finding that an agreement to "be bound by the procedures for settling jurisdictional disputes as set forth" in the primary contract was insufficient).
[33] *Allied World Ins. Co. v. New Paradigm Prop. Mgmt., LLC,* No. 2:16-cv-02992-MCE, 2017 U.S. Dist. LEXIS 160298, *7 (E.D. Cal. Sep. 28, 2017).

provision of this Agreement."[34] The court concluded that, by its express terms, the arbitration clause did not extend to the surety.[35]

3. Incorporation by Reference in State Courts

Many state courts follow a similar approach to the federal majority.[36] These jurisdictions generally require the surety to arbitrate when a bond incorporates a contract with a mandatory arbitration clause. However, Maryland follows a unique approach that emphasizes the "consensual" nature of the arbitration process.[37]

In *Hartford Accident & Indemnity Company v. Scarlett Harbor Associates Limited Partnership*, a surety appealed the lower court's denial of its motion to stay litigation pending arbitration.[38] The contract between the property owner and construction contractor contained a mandatory arbitration provision which was incorporated by reference into the surety's performance bond. In assessing whether the surety could compel arbitration, the court recognized that "[a]rbitration is consensual: a creature of contract. As such, only those who consent are bound. In the absence of an express arbitration agreement, no party may be compelled to submit to arbitration in contravention of its right to legal process."[39] The court construed the incorporation clause in the performance bond as merely incorporating the owner's promise to arbitrate with the contractor, rather than extending the arbitration obligations of the

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[34] *Id.*
[35] *Id.* at *8; *see also Island Ins. Co. v. Noresco, LLC,* No. 12-00499, 2012 U.S. Dist. LEXIS 179468, *17 (D. Haw. Dec. 18, 2012) ("In order for a nonsignatory to be bound by an arbitration clause incorporated by reference, the arbitration clause must be broad enough to allow the disputes of nonsignatories to be brought within its terms.")
[36] Haymen, et al., *supra* note 3, at 4–5 noting that courts in Alaska, Arkansas, California, Connecticut, Florida, Illinois, Kentucky, Massachusetts, Missouri, and Tennessee follow this approach.
[37] Haymen, et al., *supra* note 3, at 4–5; *Hartford Accident & Indem. Co. v. Scarlett Harbor Assocs. Ltd. P'ship*, 695 A.2d 153, 155 (Md. Ct. App. 1997).
[38] 695 A.2d at 153–54.
[39] *Id.* at 155.

owner to the surety.[40] The Court affirmed the lower court's decision, and held there was no arbitration agreement between the surety and the owner.[41]

In determining whether a non-signatory surety is bound by an agreement to arbitrate, Maryland looks to state contract law.[42] In *Schneider Electric Buildings Critical Systems v. Western Surety Co.,* the obligee asserted that the bond language that stated the surety was "jointly and severally" bound to ensure "the performance of the Construction Contract" which included an arbitration clause was sufficient to bind the surety. The court disagreed finding that the obligee misconstrued the term "performance" and that the purpose of the subcontract agreement was to ensure that the principal would "perform work" prescribed by that agreement and not every contractual provision in the incorporation-by-reference chain. The court noted that the incorporation of one contract into another contract involving different parties does not automatically transform the incorporated document into an agreement between the parties to the second contract without an indication of a contrary intention to do so.[43]

4. Statutory Requirements

The Federal Arbitration Act and most state statutes apply to those parties to the contract containing the arbitration provision and, therefore, those parties may be compelled to arbitrate.[44] The Federal Arbitration Act reflects a liberal policy towards arbitration.[45] The Supreme Court has held that the Federal Arbitration Act establishes that, "as a matter of federal law, any doubts

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[40] *Id.* at 156.
[41] *See also Schneider Electrical Buildings Critical Systems, Inc. v. Western Surety Company,* 454 Md. 698, 709-710 (Md. Ct. App. 2017) (holding that the incorporation by reference language in the bond did not transform the incorporated contracts into an agreement between surety and the obligee).
[42] *Schneider Elec. Bldgs. Critical Sys. v. W. Sur. Co.,* 149 A.3d 778 (Md. Ct. Spec. App. 2016) (stating that Maryland is now joining other courts stressing that the question of whether an agreement to arbitrate binds a non-signatory is a question of state law *relying on Arthur Anderson LLP v. Carlisle,* 556 U.S. 624 (2009); *First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938 (1995); *Perry v. Thomas,* 482 U.S. 483 (1987).
[43] *Schneider Elec. Bldgs. Critical Sys.,* 149 A.3d at 791.
[44] Ferrucci, et al., *supra* note 1, at 733.
[45] *Developers Sur. & Indem. Co. v. Carothers Constr. Inc.,* No. 9:17-1419-RMG, 2017 U.S. Dist. LEXIS 111201, *3 (D.S.C. July 18, 2017).

concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability."[46]

Before the Supreme Court's ruling in *Moses H. Cone Mem'l Hosp. v. Mercury Construction Corp.,*[47] there was some disagreement as to whether the Federal Arbitration Act applied to state court actions. In that case, the Supreme Court noted that the Act creates a body of federal substantive law of arbitrability equally applicable in both state and federal courts.[48] The Act preempts any state laws which "undercut the enforceability of arbitration agreements."[49] In a subsequent case, the Supreme Court held that the Federal Arbitration Act preempts a state law that withdraws the power to enforce arbitration agreements, but also noted that certain provisions of the Federal Arbitration Act do not apply to proceedings in state courts, such as the federal procedural rules.[50] These statutes make agreements to arbitrate after-arising disputes binding, enforceable and irrevocable.[51]

The Uniform Arbitration Act, promulgated in 1955, has been adopted by many state legislatures and federal district courts for alternative dispute resolution. The Uniform Arbitration Act does two fundamental things. First, it reverses the common law rule that denied enforcement of a contract provision requiring arbitration of disputes before there is an actual dispute. Prior to the 1955 Act, an agreement to arbitrate potential issues before a real dispute arose was prohibited by common law. Second, the 1955 Act provides a structured procedure to

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[46] *Moses H. Cone Mem. Hosp. v. Mercury Contr. Corp.,* 460 U.S. 1, 24-25 (1983) (footnotes omitted).
[47] *Id.*
[48] *Id.* at 24-27 (dicta).
[49] Ferrucci, et al., *supra* note 1, at 682 *relying on Southland Corp. v. Keating,* 465 U.S. 1, 16 (1984); *see also Shores of Pan., Inc. v. Safeco Ins. Co. of Am.,* Civ. Action No. 07-00602-KD-B, 2008 U.S. Dist. LEXIS 75956, *10 (D. Ala. Sept. 29, 2008).
[50] *Southland Corp. v. Keating,* 465 U.S. 1, 16, fn. 10 (1984)
[51] Gregory R. Veal, *Arbitration and the Surety: When You Should, How Far You Should, And What If You Don't?* p. 2 (unpublished paper submitted at the Sixth Annual Southern Surety and Fidelity Claims Conference) (with appendix containing a list of the statutes with notable variations).

be followed in arbitrations when an arbitration agreement is silent. Nineteen states have adopted the Revised Uniform Arbitration Act, and Connecticut, Kansas, Massachusetts, and Pennsylvania introduced legislation mirroring the Act in 2017.[52]

Because each state has its own statutory framework, the specific statutes that may govern a dispute should be reviewed. For example, most state statutes do not specifically mention arbitration in relation to a surety. Rhode Island and Georgia, however, have adopted provisions which specifically mention the surety. Rhode Island's statute provides:

> **§ 10-3-21 Sureties – Bound to arbitration award on construction contract. –** (a) If a contractor principal on a bond furnished to guarantee performance or payment on a construction contract and the claimant are parties to a written contract with a provision to submit to arbitration any controversy thereafter arising under the contract, the arbitration provisions shall apply to the surety for all disputes involving questions of the claimant's right of recovery against the surety. Either the claimant, the contractor principal, or surety may demand arbitration in accordance with the written contract in one arbitration proceeding. The arbitration award shall decide all controversies subject to arbitration between the claimant, on the one hand, and the contractor principal and surety on the other hand, including all questions involving liability of the contractor principal and surety on the construction bond, but a claimant must file suit for recovery against the surety within the time limits set forth by law or by the terms of the bond when there are no applicable statutory provisions. The arbitration shall be in accordance with § 10-3-1 et seq. and the court shall enter judgment on the arbitration as provided in the agreement.
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> (b) The arbitrator or arbitrators, if more than one, shall make findings of fact as to the compliance with the requirements for recovery against the surety, and those findings of fact shall be a part of the award binding on all parties to the arbitration.[53]

Based on this statute, which expressly includes any separate surety defenses within the scope of the required arbitration, the surety's considerations and options are virtually eliminated.[54]

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[52] THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, *Arbitration Act (2000)*, http://www.uniformlaws.org/Act.aspx?title=Arbitration%20Act%20(2000) (July 26, 2017).
[53] R.I. Gen. Laws §10-3-21 (2017).
[54] Veal, *supra* note 51, at 2 (with appendix for a list of the statutes with notable variations).

In Georgia, however, a surety on a performance or payment bond may be statutorily exempted from any duty to arbitrate. Georgia's Arbitration Code states that it applies to all "disputes in which the parties thereto have agreed in writing to arbitrate and shall provide the exclusive means by which agreements to arbitrate disputes can be enforced" except several matters are exempted from the provisions including "[a]ny contract of insurance, as defined in paragraph (1) of Code Section 33-1-2…"[55] which defines "Insurer" as:

> (4) "Insurer" means any person engaged as indemnitor, surety, or contractor who issues insurance, annuity or endowment contracts, subscriber certificates, or other contracts of insurance by whatever name called. Hospital service nonprofit corporations, nonprofit medical service corporations, burial associations, health care plans, and health maintenance organizations are insurers within the meaning of this title.[56]

California also has enacted a statute that specifically states that an arbitration award rendered against a "principal alone shall not be, be deemed to be, or be utilized as, an award against his surety."[57] Based on this statute, where a surety is not required or compelled to participate in an arbitration involving its principal, either by contract or statute, an arbitration award against a principal does not have res judicata effect upon a surety in California.[58]

B. Consensual

In a situation where the surety may not be required to arbitrate contractually or statutorily, the surety may nevertheless decide to agree to arbitrate a dispute. These instances may arise where a claimant demands arbitration against the principal only or where a principal initiates claims in arbitration. The surety may see arbitration as a way to avoid additional

[55] O.C.G.A. 9-9-2 (2017).
[56] O.C.G.A. 33-1-2 (2017).
[57] Cal. Civil Code §2855 (2017).
[58] *See Liton General Engineering Contractor, Inc. v. United Pacific Insurance,* 16 Cal. App. 4th 577, 20 Cal. Rptr. 2d 200 (1993).

litigation, such as enforcing indemnity rights in a separate proceeding. Instead, the surety may seek to arbitrate all disputes within the arbitration forum.

An important consideration is the potential risks to the surety for not participating in the arbitration. Should the surety decline to participate or not be a party to the arbitration, the surety may risk an adverse award against its principal being confirmed against the surety by default, res judicata or collateral estoppel principles. Courts often determine a surety's liability to be co-extensive with that of its principal and, therefore, are reluctant to allow a surety to litigate issues of the principal's liability a second time.[59] Whether an award against a principal will bind a non-party surety often hinge on the specific facts and whether the surety had sufficient notice and opportunity to participate.[60] Many courts hold that where a surety has actual notice of arbitration proceedings, the surety will be bound by an arbitration determination against its principal.[61] Therefore, when determining whether to consent to arbitration, this issue should be carefully considered.

II. Evaluation of the Advantages and Disadvantages to Participating in an Arbitration

In determining whether to agree to arbitrate or participate in an arbitration, the surety will evaluate the advantages and disadvantages of arbitration. There are a number of factors that the surety should consider including the associated costs, discovery rights, and evidentiary controls. Further, as discussed below, arbitration awards are rarely able to be vacated or modified significantly and, therefore, the inability to appeal an adverse award is a strong consideration. On the other hand, the arbitration forum provides a finality that can be attractive.

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[59] Ferrucci, et al., *supra* note 1, at 758-806 for a comprehensive discussion.
[60] *See, e.g., Mid-State Sur. Corp. v. Thrasher Eng'g, Inc.,* 575 F.Supp. 2d 731 (D. W.Va. 2008) (arbitrator's determination that principal had defaulted was preclusive against the surety where surety had notice of the arbitration).
[61] *Fewox v. McMerit Contr. Co.,* 556 So.2d 419 (Fl. Ct. App. 1989).

A. Cost Concerns

Generally, arbitration is viewed as a way to control costs, meaning that it costs less to arbitrate than litigate in a court setting. This view may or may not be true. Judges are "free" but arbitrators are not. Private alternative disputes resolution ("ADR") providers typically charge significant filing fees, from flat rates based on the number of parties[62] to a fee schedule based on the amount in controversy.[63]

In addition to filing fees, there may be other costs to be considered such as case management fees, other professional fees, including time spent for hearings, pre- and post-hearing reading and research, and hearing room rental costs. The hourly or daily cost of one or more arbitrators is also an important factor to consider not to mention the costs that will be incurred by counsel relating to discovery, pre-hearing submissions and hearing attendance. Further, in complex cases, arbitration can be a lengthy and expensive proceeding.[64]

The forum in which the arbitration will be held should also factor into cost considerations. Some arbitration clauses may specify a mandatory arbitral venue. While the venue and jurisdiction will undoubtedly be evaluated in looking at the advantages or disadvantages of a particular forum, the costs associated with location can also weigh heavily in the decision process.

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[62] For example, for two-party matters, JAMS charges a $1,200 filing fee, to be paid by the party initiating the arbitration. For matters involving three parties or more, the filing fee is $2,000. See JAMS Engineering and Construction Arbitration Rules & Procedures, effective Nov. 15, 2014, p. 5.

[63] The American Arbitration Association's filing fees are dependent on the amount of the claim and range from $750 for claims up to $75,000 to over $10,000 for claims that exceed $10,000,000. American Arbitration Association Construction Industry Arbitration Rules and Mediation Procedures, Administrative Fee Schedules, amended and effective July 1, 2016.

[64] *See, e.g., Hitachi Am., Ltd. v. Steadfast Ins. Co.,* 09 Civ. 8045 (VM)(HBP), 2011 U.S. Dist. LEXIS 41183 (S.D.N.Y. April 15, 2011) (noting discovery spanned more than three years, millions of documents produced, more than eighty depositions conducted and fifty-nine days of evidentiary hearings).

B. Potential Limitations on Discovery

One traditional criticism of arbitration is that the parties sacrifice the discovery rights that are available to parties in a traditional litigation setting.[65] However, most arbitration agreements now expressly reserve discovery rights. Further, most private ADR providers have implemented extensive arbitration rules that address the exchange of non-privileged documents and information including electronically-stored information. Those rules should be carefully considered as they may limit the timing of discovery as well as other discovery methods such as the number of depositions that can be taken.[66]

C. Evidentiary Concerns

Evidentiary concerns can be an important consideration when opting to arbitrate. As recognized by the Supreme Court, arbitrators are not bound by the rules of evidence.[67] Arbitrators have broad discretion in choosing to admit or exclude evidence, and are only required to provide a "fundamentally fair hearing."[68] The arbitrator determines the admissibility, relevance, and materiality of the evidence offered and may exclude evidence deemed to be cumulative or irrelevant.[69] Provided the arbitrator's evidentiary determinations give each party an adequate opportunity to present evidence and arguments, the arbitrator "is not bound to hear all of the evidence tendered by the parties."[70] Arbitrators are not bound by legal precedent. What

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[65] L. Graves Stiff III & J. Scott Dickens, *Arbitration and the Surety: Do I Want To? Do I Have To? What If I Don't? What If I Do?* p. 4 (unpublished paper submitted at the Ninth Annual Southern Surety and Fidelity Claims Conference, April 23-24, 1998).

[66] JAMS limits each party to two depositions unless the arbitrator determines there is a reasonable need for additional information. See JAMS Engineering and Construction Arbitration Rules & Procedures, effective Nov. 15, 2014, p.18.

[67] *Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198, 203–04 n.4 (1956).

[68] *Slaney v. Int'l Amateur Ath. Fed'n*, 244 F.3d 580, 592 (7th Cir. 2001).

[69] *LJL 33rd St. Assocs., LLC v. Pitcairn Props.*, 725 F.3d 184, 195 (2d Cir. 2013).

[70] *Slaney*, 244 F.3d at 592.

is fair, just and reasonable in accordance with established legal precedent may be the opposite of what the arbitrator considers to be a desirable, just and reasonable result.[71]

D. Impact on the Surety's defenses

Another consideration for a surety is whether the surety is able to assert its own surety defenses to claims or whether the arbitration is limited to the surety's participation in the arbitration with regard to its co-extensive liability with its principal. Many courts require the surety to arbitrate any and all claims, issues, defenses connected with the contract and the bond, including the surety's defenses.[72]

The most common rationale for requiring the arbitration of all defenses is grounded in the breadth of the arbitration clause. Once the court establishes that the clause is indeed incorporated into the bond, it looks to the language of the clause to determine the scope. Importantly, once the court establishes the existence of a valid arbitration clause, federal policy favoring arbitrability often pushes the court towards a liberal interpretation of the scope of the clause.[73]

This rationale is illustrated in the case of *United States Surety Company v. Hanover R.S.L.P.*[74] In that case, the surety moved for a declaration that issues concerning its liability

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[71] Stiff, et al., *supra* note 65, at 4.

[72] *United States Sur. Co. v. Hanover R.S. L.P.,* 543 F.Supp. 2d 492, 495-496 (W.D.N.C. 2008) (holding that any and all surety defenses were arbitrable, consistent with federal law's strong presumption favoring arbitrability) (citing *Hoffman v. Fidelity & Deposit Co. of Maryland,* 743 F.Supp. 192, 195 (D.N.J. 1990) ("[t]he court concludes that the Third Circuit would follow the Eleventh, Sixth, Fifth, Second and First Circuits and would require Fidelity to arbitrate its defenses to liability on the Bond")).

[73] *Ohio Cas. Ins. Co. v. City of Moberly,* Case No. 4:05 CV 5 JCH, 2005 U.S. Dist. LEXIS 43325, *8 (E.D. Mo. Oct. 7, 2005) (holding that the surety was bound by the arbitration clause to arbitrate all of its personal defenses because "in a majority of state courts, including Missouri, due to the strong federal policy in favor of arbitration, arbitration agreements are enforced against guarantors and sureties where the arbitration agreement is incorporated by referenced into the guaranty or performance bond"); *Granite Re Inc. v. Jay Mills Contracting Inc.,* No. 02-14-00357-CV, 2015 Tex. App. LEXIS 4182, *11 (Tex. Ct. App. Apr. 23, 2015) (stating that because the obligee "established that a valid arbitration clause between it and [the surety] exists, we now indulge a strong presumption in favor of arbitration"); *Shores of Pan., Inc. v. Safeco Ins. Co. of Am.,* No. 07-00602-KD-B, 2008 U.S. Dist. LEXIS 75956, *35 (S.D. Ala. Sept. 29, 2008) (stating that "questions of arbitrability must be addressed with a healthy regard for the federal policy forming arbitration" and holding that the surety's defenses must be part of the arbitration).

[74] *United States Sur. Co. v. Hanover R.S. L.P.,* 543 F.Supp. 2d 492 (W.D.N.C. 2008).

under the performance bond were not subject to arbitration. The subcontract's arbitration clause called for arbitration of "any dispute arising out of or relating to this Agreement."[75] The surety argued that, despite the incorporation of the arbitration clause into the bond, defenses unique to the surety, such as whether the obligee impaired the surety's position or released the principal, were not claims arising out of the performance of the subcontract, not subject to the arbitration clause, but only arose out of the bond and, therefore, were outside the scope of the arbitration clause.[76] Relying on "incorporated by reference" case law, the court strongly disagreed stating that "both the Supreme Court and [Circuit Courts of Appeals] have characterized similar formulations of 'arising out of or relating to' to be broad arbitration clauses capable of an expansive reach."[77] The court set forth a "breadth" test stating that "the test for an arbitration clause of this breadth is not whether a claim arose under one agreement or another, but whether a significant relationship exists between the claim and the agreement containing the arbitration clause."[78] The court concluded that the surety's personal defenses had a significant relationship even if not a part of the subcontract, thus ordering arbitration.[79]

Contrary to this majority position, however, some courts hold that, even if an arbitration clause is incorporated into the bond, the surety is not automatically obligated to arbitrate any or all of its claims. In a recent case out of the Kansas District Court, the court did not dispute that

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[75] *Id.* at 495.
[76] *Id.*
[77] *Id.* (internal citations omitted).
[78] *Id*. *citing American Recovery Corp. v. Computerized Thermal Imaging, Inc.,* 96 F.3d 88, 93095 (4th Cir. 1996) (the inclusion of "arising out of or relating to" language in a contractual arbitration requirement "does not limit arbitration to the literal interpretation or performance of the contract [but] embraces every dispute between the parties having a significant relationship to the contract regardless of the label attached to the dispute"); *Long v. Silver,* 248 F.3d 309 (4th Cir. 2001) (finding identical "arising out of or relating to" language to be "a broadly-worded arbitration clause [applicable] to disputes that do not arise under the governing contract when a 'significant relationship' exists between the asserted claims and the contract in which the arbitration clause is contained").
[79] *United States Sur. Co..,* 543 F.Supp. 2d at 496; *see also Boys Club of San Fernando Valley, Inc. v. Fidelity & Deposit Co.,* 8 Cal. Rptr. 2d 587, 589-593 (Cal. Ct. App. 1992) (holding that an arbitration clause in contract incorporated into a performance bond required arbitration of all of the surety's defenses, whether arising under the contract or the bond).

the arbitration clause was incorporated by referenced into the bond, but the court narrowly interpreted the language of the clause.[80] There, the court zeroed in on the contractual requirement that the dispute be between "the Contractor and Subcontractor," holding "by its terms, the arbitration provision does not apply to [the obligee's] claims on the bond, which is a dispute between [the obligee] and [the surety]."[81] The court stated that the surety only assumed obligations per the terms of the bond and the subcontract, which did not provide for the arbitration of disputes with the surety.[82]

Similarly, in *Hinkle Contracting Co., LLC v. Great Am. Ins. Co.,*[83] the court distinguished between requiring the surety to arbitrate claims arising out of the performance requirements of the subcontract and claims of the surety's personal defenses. The court referenced the language from another District Court's ruling governing the same parties and contracts, which stated that "the arbitration provisions . . . were not intended to 'bind the surety company to arbitrate with the contracting parties regarding disputes originating in the provisions of the bond" and holding a "bond dispute" does not fall within the scope of the subcontract's arbitration provisions.[84] The court further found that any bad faith claims related to the surety's performance under the bond and were not subject to the arbitration clause.[85]

As discussed, courts favor arbitration and the majority will incorporate the underlying contractual obligation to arbitrate into the bond terms. These cases illustrate that the particular language of the bond and agreements will necessarily determine not only whether the surety

[80] *Developers Sur. & Indem. Co. v. Carothers Constr., Inc,* No. 17-2292-JWL, 2017 U.S. Dist. LEXIS 135949, *7 (D. Kan. Aug. 24, 2017).
[81] *Id.* at *12.
[82] *Id.*
[83] No. 11-320-JBC, 2012 U.S. Dist. LEXIS 71202, *5 (E.D. Ky. May 21, 2012),
[84] *Id.* at *5-6.
[85] *Id.* at *8.

must participate in an arbitration but also what issues and defenses the surety will be able or required to arbitrate.

E. Concerns over Finality of an Arbitration Decision

While arbitration may provide a means to resolve disputes, arbitration awards are binding and are virtually unappealable except in very specific instances. As discussed more fully below, grounds for appeal rarely occur and are construed narrowly to uphold awards.[86] The decision to arbitrate voluntarily should include the consideration that there is less substantive protection and less procedural safeguards coupled with the finality of the arbitrator's decision.

F. Concern over Settlement Incentives

In a typical litigation setting, the parties will be directed and encouraged to engage in settlement discussions. Often a judge or magistrate will conduct settlement conferences and may even require the parties to participate in mandatory mediation prior to proceeding to trial. Generally, arbitration does not have a similar structure or requirement. While many ADR companies provide a framework for settlement discussions, often the decision to do so is left to the parties. Therefore, in the instance where a surety has the option of whether to arbitrate or not, the potential lack of direction or requirement to engage in settlement discussions can be an important concern.

III. What Issues Should the Surety Arbitrate?

The question of whether the surety has to arbitrate all claims in a proceeding is not easily answered. Arbitration clauses are creatures of contractual interpretation and should be carefully reviewed to determine the intent of the parties as to what issues would be subject to arbitration. As discussed previously, courts generally employ a broad interpretation of arbitration clauses to include all disputes and scrutinize narrow arbitration clauses. The intentions of the parties to a

[86] *See also* Veal, *supra* note 51, at 5 (with appendix for a list of the statutes with notable variations).

contract are to be generously construed as to issues of arbitrability.[87] However, a party cannot be required to submit to arbitration a dispute which it has not agreed to submit.[88] Where a narrow, rather than a broad, arbitration clause is involved, courts generally scrutinize the contract more closely to determine whether the parties intended that a particular dispute be arbitrated.[89]

Highlighting the potential for dispute over how far reaching arbitration clauses may extend is the case of *Hanover Ins. Co. v. Atlantis Drywall & Framing, LLC.*[90] In that case, the surety had issued payment and performance bonds relating to a subcontract between its principal and obligee. Those bonds incorporated by reference the subcontract containing an arbitration clause. The surety's indemnitors sought to force the surety to arbitrate its indemnity claims contending that although the indemnity agreements did not expressly contain an arbitration provision, the indemnity agreements were part of a single transaction. The indemnitors argued that, under Alabama law, several writings executed between the same parties substantially at the same time and relating to the same subject-matter may be read together as forming parts of one transaction and it is not necessary that the instruments should in terms refer to each other if they are parts of a single transaction.[91] The court concluded that the indemnity agreements, bonds, and subcontract should be viewed a single transaction and remanded the case to compel arbitration of the indemnity issues. The court later vacated the previous panel opinion and granted rehearing[92] but the case illustrates potential issues on the parties' intent to arbitrate disputes.

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[87] *Baltimore v. Baltimore City Composting Partnership,* 800 F.Supp. 305 (D. Md. 1992).
[88] *Dobson Bros. Constr. v. Ratliff, Inc.,* 4:08CV3103, 2009 U.S. Dist. LEXIS 53876 (D. Neb. Feb. 27, 2009) *citing AT&T Technologies, Inc. v. Communications Workers of America,* 475 U.S. 643 (1986).
[89] *Baltimore v. Baltimore City Composting Partnership,* 800 F.Supp. 305 (D. Md. 1992).
[90] 579 Fed. Appx. 742 (11th Cir. 2014).
[91] *Id.* at 745.
[92] *See Hanover Ins. Co. v. Atlantis Drywall & Framing, LLC,* 611 Fed. Appx. 585 (11th Cir. 2015).

There are few cases that can be cited in favor of segregating some issues for arbitration while preserving others.[93] By contrast, in *Shawnee Hospital Authority v. Dow Construction, Inc.,*[94] the principal and surety sought to compel arbitration of a latent-defect claim. The initial litigation was brought by the obligee against both the principal and surety who then filed counterclaims and sought to compel arbitration. The trial court denied the request but no appeal was taken. The parties later reached a settlement but excluded all after-arising claims from latent construction defects. The obligee later sought to reopen the litigation to enforce the settlement agreement's terms imposing liability for latent defects. The principal's and surety's motion to compel arbitration was against denied on the basis this time that the settlement agreement superseded the prior agreements that may have contained the arbitration clauses. The court found that the terms of settlement contained no express provision for arbitration of the latent-defect claims.[95]

IV. Rejection of the Surety as a Participant

A litigant can compel arbitration under the Federal Arbitration Act if the litigant can demonstrate (1) the existence of a dispute between the parties; (2) a written agreement that includes an arbitration provision which purports to cover the dispute; (3) the relationship of the transaction, which is evidenced by the agreement, to interstate or foreign commerce; and (4) the failure, neglect or refusal of the party to arbitrate the dispute.[96] Because the Federal Arbitration Act in essence guarantees the enforcement of a private contract, courts first must consider the

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[93] Veal, *supra* note 51, at 10 *referring to Commercial Union Ins. Co. v. Gilbane Building Co.,* 992 F.2d 386 (1st Cir. 1993)(surety was allowed to carve out one claim from thirteen for arbitration purposes).
[94] 812 P.2d 1351 (Okla. 1990).
[95] *Id.* at 1354.
[96] *Developers Sur. & Indem. Co. v. Carothers Constr. Inc.,* No. 9:17-1419-RMG, 2017 U.S. Dist. LEXIS 111201, *3 (D.S.C. July 18, 2017); *relying on Am. Gen. Life & Accident Ins. Co. v. Wood,* 429 F.3d 83 (4th Cir. 2005) and *Adkins v. Labor Ready, Inc.,* 303 F.3d 496 (4th Cir. 2002); *see also Great Am. Ins. Co. v. Hinkle Contr. Corp.,* 497 Fed. Appx. 348 (4th Cir. 2012).

contract's terms in ascertaining the scope of the arbitration agreement at issue.[97] However, a party can waive its right to compel arbitration "when both: (1) the party seeking arbitration 'substantially participates in litigation to a point inconsistent with an intent to arbitration'; and (2) 'this participation results in prejudice to the opposing party.'"[98]

A surety's motion to compel arbitration is more often denied in jurisdictions focusing on intent as evidenced by the *AgGrow Oils LLC v. National Union Fire Insurance Company* and *Hartford Accident & Indemnity Company v. Scarlett Harbor Associates Limited Partnership* cases.[99] In *AgGrow Oils LLC*, the surety sought to enforce a mandatory arbitration clause in a construction contract which was incorporated by reference into the surety bond.[100] The court assessed whether the incorporation clause adequately reflected the surety's intent to arbitrate disputes since the bond required judicial resolution of disputes and the construction contract contained a provision that it "not be construed to create a contractual relationship between any persons" other than the parties to the primary contract.[101] The court denied the surety's motion and held there was no arbitration agreement between the surety and the obligee.[102] Similarly, in the *Hartford Accident & Indemnity Company* case, in assessing whether the surety could compel arbitration, the court construed the incorporation clause in the performance bond as merely incorporating the owner's promise to arbitrate with the contractor, rather than extending the arbitration obligations of the owner to the surety.[103]

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[97] *Great Am. Ins. Co. v. Hinkle Contr. Corp.,* 497 Fed. Appx. 348, 352 (4th Cir. 2012).
[98] *Netplannyer Sys. v. GSC Constr., Inc.,* Case No. 4:16-CV-150 (CDL), 2017 U.S. Dist. LEXIS 131210, *2 (D. Ga. Aug. 17, 2017) *citing Morewitz v. W. of Eng. Ship Owners Mut. Prot. & Indem. Ass'n (Lux.),* 62 F.3d 1356, 1365 (11th Cir. 1995) (and finding that surety and principal waived right to compel arbitration by engaging in conduct inconsistent with insisting on their right to arbitrate by waiting until eve of trial to raise issue).
[99] *See Hartford Accident & Indem. Co. v. Scarlett Harbor Assocs. Ltd. P'ship,* 695 A.2d 153 (Md. Ct. App. 1997) and *AgGrow Oils, L.L.C. v. National Union Fire Ins. Co.*, 242 F.3d 777 (8th Cir. 2001).
[100] *Id.* at 779-780.
[101] *Id.* at 781.
[102] *Id.* at 783.
[103] *Hartford Accident & Indem. Co.,* 695 A.2d at 156.

Another case focusing on the intent of the parties is *Excavating Engineers, Inc. v. National Fire Ins. Co.*[104] There, a subcontractor sued a general contractor and its surety on a payment bond. The surety sought to compel arbitration based on a clause in the primary contract which stated "[a]ny controversy arising out of this subcontract or a breach of it may be settled by arbitration under the rules of the American Arbitration Association applicable to the construction industry at Contractor's option."[105] A subsequent clause provided the "[s]ubcontract . . . shall not give third parties other than the owner any claim, demand or right of action against contractor or subcontractor." The court stated "a surety has no existing right to arbitrate" unless the parties to the contract "intended to primarily and directly benefit the third party." Reading the two clauses together, the Court determined the contract did not express an intent to benefit the surety, and held the surety could not compel arbitration.[106]

The case of *Mendez v. Palm Harbor Homes, Inc*.[107]presents a unique scenario where a surety was unable to compel arbitration based on the cost of the proceedings. In *Mendez*, a purchaser of a mobile home sued the seller and its surety when the sale fell through. The seller and surety sought to compel arbitration in accordance with the sales contract and arbitration agreement. The plaintiff argued that he should not be compelled to arbitrate under the contract because the entry costs of arbitration would be prohibitive. In deciding whether the plaintiff was required to arbitrate his disputes, the court noted that "Washington's policy favoring arbitration is grounded on the proposition that arbitration allows litigants to avoid the formalities, expense, and delays inherent in the court system."[108] Taking into account the plaintiff's $20,000 annual salary, his $1,500 claim, and the $2,000 entry cost to arbitration, the court held that the

[104] 524 So.2d 1112 (Fla. Dist. Ct. App. 1988).
[105] *Id.*
[106] *Id.*
[107] 45 P.3d 594 (Wash. Ct. App. 2002).
[108] *Id.* at 604.

arbitration costs were prohibitively high and the plaintiff was not required to arbitrate his dispute.[109]

In the recent case of *Portland General Electric Co. v. Liberty Mutual Ins. Co.,*[110] the owner objected to including two sureties in an arbitration and sought a preliminary injunction prohibiting the sureties from arbitrating their claims against the owner. The Ninth Circuit reversed the district court's granting of the preliminary injunction and agreed with the sureties that the question of whether the surety's claim could be arbitrated was a question for the arbitrator. The court noted that the question was the scope of the arbitration clause at issue and one for the arbitrator to decide.

V. The Mechanics of Arbitration

A. Beginning the Process

The arbitration agreement is the starting point for determining the authority and enforcement powers of the arbitrator. Questions as to the arbitrability of issues generally are for a court to decide unless the parties clearly and unmistakably provide otherwise.[111] Questions as to the validity and scope of an arbitration agreement should be decided by the arbitrators, not the courts. Parties may delegate the adjudication of gateway issues such as arbitrability of claims to the arbitrator if they clearly and unmistakably agree to do so.[112] Courts have found such delegation, for example, where the parties incorporated by reference the rules of the American Arbitration Association, which state in relevant part that the "arbitrator shall have the power to

[109] *Id.* at 607–08.
[110] *Portland General Electric Co. v. Liberty Mutual Ins Co.,* 862 F.3d 981 (9th Cir. 2017).
[111] *GOE Lima, LLC v. Ohio Farmers Ins Co. (In re GOE Lima, LLC),* No. 08-35508, Ch. 11 Adv. Pro. No. 09-3204, 2012 Bankr. LEXIS 4591, *20 (N.D. Ohio, Oct. 1, 2012) *citing Howsam v. Dean Witter Reynolds, Inc.,* 537 U.S. 79 (2002) and *First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938 (1995).
[112] *Portland General Electric Co.,* 862 F.3d 981; *GOE Lima, LLC,* 2012 Bankr. LEXIS 4591, *20.

rule on his or her own jurisdiction, including any objections with respect to the validity of the arbitration agreement."[113]

Commencing an arbitration typically is dictated by the terms of the contractual language. Some alternative disputes resolution ("ADR") companies outline specific procedures which include a written demand or confirmation of the parties to participate and submit to the entities' rules.[114] Alternatively, a court order compelling arbitration may begin the procedure.

A major difference between litigation and arbitration is that, in an arbitration setting, the parties are able to choose their potential triers of fact. Because it is very difficult to challenge or appeal an arbitration award, selecting the right arbitrator (or arbitrators depending on whether a three-member tribunal is utilized) who understands the issues relating to the particular dispute is very important. While arbitrators are required to be impartial and independent,[115] there are no restrictions on who can become an arbitrator. Similar to the mediation setting, non-lawyers can be appointed arbitrators of disputes. Because an arbitrator does not need to have formal training, a non-lawyer arbitrator with certain specific experience may be an advantage for opting for arbitration over a traditional litigation setting,

In addition to the arbitrator's qualifications and experience with the particular issues, the success and management skills of the arbitrator should be considered. The potential candidate's caseload and whether the candidate has the availability and time to devote to the claims should not be overlooked. Well-known arbitrators with good track records may be in high demand and have significant caseloads. In those instances, the parties will necessarily weigh whether a delay

[113] *Id. citing Brennan v. Opus Bank,* 796 F.3d 1125, 1130 (9th Cir. 2015).
[114] *See, e.g.,* American Arbitration Association Construction Industry Arbitration Rules and Mediation Procedures, Rules 4 and 5, effective July 1, 2015.
[115] *See, e.g.,* Uniform Arbitration Act, Section 11 stating that an individual who has a known direct and material interest in the outcome of the arbitration proceeding, or a known, existing, and substantial relationship with a party may not serve as an arbitrator required by an agreement to be neutral.

in proceeding to arbitration is worth the wait, particularly if the arbitrator is the best candidate to resolve the dispute due to his or her particular legal or professional experience.

The Federal Arbitration Act provides that if an arbitration provision sets forth the method of naming or appointing an arbitrator that method is to be followed. However, if no method be provided or if a party fails to use a prescribed method, then either party can apply to the court to designate and appoint an arbitrator.[116]

Where an agreement to arbitrate or arbitration clause specifies a particular alternative disputes resolution ("ADR") company, such as American Arbitration Association or JAMs, those entities often have procedures to assist with the selection of arbitrators. For example, in the event of the parties cannot agree on an arbitrator, the ADR agency may provide a list of candidates with descriptions and backgrounds and have specific procedures and timelines under which the parties operate to select an arbitrator.[117]

Some ADR companies offer various procedural tracks. A traditional arbitration track is structured similar to a litigation track where case management hearings are conducted, the arbitrator controls the discovery process and hearing and ultimately determines the award. Resolution through document submission is a more simplified process where no actual hearing is conducted. This type of track allows flexibility and more emphasis on the use of technology. Other options may tailor the process to smaller cases such as the American Arbitration Association's Fast Track Procedure which is designed for cases involving claims between two parties with alleged damages of less than $100,000.00 and allows for an expedited hearing and award.

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[116] 9 U.S.C. §5 (2017).

[117] See, e.g., JAMS Engineering and Construction Arbitration Rules & Procedures, Rule 15, effective Nov. 15, 2014; *See, e.g.,* American Arbitration Association Construction Industry Arbitration Rules and Mediation Procedures, Rules 3 and 14, effective July 1, 2015.

B. Pre-Hearing Matters

Once commenced, preliminary conferences often take place with the arbitrator and the parties. Several matters should be addressed including discovery, pleadings, scheduling of the hearing, pre-hearing exchanges of information, exhibits, motions and briefs. Similar in some respects to traditional litigation and pre-trial procedures, the conference often covers the parameters of the scheduling of any dipositive motions, preparation of exhibits, joint exhibit lists and the resolution of admissibility of exhibits. The parties may also discuss the attendance of witnesses at the hearing and other matters particular to the case.

As noted above, a typical criticism of arbitration versus opting for the traditional litigation setting was the perceived restrictions on discovery in the arbitration forum. This may or may not be true. Arbitration agreements may spell out discovery parameters although that type of detail is rarely seen incorporated into a construction contract provision. ADR companies often have discovery rules built into their procedures that require good faith exchanges of all non-privileged documents and electronically stored information relevant to the matter. Those rules often mirror the disclosures required by federal and state courts such as the disclosure of individuals with relevant knowledge, witnesses that may be called to testify and experts that have been retained to provide testimony. However, unlike a typical court case, there may be restrictions on the number of depositions unless the arbitrator agrees there is a reasonable need for more.[118]

Pre-hearing submissions may be required or agreed to by the parties and exchanged in the weeks prior to the hearing similar to pre-trial order procedures employed by federal and some state courts. Those submissions typically call for (1) a list of witnesses to be called at the

[118] See, e.g., JAMS Engineering and Construction Arbitration Rules & Procedures, Rule 17, effective Nov. 15, 2014 limiting the number of depositions to two per party.

hearing, including any experts; (2) a description of anticipated testimony; (3) a list of exhibits intended to be used at the hearing; and (4) copies of any exhibits not previously exchanged. Similar to pre-mediation statements, the parties may be required or chose to submit statements of their respective positions, summaries of the facts and evidence, discussion of any applicable case law and the damages sought.

C. The Arbitration Hearing

The arbitration hearing process is based on the model of a civil trial and there are similarities and differences. Of course, the major difference is that the technical rules of evidence and procedure do not apply in an arbitration hearing. Strict conformity with the rules of evidence is not required and the arbitrator can consider the evidence he or she feels is relevant and weigh that evidence as the arbitrator deems appropriate.

The Federal Arbitration Act empowers arbitrators to summon any person, including third-party witnesses, and compel them to appear as a witness and produce any documents that may be deemed material as evidence in the case.[119] The fees for such attendance are to be the same as the fees in United States courts.[120] Because arbitrators do not have the authority to enforce compliance, the Act also allows the arbitrator to petition the United States district court to compel the attendance of anyone who fails to comply with the summons or subpoena or to hold that person in contempt in the same manner provided by law for securing the attendance of witnesses in the courts of the United States.[121]

The arbitrator will typically determine the order of proof which is generally similar to a court trial. Witnesses testify under oath if requested by the arbitrator although the arbitrator often has discretion to consider deposition testimony as well. The parties will introduce evidence and

[119] 9 U.S.C. §7 (2017).
[120] *Id.*
[121] *Id.*

call witnesses to support their case. While a trier of fact in a trial may ask questions, it is typical for an arbitrator to ask questions to ensure that he or she has a clear understanding of relevant issues and facts. The parties will have an opportunity to conduct cross-examination. Following the parties' presentations and any subsequent questions from the arbitrator, each party typically makes a closing statement summarizing the points of their respective cases. When the arbitrator determines that all relevant and material evidence has been presented the arbitrator will close or adjourn the hearing. The arbitrator will then determine the award and close the hearing at that time or defer the closing of the hearing and adjourn to a later time to permit post-hearing briefs or other closing arguments.

D. The Award and Enforcement Powers of the Arbitrator

The Federal Arbitration Act sets out the legislative framework for the enforcement of arbitration agreements and arbitral awards in the United States.[122] When the terms of an arbitration agreement or clause do not limit the arbitrator, an arbitrator is normally empowered to grant any relief "reasonably fitting and necessary to the final determination of the matter submitted to them."[123] The Act gives the arbitrator wide deference in awarding remedies contemplated by the arbitration agreement.[124] Unless the contract expressly provides that state law is to govern over the Federal Arbitration Act, the Federal Arbitration Act applies.[125]

The Uniform Arbitration Act was revised in 2000 and provides a framework for governing arbitration, and has been adopted by many states. The Revised Uniform Arbitration Act provides:

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[122] Claudia Salomon and Samuel de Villiers, *The United States Federal Arbitration Act: A Powerful Tool for Enforcing Arbitration Agreements and Arbitral Awards,* Lexis@PSL Arbitration (April 17, 2014).
[123] *Michigan Mut. Ins. Co. v. Unigard Sec. Ins. Co.,* 44 F.3d 826, 831 (9th Cir. 1995).
[124] 9 U.S.C.S. § 10(a)(4) (2017).
[125] *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 62–64 (1995).

> An arbitrator may award punitive damages or other exemplary relief if such an award is authorized by law in a civil action involving the same claim and the evidence produce at the hearing justifies the award under the legal standards otherwise applicable to the claim. . . . As to all [other] remedies . . . an arbitrator may order such remedies as the arbitrator considers just and appropriate under the circumstances of the arbitration proceeding. The fact that such a remedy could not or would not be granted by the court is not a ground for refusing to confirm an award . . . or for vacating an award.[126]

While only three jurisdictions have adopted language identical to the above provision, many state statutes provide similar standards, and generally give arbitrators substantial latitude in fashioning awards.[127]

The Federal Arbitration Act and applicable state statutes strongly favor confirmation of arbitration awards. The Act also supplies mechanisms for enforcing arbitration awards: a judicial decree confirming an award, an order vacating it, or an order modifying or correcting it.[128] The Federal Arbitration Act provides that at any time within one year after the award is made any party to the arbitration may apply to the applicable court for an order confirming the award, and the court must grant such an order unless the award is vacated, modified, or corrected.[129]

The grounds for vacating are, generally, (1) where the award was procured by corruption or fraud; (2) where there was evident partiality or corruption in the arbitrators; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them.[130] Sections 10(a)(1) through (a)(3) focus on the fairness and impartiality of the arbitration process, while section (a)(4) is concerned

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[126] UNIFORM ARBITRATION ACT §§ 21(a)–(c) (2000).
[127] Or. Rev. Stat. Ann. § 36.700 (2017); Minn. Stat. Ann. § 572B.21 (2017); Wash. Rev. Code Ann. § 7.04A.210 (2017).
[128] *Hall St. Assocs., LLC v. Mattel,* 552 U.S. 576 (2008)
[129] 9 U.S.C.S. § 9 (2017).
[130] 9 U.S.C.S. § 10 (2017).

with the actual correctness of the award.[131] There is a dispute among the Circuits as to whether there is a fifth ground for vacating an award due to the arbitrator's manifest disregard for the law while other Circuits have ruled that the Supreme Court has been clear that only the four grounds enumerated in Section 10 are means to vacate.[132]

Section 11 of the Federal Arbitration Act focuses on the grounds for modifying or correcting an award and are limited to where (a) there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award; (b) the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted; or (c) the award is imperfect in matter of form not affecting the merits of the controversy.[133]

1. Vacating an Award for Fraud or Corruption

As noted, courts may vacate an arbitration award if it was procured "by corruption, fraud, or undue means."[134] The Sixth, Seventh, Ninth, and Eleventh Circuits follow a three-part test for vacating awards on the basis of fraud. The movant must (1) establish the fraud by clear and convincing evidence, (2) the fraud must not have been discoverable upon the exercise of due diligence prior to or during the arbitration, and (3) the movant must demonstrate that the fraud materially related to an issue in the arbitration.[135]

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[131] Katherine A. Helm, *The Expanding Scope of Judicial Review of Arbitration Awards: Where Does the Buck Stop?* 61 DISP. RESOL. J. 16 (2006-2007).
[132] Saloman, et al., *supra* note 122.
[133] 9 U.S.C.S. § 11 (2017).
[134] 9 U.S.C.S. § 10(a)(1) (2017).
[135] *Int'l Bhd. Of Teamsters, Local 519 v. UPS*, 335 F.3d 497, 503 (6th Cir. 2003); *Gingiss Int'l v. Bormet*, 58 F.3d 328, 333 (7th Cir. 1995); *A.G. Edwards & Sons, Inc. v. McCollough*, 967 F.2d 1401, 1404 (9th Cir. 1992); *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1383 (11th Cir. 1988).

2. Vacating an Award for Arbitrator's Evident Partiality

The Federal Arbitration Act provides that a court may vacate an arbitration award "where there was evident partiality or corruption in the arbitrators."[136] Partiality issues most commonly arise when the arbitrator fails to disclose a relationship or interest that is suggestive of bias.

The standard applied to establish evident partiality may differ slightly depending on the jurisdiction. For example, in the Ninth Circuit, to show "evident partiality" the movant must establish "specific facts indicating actual bias toward or against a party or show that [the arbitrator] failed to disclose to the parties information that creates a reasonable impression of bias."[137] The Second Circuit follows a slightly different approach, and does not require proof of actual bias so long as a "conclusion of partiality can be inferred from objective facts inconsistent with impartiality."[138]

Movants under section 10(a)(2) have a difficult time proving partiality, and courts often find undisclosed relationships to be "too insubstantial" to warrant vacating the award.[139] Some examples of insubstantial relationships include: arbitrator's past work as an expert witness for a party, arbitrator's prior service on panels with the president of a party's firm, arbitrator's acceptance of campaign contributions from a party, two arbitrators' previous joint ownership of an airplane, and an arbitrator's previous work as co-counsel with a party.[140] However, the

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[136] 9 U.S.C.S. § 10(a)(2) (2017).
[137] *Lagstein v. Certain Underwriters at Lloyd's*, 607 F.3d 634, 645–46 (9th Cir. 2010).
[138] *Scandinavian Reinsurance Co. v. St. Paul Fire & Marine Ins. Co.*, 668 F.3d 60, 72 (2d Cir. 2012).
[139] *Id.* at 72.
[140] *Freeman v. Pittsburgh Glass Works, LLC*, 709 F.3d 240 (3d Cir. 2013) (finding campaign contributions to arbitrator from one of the parties did not rise to evident partiality); *Uhl v. Komatsu Forklift Co.*, 512 F.3d 294 (6th Cir. 2008) (finding insignificant the arbitrator's previous work as co-counsel with one of the parties); *Lucent Techs., Inc. v. Tatung Co.*, 379 F.3d 24 (2d Cir. 2004) (finding two arbitrators' co-ownership of an airplane insignificant); *ANR Coal Co. v. Cogentrix of N.C., Inc.*, 173 F.3d 493 (4th Cir. 1999) (finding that arbitrator's law firm previously represented a party did not rise to evident partiality); *Andros Compania Maritima, S.A. v. Marc Rich & Co.*, A.G.,

existence of an ongoing business relationship between an arbitrator and a party may give rise to evident partiality and warrant vacating the award.[141]

3. Vacating an Award for Arbitrator's Misconduct

Courts may vacate an arbitration award "where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced."[142] This is an extremely deferential standard, as arbitrators have substantial discretion to admit or exclude evidence.[143]

Most jurisdictions define "misconduct" as conduct which "so affects the rights of a party that it may be said that he was deprived of a fair hearing."[144] Thus, whether alleging a refusal to postpone the hearing, a failure to hear material evidence, or other misbehavior, the conduct must deprive the movant of a fair hearing for vacatur to be appropriate.

4. Vacating an Award When the Arbitrator Exceeds its Powers

Vacatur is also appropriate under the Federal Arbitration Act "where the arbitrators exceeded their powers or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made."[145] The Supreme Court of the United States has stated that "an error – or even a serious error" is not enough to vacate an award.[146] Rather, and arbitrator must act "outside the scope of his contractually delegated authority" and issue an

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579 F.2d 691 (2d Cir. 1978) (finding no evident partiality where arbitrator served on 19 arbitration panels with president of party's firm).

[141] *New Regency Prods., Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101 (9th Cir. 2007); *Applied Indus. Materials Cor. v. Ovalar Makine Ticaret Ve Sanayi, A.S.*, 492 F.3d 132 (2d Cir. 2007) (finding evident partiality where arbitrator's corporation had ongoing business relationship with party).

[142] 9 U.S.C.S. § 10(a)(3) (2017).

[143] *LJL 33rd St. Assocs., LLC v. Pitcairn Props.*, 725 F.3d 184 (2d Cir. 2013).

[144] *Century Indem. Co. v. Certain Underwriters at Lloyd's*, 584 F.3d 513, 557 (3d Cir. 2009); *Nat'l Cas. Co. v. First State Ins. Group*, 430 F.3d 492, 497 (1st Cir. 2005).

[145] 9 U.S.C.S. § 10(a)(4) (2017).

[146] *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2068 (2013).

award reflecting his own notions of economic justice, "rather than drawing its essence from the contract."[147] The relevant inquiry is whether the arbitrator's award "was so unfounded in reason and fact, so unconnected with the wording and purpose of the contract as to manifest an infidelity to the obligation of an arbitrator."[148] Provided the arbitrator makes a good faith attempt to enforce the contract, and doesn't decide issues not submitted to him or award remedies not contemplated by the agreement, the award will be enforced.[149]

5. Modifying or Correcting an Award

Even though an arbitration award is binding, it does not mean that the losing party does not have remedies available to vacate, modify, or correct the award. If a party wants to challenge the award, there is a statutory time, manner, and place to do so.[150] The only option for challenging an award under the Federal Arbitration Act is to file a motion to vacate or modify an award.[151] Importantly, given the federal policy favoring arbitration, it is much easier to confirm an award than it is to vacate, modify, or correct an award. Under the Act, a motion to confirm an award may be made up to a year after the award is delivered versus the three months for vacating or modifying.[152]

Because of the binding nature of the award, the three-month time period is strictly enforced. In *Taylor v. Nelson*,[153] the Fourth Circuit held that the nonprevailing party failed to act with due diligence in seeking vacatur within three months of the award.[154] There, the nonprevailing party waited to file his motion to vacate until five months after the arbitration

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[147] *Id.*
[148] *Cooper v. WestEnd Capital Mgmt., LLC*, 832 F.3d 534, 546 (5th Cir. 2016).
[149] *Sutter v. Oxford Health Plans, LLC*, 675 F.3d 215, 219–20 (3d Cir. 2012).
[150] According to the Federal Arbitration Act "[n]otice of a motion to vacate, modify, or correct an award must be served upon the adverse party or his attorney with-in three months after the award is filed or delivered . . . ." 9 U.S.C. § 12.
[151] *See Contech Constr. Prods., Inc. v. Heierli,* 764 F.Supp. 2d 96 (D.D.C. 2011).
[152] 9 U.S.C. §§ 9, 12 (2017).
[153] *Taylor v. Nelson,* 788 F.2d 220 (4th Cir. 1986).
[154] *Id.* at 225-226.

award was entered.[155] The prevailing party had filed a motion to confirm and the nonprevailing party opposed the motion to confirm on the grounds that the stayed federal court action needed to be resolved.[156] Subsequently, the nonprevailing party filed a motion to vacate the arbitration award, but the court held that it was untimely. The court rejected the argument that the deadline to file a motion to vacate was tolled.[157] Courts have continued to follow this trend, leaving no question that a party may not "sleep on its right" to request vacatur, independent of the procedural posture of any request by the other side to confirm the award.[158]

It should be noted that the rule does not require that the motion be filed within three months. It requires that the motion be **served** within three months.[159] In *Argentine Republic v. National Grid PLC*, the Court of Appeals for the District of Columbia strictly enforced this provision when it disallowed a motion to vacate filed three days before the three-month deadline but that was not served within that time-frame.[160] Procedurally, once the three months to seek vacatur or modification has passed, the only means to challenge the award is by challenging a motion to confirm an award on the basis that it has not met the burden for a motion to confirm.[161] In those instances, a motion to dismiss a motion to confirm, even if not filed within the three-month window, often acts as a motion to vacate.[162]

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[155] *Id*. at 222
[156] *Id.*
[157] *Id.* at 225 ("once the three-month period has expired, an attempt to vacate an arbitration award could not be made even in opposition to a later motion to confirm).
[158] *See Choice Hotels Int'l, Inc. v. Shiv Hospitality, LLC,* 491 F.3d 171, 177-178 (4th Cir. 2007); *Ameser v. Nordstrom, Inc.,* 442 Fed. Appx. 967 (5th Cir. 2011); *Dalal v. Goldman Sachs & Co.,* 541 F.Supp.2d 72 (D.D.C. 2008); *Webster v. A.T. Kearney, Inc.,* 507 F.3d 568 (7th Cir. 2007).
[159] 9 U.S.C. § 12.
[160] 637 F.3d 365, 368 (D.C. Cir. 2011).
[161] *Int'l Trading & Indus. Inv. Co. v. DynCorp Aerospace Tech.,* 763 F.Supp.2d 12 (D.D.C. 2011).
[162] *Taylor v. Nelson,* 788 F.2d 220, 225 (4th Cir. 1986); *see also E. Seaboard Const. Co., Inc. v. Gray Constr., Inc.,* 553 F.3d 1, 6 (1st Cir. 2008).

VI. Conclusion[163]

The surety's participation in an arbitration is dependent on its ability to arbitrate. Courts favor arbitration and the majority require the surety to arbitrate when the surety's bond incorporates a contract containing an arbitration clause. The terms of the bond, arbitration provision and any other contracts will be scrutinized by the courts to determine the arbitrability of parties and issues. The surety should also be cognizant of any applicable statutory requirements.

Many issues will factor into the surety's evaluation of arbitrating a matter. Some of which include the associated costs, any constraints on discovery, the availability of potential arbitrators and the specific issues involved with the case. Arbitrators are not bound by the rules of evidence and the finality of awards can be both advantageous and concerning. Arbitrators have broad discretion in fashioning arbitration awards, and the awards will often be enforced absent substantial deviation from the agreement. Because judicial review of the arbitration award will only result in vacatur if the court finds fraud, partiality, misconduct, or an overextension of the arbitrator's powers, the surety should carefully evaluate all aspects of the arbitrable case.

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