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ARBITRATION - REQUIRED OR NOT, AND WHY DOES THE SURETY CARE?

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I. INTRODUCTION-WHAT IS ARBITRATION?

A. In General

Arbitration is an alternative dispute resolution mechanism ideal for litigating legal claims outside of a courtroom. Addressing legal issues by arbitration has increased in popularity generally, and certainly in the narrower context of construction disputes. Much of the attraction to arbitration is flexibility, a swifter conclusion, and limited appeal rights. Additionally, parties to arbitration have more control over certain pertinent matters, such as the level of expertise of the decision maker over the issues surrounding the dispute.

Arbitration of construction-related claims, including those involving a surety, can be beneficial in many ways. Yet, sometimes submitting a dispute to arbitration can be risky. As a result, agreeing to submit disputes to arbitration has become a relatively standard practice in the construction industry.

This article seeks to provide guidance to the surety professional when faced with a bonded construction contract that calls for arbitration, or when a principal and obligee (or principal and subcontractor) agree to submit to some form of arbitration. Because arbitrations can vary significantly, each situation must be analyzed on an individual basis.

B. Submitting a Dispute to Arbitration

A legal dispute is generally submitted to arbitration either by a pre-dispute contractual agreement, or by a stipulation of the parties. Because public policy encourages the use of this mechanism, courts will generally support the parties' decision and agreement to arbitrate by either method.

(i) Provided by Contract

Generally, the decision to arbitrate disputes is made at the onset of a contractual relationship. There are several factors that parties should consider when drafting an arbitration clause. The clause will ultimately provide a guide for the parties and decision makers should a legal dispute arise.[1]

Arbitration provisions may address a number of considerations or, alternatively, may leave various determinations open for the court or arbitrator's interpretation.[2] For instance, arbitration provisions sometimes specify what parties are bound to arbitration proceedings.[3] Moreover, parties may predetermine the particular rules or arbitration organization the parties are to use in the event of a legal dispute.[4] The arbitration provision may also declare that

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[1] *See, e.g., American Exp. Co. v. Italian Colors Restaurant*, 570 U.S. 228, 233 (2013) (because arbitration is a matter of contract, "courts must rigorously enforce arbitration agreements according to their terms."). *See also Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 559 U.S. 662, 682 (2010) (quoting *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 498 U.S. 468, 479 (1989)) ("Whether enforcing an agreement to arbitrate or construing an arbitration clause, courts and arbitrators must 'give effect to the contractual rights and expectations of the parties.'").

[2] *See Granite Rock Co. v. International Broth. of Teamsters*, 561 U.S. 287, 301 (2010).

[3] *See Stolt-Nielsen S.A.*, 559 U.S. at 663 (citing *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 289 (2002)).

[4] *See Stolt-Nielsen S.A.*, 559 U.S. at 663 (citing *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 498 U.S. 468, 479 (1989)).

arbitration is binding or non-binding, as well as whether submitting the matter to arbitration is mandatory or discretionary. Further, because the arbitrator does not necessarily need to be an attorney or judge, the arbitration agreement may also include language that identifies what expertise the arbitrator must possess.[5] As explained by the United States Supreme Court, "[t]he point of affording parties discretion in designing arbitration is to allow for efficient, streamlined procedures tailored to the type of dispute."[6] Thus, it is preferable that the arbitration provision provide as much specific procedural guidance as possible regarding the arbitration administrator, number of arbitrators, and who will pay the cost of arbitration. These issues can be burdensome and cause delay.

Additionally, the language in an arbitration clause addressing the scope of arbitrable issues can be broad or narrow.[7] The provisions should specify the scope of the issues that are required to be submitted to the arbitrator.[8] The broader the scope of issues to be arbitrated under the parties' agreement, the greater latitude and authority the arbitrator has in making his or her decision or award, and there is less chance for piecemeal litigation of related disputes.[9]

For instance, arbitration clauses that expressly cover all claims "arising out of or relating to the contract," or similar language, are considered broad and expand the scope to include consequential issues that touch matters covered by the contract.[10] The broad application of arbitration provisions with this language is widely recognized.

(ii) *Stipulation to Arbitrate*

Even if the parties to a legal dispute did not enter into a valid contractual arbitration agreement pre-dispute, they may subsequently stipulate to submit the claims to arbitration. Some states, such as Florida and Louisiana, have enacted statutes that permit parties to voluntarily submit their claims to binding arbitration. Pursuant to section 44.104(1), Florida Statutes:

> Two or more opposing parties who are involved in a civil dispute may agree in writing to submit the controversy to voluntary binding arbitration, or voluntary trial resolution, in lieu of litigation of the issues involved, prior to or after a lawsuit has been filed, provided no constitutional issue is involved.

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[5] *See Stolt-Nielsen S.A.*, 559 U.S. at 663 (2010) ("[Parties] may choose who will resolve specific disputes.").
[6] *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 343 (2011).
[7] *See* Martin Domke, Larry Edmonson, & Gabriel M. Wilner, DOMKE ON COMMERCIAL ARBBITRATION § 16:2 (2017).
[8] *See E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279, 289 (2002) ("Absent some ambiguity in the agreement, however, it is the language of the contract that defines the scope of disputes subject to arbitration.").
[9] *See KPMG LLP v. Cocchi*, 132 S.Ct. 23, 25-26 (2011) (holding that where a dispute involves arbitrable and nonarbitrable claims, courts are required to compel arbitration of the arbitrable issues even though it may result in separate proceedings in different forums).
[10] *See* Philip L. Bruner & Patrick J. O'Connor, Jr., BRUNER & O'CONNOR CONSTRUCTION LAW § 21:125 (2017). *See also Great American Ins. Co. v. Hinkle Contracting Corp.*, 497 Fed.Appx. 348, 354 (4th Cir. 2012) (holding that the surety's claims and defenses were "related to" the subcontract because they bear a significant relationship to the subcontract); *Jewish Federation of Greater New Orleans v. Fidelity & Deposit Co. of Maryland*, 273 F.3d 1094, 1094 (5th Cir. 2001) (quoting *Pennzoil Exploration & Prod. Co. v. Ramco Energy Ltd.*, 139 F.3d 1061, 1068 (5th Cir. 1998)) ("Because the arbitration provision is not limited to 'Any controversy or Claim arising out of … the Contract', but also applies to 'Any controversy or Claim … related to the [construction] Contract', it is not necessary that the dispute arise out of the construction contract to be arbitrable, but only that the dispute 'touch matters covered by [the contract]'.").

Similarly, section 9:4201, Louisiana Statutes Annotated, provides that not only shall a pre-dispute arbitration provision be enforced, but that also:

> …an agreement in writing between two or more persons to submit to arbitration any controversy existing between them at the time of the agreement to submit, shall be valid, irrevocable, and enforceable.

Significantly, these state-instituted rules provide parties the opportunity to subsequently agree to submit matters to arbitration even though they did not validly stipulate to arbitration before the controversy arose.[11]

(iii) *Court Referred Arbitration*

While the vast majority of legal disputes are submitted to arbitration pursuant to the parties' contractual agreement or subsequent stipulation, there are some unique instances where parties may be sent to arbitration through alternative methods.

Specifically, some states have enacted laws allowing for court-annexed arbitration.[12] Generally, where a court is permitted to refer parties to arbitration, the arbitrator's award or decision is "non-binding."

In nonbinding arbitration, the arbitrator's decision in essence serves as an advisory opinion,[13] which can help the parties determine whether settlement, submitting the matter to binding arbitration, or trial is the appropriate next step.[14] Nonbinding arbitration does not prevent the parties from subsequently submitting the dispute to a court or jury.[15]

On the other hand, binding arbitration is a final adjudication of the merits of a case.[16] By agreeing to submit claims to binding arbitration, parties give up their right to a jury trial for those issues submitted to arbitration.[17]

Florida law permits a court to order parties to a legal dispute to participate in a "nonbinding" arbitration, even if the parties have not agreed to do so.[18] The application of this statute could have serious repercussions for the parties involved. Although the arbitrator's decision or award is technically "nonbinding," the decision *will* be final and binding against the parties if neither party requests a trial *de novo* within the requisite timeframe under the

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[11] *See Friendly Homes of the South Inc. v. Fontice*, 932 So.2d 634, 637 (Fla. 2d DCA 2006) (applying Fla. Stat. § 44.104) ("The parties having jointly stipulated for arbitration in this case, Friendly Homes was entitled to arbitration regardless of whether the May 1997 'Arbitration Document Disclosure' was effective."); s*ee also North American Specialty Ins. Co. v. First Millennium Const., LLC*, 2015 WL 1842962, at *2 (E.D. La. April 21, 2015) (applying La.Rev.Stat. § 9:4201).

[12] *See* Thomas H. Oehmke, COMMERCIAL ARBITRATION § 1:18 (2017) (listing certain states that compel arbitration of certain civil matters).

[13] *See* Thomas H. Oehmke, COMMERCIAL ARBITRATION § 1:15.

[14] *See* Thomas H. Oehmke, COMMERCIAL ARBITRATION § 1:14.

[15] *See* Alan S. Gutterman, BUSINESS TRANSACTIONS SOLUTIONS § 101:20 (March 2018 Update).

[16] *Id.*

[17] *See Kindred Nursing Centers Ltd. Partnership v. Clark*, 137 S.Ct. 1421, 1427 (2017) (stating that a waiver of the right to go to court and receive a jury trial is the primary characteristic of an arbitration agreement).

[18] Fla. Stat. § 44.103.

pertinent statute.[19] Subsection 44.103(5), Florida Statutes, which sets forth the procedure for converting a nonbinding arbitration award to one that is final and binding, states:

> The arbitration decision shall be presented to the parties in writing. An arbitration decision shall be final if a request for a trial de novo is not filed within the time provided by rules promulgated by the Supreme Court. The decision shall not be made known to the judge who may preside over the case unless no request for trial de novo is made as herein provided or unless otherwise provided by law. If no request for trial de novo is made within the time provided, the decision shall be referred to the presiding judge in the case who shall enter such orders and judgments as are required to carry out the terms of the decision, which orders shall be enforceable by the contempt powers of the court, and for which judgments execution shall issue on request of a party.

Additionally, even if the parties do proceed to trial after the arbitrator renders a decision, the party requesting a trial *de novo* may still be impacted by the arbitrator's decision or award. Specifically, a plaintiff requesting a trial *de novo* after a court-ordered nonbinding arbitration runs the risk of being assessed "arbitration costs, court costs, reasonable attorney's fees, and other reasonable costs such as investigation expenses and expenses for expert or other testimony which were incurred after the hearing and continuing through the trial of the case" if a judgment, entered in favor of the requesting party, is at least 25 percent less than the arbitration award.[20]

Conversely, a defendant requesting a trial *de novo* after a court-ordered nonbinding arbitration award may be liable for these same costs if the judgment is at least 25 percent more than the arbitration award.[21] Take the same hypothetical arbitration award in the plaintiff's favor for $100,000. If the defendant, rather than the plaintiff, requests a trial *de novo,* after the court-ordered non-binding arbitration, and a judgment is entered in the plaintiff's favor for $125,000 or more, the defendant may likewise be liable for the attorneys' fees and costs from the date of the arbitration award forward.

Courts in Florida are utilizing this statute in limited circumstances—in an attempt to bring about a pre-trial resolution. What makes participation with this procedure challenging is the informal nature of the proceedings, and the limited evidence that is actually required. As the growth and favorability of arbitration progresses, and courts become more burdened, more statutes may be implemented to encourage the settlement of legal matters outside the courtroom. Accordingly, any party to a potential legal dispute should consider the different ways in which it may be forced to arbitrate and what type of impact the arbitrator's decision may have.

[19] *Id.*
[20] Fla. Stat. §§ 44.103(6) and (6)(a).
[21] Fla. Stat. §§ 44.103(6) and (6)(b).

C. Organizations that Administer Arbitrations

There are three main private arbitration organizations that administer arbitrations: American Arbitration Association ("AAA"),[22] Judicial Arbitration and Mediation Services ("JAMS"),[23] and the International Institute for Conflict Prevention and Resolution ("CPR").[24] Each of these organizations has its own rules and procedures, timelines, arbitrators, and schedules of fees and costs.

Each organization also has practice specific rules. For instance, a construction dispute arbitrated before AAA may proceed using the Construction Industry Arbitration Rules and Mediation Procedures.[25] According to AAA:

> The ***AAA Construction Rules and Mediation Procedures*** were developed with input from the **National Construction Dispute Resolution Committee (NCDRC)**, an advisory group founded in 1966 by the AAA in cooperation with the American Institute of Architects (AIA) and other industry, trade, and professional associations.[26]

Likewise, JAMS instituted the JAMS Engineering and Construction Arbitration Rules & Procedures,[27] the JAMS Engineering and Construction Arbitration Rules & Procedures for Expedited Arbitration,[28] and a distinct procedure for Dispute Resolution Rules for Surety Bond Disputes.[29] As explained by JAMS:

> JAMS Surety Bond Expedited Dispute Resolution recognizes the unique nature of surety disputes and the necessity of resolving them quickly. The JAMS Dispute Resolution Rules for Surety Bond Disputes provide for adjudicator appointment within three days of filing of a demand. Adjudicators drawn from the JAMS GEC Panel issue a binding decision within 30 days of the adjudication commencement date.[30]

Finally, CPR has also created its own Rules for Expedited Arbitration of Construction Disputes.[31] CPR states:

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[22] AMERICAN ARBITRATION ASSOCIATION, https://www.adr.org/ (last visited Mar. 29, 2018).
[23] JUDICIAL ARBITRATION AND MEDIATION SERVICES, https://www.jamsadr.com/ (last visited Mar. 29, 2018).
[24] INTERNATIONAL INSTITUTE FOR CONFLICT PREVENTION AND RESOLUTION, https://www.cpradr.org/ (last visited Mar. 29, 2018).
[25] Construction Industry Arbitration Rules and Mediation Procedures, AMERICAN ARBITRATION ASSOCIATION, effective July 1, 2015.
[26] *Construction, Real Estate and Environmental,* AMERICAN ARBITRATION ASSOCIATION, https://www.adr.org/Construction (last visited Mar. 29, 2018).
[27] Engineering and Construction Arbitration Rules & Procedures, JAMS, effective November 15, 2014.
[28] Engineering and Construction Arbitration Rules & Procedures for Expedited Arbitration, JAMS, effective February 2015.
[29] Dispute Resolution Rules for Surety Bond Disputes, JAMS, effective February 2015.
[30] *Global Engineering and Construction Dispute Resolution*, JAMS, https://www.jamsadr.com/construction (last visited Mar. 29, 2018).
[31] Rules for Expedited Arbitration of Construction Disputes, CPR, effective June 30, 2006.

> Domestically, the use of arbitration in construction disputes continues unabated as does dissatisfaction with its prolonged time frames and expense.
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> The United Kingdom's speedier construction adjudication process propelled CPR to challenge the existing American structure and develop an expedited arbitration procedure for construction disputes centered on a 100-day hearing time frame.[32]

Parties can and should consider their options and include their preference of organization in their arbitration provision. Unfortunately, a surety does not generally have involvement in the selection of the arbitration organization.

D. General Procedural Process

Each arbitration proceeding will differ depending on the arbitration provision itself, the organization used to arbitrate, and the particular set of rules the organization applies to the proceeding.[33] The general method for commencing arbitration begins with the service of a demand for arbitration. The parties may then be given the opportunity to pick their arbitrator(s) from a list of potential options. During arbitration, there may be one arbitrator or a panel of three arbitrators, depending on the organization, rules, and stipulation between the parties.

Once the parties have chosen their arbitrator(s), the parties may agree or be required to participate in a preliminary conference to establish the issues pertinent to the matter, and set a schedule for discovery and the final hearing. The parties will also discuss the applicability of rules of evidence, and procedural rules, to the arbitration. Discovery is generally more flexible in arbitration than in litigation—which can benefit the parties, or provide an advantage to one party over another depending on the amount of documentation available that is pertinent to a particular dispute. Motion practice is generally limited in arbitration, as compared to litigation. Generally, arbitrations are supposed to conclude faster than court proceedings, however, in complex litigation matters, arbitrations may also carry on for months, if not years, similar to a judicial proceeding. Prior to and after the final hearing, the arbitrator(s) may request that the parties submit briefs to be considered in the determination of the dispute.

Once the arbitrator's decision has been made, parties may request that a court enter a final judgment confirming the arbitrator's decision.[34] The court will generally not modify or correct the arbitrator's decision or award except in rare instances, such as (1) "[w]here 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," (2) "[w]here 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 (3) "[w]here the award is

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[32] *CPR Rules for Expedited Arbitration of Construction Disputes*, CPR: INTERNATIONAL INSTITUTE FOR CONFLICT PREVENTION AND RESOLUTION, https://www.cpradr.org/resource-center/rules/arbitration/cpr-rules-for-expedited-arbitration-of-construction-disputes (last visited Mar. 29, 2018).

[33] Grace Winkler Cranley and Tina M. Kocke, *Arbitration: Participation of the Surety as a Named Party* 26-29 (unpublished paper submitted at the American Bar Association 2018 Fidelity and Surety Law Midwinter Conference).

[34] 9 U.S.C.A. § 9.

imperfect in the matter of form not affecting the merits of the controversy."[35] Although the arbitration award will not have precedential value, once a court enters final judgment on the award, the prevailing party may enforce the decision in the same manner as it would if the decision was initially made by the court.[36]

Finally, the scope of issues that may be considered on appeal of an arbitration is far more limited than for judicially-decided litigation, and are generally restricted to accusations of corruption, partiality, misconduct, or fraud on the part of an arbitrator, or in the procurement of the award.[37]

E. Applicable Law

(i) Federal Arbitration Act ("FAA")

In order to promote the policy favoring arbitration, Congress enacted the Federal Arbitration Act ("FAA"), which broadly applies to transactions that involve interstate commerce.[38] Generally speaking, the FAA makes contractual arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[39] "Under the FAA, state courts as well as federal courts are obliged to honor and enforce agreements to arbitrate."[40]

Although the FAA promotes and favors arbitration, "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."[41] Accordingly, "[w]hether enforcing an agreement to arbitrate or construing an arbitration clause, courts and arbitrators must 'give effect to the contractual rights and expectations of the parties.'"[42] As previously explained, parties to an arbitration agreement are able to contractually structure their arbitration requirements, which may include agreements or limitations on the issues to be submitted to arbitration, procedures or rules to be followed, and parties to be bound by the arbitration clause.[43] Thus, the language of an arbitration provision must be analyzed to determine whether that claim must be submitted to arbitration.

To address this issue, state and federal courts apply state contract interpretation laws and principles, coupled with the federal policy of resolving any doubts concerning arbitrability in favor of arbitration. The United States Supreme Court has clarified that state contract laws and principles must be applied to determine both the scope of the arbitration agreement and the parties bound to the arbitration provision.[44] Accordingly, whether a surety will be bound by

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[35] 9 U.S.C.A. § 11.
[36] 9 U.S.C.A. § 13.
[37] 9 U.S.C.A. § 10.
[38] 9 U.S.C.A. § 1 *et seq.*
[39] 9 U.S.C.A. § 2.
[40] *Vaden v. Discover Bank*, 556 U.S. 49, 59 (2009).
[41] *Shores of Panama, Inc. v. Safeco Ins. Co. of America*, 2008 WL 4417558 *3 (S.D. Ala. 2008) (internal citations omitted). *See Stolt-Nielsen S.A.*, 559 U.S. at 682 (quoting *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 498 U.S. 468, 479 (1989)) ("[T]he FAA imposes certain rules of fundamental importance, including the basic precept that arbitration 'is a matter of consent, not coercion.'").
[42] *Stolt-Nielsen S.A.*, 559 U.S. at 682 (quoting *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 498 U.S. 468, 479 (1989)).
[43] *Id.* at 683.
[44] *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 630-631 (2009) (explaining that the provisions of the FAA do not "purport[] to alter background principles of state contract law regarding the scope of agreements (including the

an arbitration provision in an incorporated contract will be determined by the Court with jurisdiction over the dispute (whether determined by contractual agreement or where the cause of action accrued).

(ii) *State Arbitration Codes*

As previously mentioned, the FAA broadly governs arbitration for contracts involving interstate commerce, and state courts are bound to safeguard the policies expressed in the FAA. However, all states have enacted arbitration statutes to provide for procedural methods of arbitration that are not governed by the FAA, and also to establish their own policies and procedures consistent with the FAA. Attached as Appendix 1 is a list of the arbitration statutes for pertinent southern states.

Due to the law of preemption, state arbitration codes and statutes must not conflict with section 2 of the FAA, which render arbitration agreements enforceable.[45] Despite a state's enactment of its own arbitration law or code, the FAA prohibits any state rule that discriminates, on its face, against arbitration, or even covertly accomplishes the same objective by disfavoring contracts that have the defining features of arbitration agreements.[46]

II. WHEN IS THE SURETY REQUIRED TO ARBITRATE?

A. Participation in Arbitration based on Arbitration Provision in Contract Incorporated by Reference in Bond

In almost every circumstance, a bond does not contain an arbitration provision. However, a surety's claims and liabilities may be impacted by or subjected to arbitration nonetheless.[47] Specifically, a performance or payment bond frequently incorporates by reference the underlying bonded contract between the principal and obligee. If the incorporated contract contains an arbitration provision, the surety will likely be required to participate in arbitration proceedings despite it being a non-signatory to the contract containing the arbitration clause. Whether and to what extent a surety is bound to an incorporated

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question of who is bound by them."); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995) ("When deciding whether the parties agreed to arbitrate a certain matter (including arbitrability), courts generally … should apply ordinary state-law principles that govern the formation of contracts.").

[45] *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 341-44 (2011) (holding that the FAA preempts both state laws that outright prohibit the arbitration of a particular type of claim and those that are normally thought to be generally applicable but are applied in a fashion that disfavors arbitration).

[46] *See Kindred Nursing Centers Ltd. Partnership v. Clark*, 137 S.Ct. 1421, 1426-27 (2017) (holding that the "Kentucky Supreme Court's clear-statement rule [ ] fails to put arbitration agreements on an equal plane with other contracts.").

[47] Articles have frequently addressed whether and to what extent a surety can be exposed to arbitration even though the surety's bond does not contain an arbitration provision within itself. *See, e.g.,* Thomas H. Hayman, Patrick T. Uiterwyk and John A. McDevitt, *Incorporation by Reference: A Surety's Duty to Arbitrate*, 11 Eastern Bond Claims Rev. (May 2008); Cranley, *supra* note 33; J. Trey Felty, Amy E. Bentz, and Gina D. Shearer, *Issues Affecting and Impacts of Arbitration on the Surety and Related Ethical Considerations* (unpublished paper submitted at the American Bar Association 2018 Fidelity and Surety Law Midwinter Conference); and Aaron G. Weishaar, Christopher M. Indelicato, and Jennifer Leuschner, *Scope and Enforceability of Arbitration Clauses and Requirements* (unpublished paper submitted at the American Bar Association 2018 Fidelity and Surety Law Midwinter Conference).

contract's arbitration provision will generally depend on the relevant jurisdiction and the language of the underlying arbitration clause.[48]

(i) *Surety as a Party to the Arbitration Clause – Incorporation by Reference*

a. Federal Courts

The majority of federal courts provide that a surety is bound to an arbitration provision by virtue of the bond's incorporation of the contract containing the arbitration clause. Specifically, the First,[49] Second,[50] Fourth,[51] Fifth,[52] Sixth,[53] Seventh,[54] and Eleventh[55] Circuit Courts of Appeal all follow this general rule. Likewise, the Third Circuit has held that a general incorporation by reference clause also incorporates an arbitration agreement by relying on surety cases in a different context.[56]

The extent of a surety's rights as a non-signatory to an arbitration provision also varies depending on the jurisdiction. For example, both federal and state courts within the Eleventh Circuit Court of Appeals have extended the general incorporation by reference doctrine to hold that sureties may also have the right to compel a party to participate in arbitration.[57]

A further application of the rule has been in the context of "chain[s] of incorporation."[58] For instance, some courts hold that claims involving a surety are subject to an express

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[48] Weishaar, et al., *supra* note 47, at 6-8; s*ee also Granite Re Inc. v. Jay Mills Contracting Inc.*, 2015 WL 1869216 (Tex. App. – Fort Worth April 23, 2015) (first analyzing whether there was a valid agreement to arbitrate between the surety and the principal and then analyzing whether the claims fell within the scope of the agreement).

[49] *Commercial Union Ins. Co. v. Gilbane Bldg. Co.*, 992 F.2d 386, 389 (1st Cir. 1993).

[50] See *Compania Espanola de Petroleos, S.A. v. Nereus Shipping, S.A.*, 527 F.2d 966, 973 (2d Cir. 1975) (abrogated on other grounds by *U.K. v. Boeing Co.*, 998 F.2d 68 (2d Cir. 1993)) for the proposition that a guarantor will be bound by an arbitration provision in an incorporated contract unless the arbitration provision containing language limiting the parties bound by the clause. In other contexts, the Second Circuit has ruled that a party can be compelled to participate in arbitration where the party's contract generally incorporates by reference another document containing an arbitration provision. *Pagaduan v. Carnival Corporation*, 709 Fed.Appx. 713, 715-716 (2d Cir. 2017).

[51] *Great Am. Ins. Co. v. Hinkle Constr. Corp.*, 497 Fed.Appx. 348 (4th Cir. 2012).

[52] *Jewish Federation of Greater New Orleans v. Fidelity & Deposit Co. of Maryland*, 273 F.3d 1094 (5th Cir. 2001).

[53] *Exchange Mut. Ins. Co. v. Haskell Co.,* 742 F.2d 274 (6th Cir. 1984).

[54] *See Grundstad v. Ritt*, 106 F.3d 201, 204 at n.4 (7th Cir. 1997) ("As a factual matter, a nonsignatory guarantor of an agreement containing an arbitration provision may be bound by the arbitration provision when the particular guaranty *explicitly* incorporates the underlying agreement by reference.").

[55] *See U.S. Fidelity and Guar. Co. v. West Point Const. Co., Inc.,* 837 F.2d 1507, 1508 (11th Cir. 1988). *See also Shores of Pan., Inc. v. Safeco Ins. Co. of Am.*, 2008 WL 4417558 (S.D. Ala. Sept. 29, 2008); *Transamerica Premier Ins. Co. v. Collins & Co., General Contractors, Inc.*, 735 F.Supp. 1050, 1051-52 (N.D. Ga. 1990).

[56] *See Century Indem. Co. v. Certain Underwriters at Lloyd's, London, subscribing to Retrocessional Agreements Nos. 950548, 950549, and 950646*, 584 F.3d 513, 535-538, 555 (3d Cir. 2009). The Third Circuit has also held that a surety was not a party to an arbitration provision where the surety was not a signatory to the contract containing an arbitration provision and the bond did not even generally incorporate by reference the contract containing the arbitration provision. *See Cost Bros., Inc. v. Travelers Indem. Co.*, 760 F.2d 58, 60 (3d Cir. 1985).

[57] *See, e.g., Berkman Plaza 2, LLC v. Fidelity & Deposit Company of Maryland,* 2009 WL 10671363, at *2 (N.D. Ga. July 31, 2009); *Firemen's Ins. Co. v. Edgewater Beach Owner's Ass'n*, 1996 WL 509720, at *3 (N.D. Fla. June 25, 1996); *Henderson Investment Corporation v. International Fidelity Company*, 575 So.2d 770, 772 (Fla. 5th DCA 1991).

[58] *Commercial Union Ins. Co. v. Gilbane Bldg. Co.*, 992 F.2d 386, 388 (1st Cir. 1993).

agreement to arbitrate when the performance bond incorporated by reference a subcontract, which, in turn, incorporated a prime contract containing an arbitration bond.[59]

On the other hand, the Eighth Circuit Court of Appeals, applying North Dakota law, determined a surety cannot compel arbitration, or be compelled to arbitrate, pursuant to an arbitration provision contained in a contract incorporated by reference in its bond.[60] Specifically focusing on the incorporation clause, the court determined that the bond's incorporation clause did not clearly reflect a mutual intent to compel arbitration of all disputes between the surety and the obligee, but instead had the mere obvious purpose of clarifying the extent of the surety's liability to the obligee.[61] The court refrained from engaging in any analysis of the arbitration provision itself, and instead ruled that a general incorporation clause does not automatically make the surety a party to the arbitration provision.[62]

b. State Law

Many state courts, including those in Alabama, Florida, and South Carolina, follow the majority rule, which binds sureties to arbitration provisions in contracts incorporated into the bond.[63] Moreover, Florida and Kentucky, have also found that because a surety is bound by the underlying contract's arbitration provision and can therefore be compelled to arbitrate, the surety can also be permitted to compel arbitration.[64]

Conversely, under Maryland law, a surety "is not compelled to arbitrate any dispute involving the performance bond it issued, simply because that bond incorporated by reference an agreement, to which it was not a party, containing a mandatory arbitration clause."[65]

As a result of the conflicting decisions on this issue, examining the law of the dispute's jurisdiction is necessary to determine whether a surety will be compelled to arbitration pursuant to the incorporation by reference doctrine.

(ii) *Arbitrability of Issues - Language in Arbitration Provision*

The scope and language of an arbitration provision can have a profound impact on whether the surety will be required or permitted to submit its own claims or special "surety"

[59] *See Commercial Union Ins. Co. v. Gilbane Bldg. Co.*, 992 F.2d 386, 389 (1st Cir. 1993); *Exchange Mut. Ins. Co. v. Haskell Co.,* 742 F.2d 274 (6th Cir. 1984).
[60] *AgGrow Oils, L.L.C. v. National Union Fire Ins. Co.*, 242 F.3d 777, 780-781, 782 (8th Cir. 2001); *Liberty Mut. Ins. Co. v. Mandaree Public School District #36*, 503 F.3d 709, 711 (8th Cir. 2007).
[61] *AgGrow Oils, L.L.C.*, 242 F.3d at 780-781, 782.
[62] *Id.* at 781, 782 (emphasizing that the bond's incorporation clause did not specifically or expressly reflect the surety's clear intent to arbitrate its disputes).
[63] *See Developers Sur. & Indem. Co. v. Carothers Constr., Inc.*, 2017 WL 3054646 (D.S.C. July 18, 2017) (applying South Carolina law); *St. Paul Fire & Marine Ins. Co., Inc. v. La Firenza, LLC*, 2007 WL 2010759, *3 (M.D. Fla. July 6, 2007); *Shores of Pan. Inc. v. Safeco Ins. Co. of Am.*, Civil Action No. 07-00602-KD-B, 2008 WL 4417558, *2 (S.D. Ala. Sept. 29, 2008).
[64] *See Buck Run Baptist Church, Inc., v. Cumberland Surety Ins. Co.*, 983 S.W.2d 501 (Ky. 1998); *Henderson Inv. Corp. v. International Fidelity Ins. Co.*, 575 So.2d 770, 772 (Fla. 5th DCA 1991).
[65] *Schneider Electric Buildings Critical Systems, Inc. v. Western Surety Company*, 149 A.3d 778, 791 (Md. Ct. Spec. App. 2016).

defenses to an arbitration proceeding.[66] Thus, even if the claim is in a jurisdiction which follows the incorporation by reference doctrine, the particular language of the arbitration clause may still limit the issues to be arbitrated and parties required to participate in arbitration proceedings.[67]

Limiting language in an arbitration agreement, such as allowing the arbitration of "any claim between the owner and the contractor," may allow a surety to argue that issues relating to its claims do not fall within the arbitration agreement.[68] On the other hand, provisions that require the arbitration of "any claim or controversy," may be held to incorporate all of a surety's claims and personal defenses.[69]

Recently, several courts examined and ruled on the binding nature of an incorporated contract's arbitration provision with the same surety and obligee.[70] Although the incorporation by reference clauses and arbitration provisions were identical, the courts came to different results after applying the contract interpretation and surety law of their respective circuit courts.[71]

This example of divergent opinions based on the analysis of the same parties, contract, and bond emphasizes that the surety and its counsel should be well versed on the law of the subject jurisdiction.

B. Waiver of Arbitration Requirement

Like many other contractual rights, certain actions, or inaction, can result in a waiver of the right to compel arbitration.[72] However, in determining whether the right to compel arbitration has been waived, courts still take into account the strong policy in favor of arbitration.[73]

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[66] *E.g. U.S. Sur. Co. v. Hanover R.S. Ltd. Partnership*, 543 F.Supp.2d 492 (W.D. N.C. 2008) (holding that incorporated arbitration provision required arbitration of the surety's defenses where clause required arbitration of "[a]ny dispute arising out of or relating to" the contract).

[67] Hayman, et al., *supra* note 47, at 7-8, 9-10; Felty, et al., *supra* note 47, at 2; s*ee also Western Surety Company v. U.S. Engineering Company*, 211 F.Supp.3d 302, 307-311 (D.D.C. 2016) (holding that although surety is bound by the incorporated contract as a whole, surety is not bound by the arbitration clause by virtue of the limiting language in the arbitration provision).

[68] *See Developers Sur. & Indem. Co. v. Carothers Constr., Inc.*, 2017 WL 3674975 (D. Kan. August 24, 2017).

[69] *Great Am. Ins. Co. v. Hinkle Constr. Corp.*, 497 Fed.Appx. 348 (4th Cir. 2012); *Jewish Federation of Greater New Orleans v. Fidelity & Deposit Co. of Maryland*, 273 F.3d 1094, 1094 (5th Cir. 2001) (holding that the surety was compelled to arbitrate its personal defense on the bond because the arbitration clause in the incorporated contract included "[a]ny controversy of Claim arising out of or related to the Contract…").

[70] The courts included federal courts in Connecticut (Case No. 3:17-cv-875), Georgia (Case No. 1:17-cv-1979-SCJ), Kansas (Case No. 17-2292), and South Carolina (Case No. 9:17-1419).

[71] *See Developers Sur. & Indem. Co. v. Carothers Constr., Inc.*, 2018 WL 1383402 (D. Conn. March 19, 2018); *Developers Sur. & Indem. Co. v. Carothers Constr., Inc.*, Case No. 1:17-cv-1979-SCJ (N.D. Ga. February 27, 2018); *Developers Sur. & Indem. Co. v. Carothers Constr., Inc.*, 2017 WL 3674975 (D. Kan. August 24, 2017); *Developers Sur. & Indem. Co. v. Carothers Constr., Inc.*, 2017 WL 3054646 (D. S.C. July 18, 2017).

[72] *See Cooper v. WestEnd Capital Management, L.L.C.*, 832 F.3d 534, 542 (5th Cir. 2016); *Grigsby & Associates, Inc. v. M Securities Inv.*, 635 Fed.Appx. 728, 731-732 (11th Cir. 2015).

[73] *Cooper*, 832 F.3d at 542 (quoting *Al Rushaid v. Nat'l Oilwell Varco, Inc.*, 757 F.3d 416, 421-22 (5th Cir. 2014) ("'[I]n light of the federal policy favoring arbitration, there is a strong presumption against finding a waiver of arbitration.'").

Many courts find that a party waived its right to arbitrate when it "substantially participates in litigation to a point inconsistent with an intent to arbitrate and this participation results in prejudice to the opposing party."[74] On the other hand, some courts hold that prejudice to the opposing party is not necessary if waiver is based upon an inconsistent act such as answering a complaint or cross-claim without demanding arbitration.[75] Still, "'[t]here is a strong presumption against finding a waiver of arbitration, and the party claiming that the right to arbitrate has been waived bears a heavy burden.'"[76]

Generally a party does not sufficiently invoke the judicial process unless it "'engage[s] in some overt act in court that evidences a desire to resolve the arbitrable dispute through litigation rather than arbitration.'"[77] Acts that may be considered sufficiently inconsistent with the contractual right to arbitrate so as to constitute a waiver include the filing a substantive pleading on the merits of the cause without demanding arbitration.[78] However, determining whether a waiver has occurred is a factual issue.[79]

III. WHY SHOULD THE SURETY CONSIDER ARBITRATION IF NOT REQUIRED?

A. Arbitration Award Binding on Surety

The issue of whether an arbitration award is binding on a surety or has a preclusive effect as to certain claims or defenses generally arises following an arbitration proceeding between the principal and the obligee.[80]

Even if a surety does not participate in an arbitration proceeding, the arbitration award may be final and binding upon the surety. For instance, courts have held that "[w]here a surety has actual notice of arbitration proceedings instituted against its principal, the surety will be bound by an arbitration determination against its principal."[81]

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[74] *Morewitz v. West of England Ship Owners Mut. Protection and Indem. Ass'n (Luxembourg)*, 62 F.3d 1356, 1366 (11th Cir. 1995)

[75] *See Bared and Co., Inc. v. Specialty Maintenance and Const., Inc.*, 610 So.2d 1, 3 (Fla. 2d DCA 1992)

[76] *U.S. ex rel. On The Water, LLC v. Otak Group, Inc.,* 2010 WL 2044897 *2 (S.D. Miss. May 19, 2010) (quoting *Republic Inc. So. v. PAICO Receivables, LLC*, 383 F.3d 341, 344 (5th Cir. 2004) (internal citations omitted)) (finding no waiver of right to compel arbitration because the principal had neither invoked the judicial process nor prejudiced the obligee). *See also Industrial and Mechanical Contractors, Inc. v. Polk Const. Corp.*, 2014 WL 4983486, *1 (E.D. La. October 6, 2014) (quoting *Republic Inc. So. v. PAICO Receivables, LLC*, 383 F.3d 341, 344 (5th Cir. 2004) (internal citations omitted)).

[77] *On The Water, LLC*, 2010 WL 2044897 *2. *See also Industrial*, 2014 WL 4983486, *2.

[78] *See Miller & Solomon General Contractors, Inc. v. Brennan's Glass Co., Inc.*, 824 So.2d 288, 290-291 (Fla. 4th DCA 2002)

[79] *Industrial*, 2014 WL 4983486, *2 (holding that the principal did not sufficiently invoke the judicial process as to constitute a waiver of the right to arbitrate even though the principal and surety had moved for summary judgment).

[80] Felty, et al., *supra* note 47, at 5-8; Jonathan Bryan and Ryan Springer, *Arbitration and the Surety: Res Judicata and Collateral Estoppel Effect Upon the Surety – 50 State Survey* (unpublished paper submitted at the American Bar Association 2018 Fidelity and Surety Law Midwinter Conference).

[81] *Shores of Pan., Inc. v. Safeco Ins. Co. of Am.*, 2008 WL 4417558, at * 4 (S.D. Ala. Sept. 29, 2008) (internal citations omitted). *See also Von Engineering Co. v. R.W. Roberts Const. Co., Inc.*, 457 So.2d 1080, 1082 (Fla. 5th DCA 1984) ("Principles of indemnity law hold that when a surety has notice of a suit against the principal and is afforded an opportunity to appear and defend, a judgment rendered without fraud or collusion is *conclusive* against the surety as to all material questions therein determined.").

Moreover, just like a court-entered judgment, some courts hold that if the surety did not know of the arbitration or have an opportunity to defend the claim against the principal on the bond, the arbitration award may still, at the very least, constitute *prima facie* evidence that the surety is liable unless there is proof that the award was procured through fraud or collusion, or the surety's liability on the award resulted from actions other than those indemnified against under the conditions of the bond.[82]

Based upon these issues, at least one court has explicitly held that a surety has a *right* to participate in pending arbitration between the principal obligor and the obligee.[83] Due to the potential impact an arbitrator's decision or award may have on a surety, the surety should strongly consider participating in the arbitration even if it is not required to do so—and discuss the advantages and disadvantages of so doing with legal counsel.

B. A Surety May Want to Initiate Arbitration

Arbitration has many benefits that may incentivize a surety to request that a claim be submitted to arbitration. As previously mentioned, although courts are split as to whether a surety can compel an obligee to arbitrate claims on the bond, this practice has been permitted.[84] The reciprocal application of the incorporation by reference doctrine can provide the surety the opportunity to address legal issues in an expedited, confidential, and informal manner while also refraining from creating any precedent that may prejudice later disputes.[85] Thus, where the dispute is in a jurisdiction that permits a surety to initiate or participate in ongoing arbitration, the surety should seriously consider this option if it is advantages to do so.

IV. CONCLUSION

Clearly, merely because a surety's bond does not contain an arbitration provision does not mean that the surety will avoid arbitration. The surety will likely be bound by an arbitrator's decision of claims between the principal and obligee and will likely be required to submit to arbitration. There are several variables that can influence a surety's potential exposure to arbitration, including the pertinent jurisdiction of the dispute and the terms of the arbitration provision.

A surety should keep a close eye on any potential arbitration clauses in incorporated contracts, whether directly incorporated into the bond or through a chain of incorporated contracts. Due to the complex analysis that will be necessary on the relevant laws and facts to determine what impact the arbitration clause could have on the surety, the surety should consult with its counsel to examine the appropriate strategy when face with an arbitrable dispute arising from an arbitration provision in an underlying bonded contract.

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[82] *Von Engineering Co. v. R.W. Roberts Const. Co., Inc.*, 457 So.2d 1080, 1082 (Fla. 5th DCA 1984) (citing *Heritage Ins. Co. v. Foster Elec. Co.*, 393 So.2d 28 (Fla. 3d DCA 1981)).
[83] *Firemen's Ins. Co. v. Edgewater Beach Owner's Ass'n*, 1996 WL 509720, at *3 (N.D. Fla. June 25, 1996).
[84] *See Henderson Inv. Corp. v. International Fidelity Ins. Co.*, 575 So.2d 770, 772 (Fla. 5th DCA 1991).
[85] Felty, et al., *supra* note 47, at 4-5.

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Michele dedicates her practice to representing clients in all aspects of the dispute resolution process, including, performing pre-suit investigations and risk management analysis, attending mediation sessions, drafting pleadings, motions, and briefs, conducting depositions, and advocating for clients at hearings, trials, and arbitrations. Michele also frequently negotiates pre-suit and post-suit settlements on behalf of her clients, as she believes in the value of avoiding judicial intervention if that is the best course. In addition, Michele regularly advises clients on a variety of issues outside of the litigation context, including, employment concerns, construction matters, and contractual obligations. Michele earned her B.A. in Organizational Communication in 1995 and her J.D., *cum laude*, from Stetson University College of Law in 2002.

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APPENDIX 1

STATE	ARBITRATION STATUTES/CODES
Ala.	Ala. Code §§ 6-6-1 to 6-6-16 (Arbitration and Award) **But see* Ala. Code. § 8-1-43(3), which provides that a predispute arbitration agreement cannot be specifically enforced.
Fla.	Fla. Stat. §§ 44.1011 to 44.406 (Mediation Alternatives to Judicial Action) – specifically §§ 44.103 (Court-Ordered, Nonbinding Arbitration) and 44.104 (Voluntary Binding Arbitration and Voluntary Trial Resolution) Fla. Stat. §§ 682.01 to 682.22 (Florida Arbitration Code)
Ga.	Ga. Code Ann. §§ 9-9-1 to 9-9-18
Kan.	Kan. Stat. Ann. §§ 5-201 to 5-213 (Any Controversy) Kan. Stat. Ann. §§ 5-401 to 5-422 (Uniform Arbitration Act) Kan. Stat. Ann. §§ 5-501 to 5-518 (Dispute Resolution)
Ky.	Ky. Rev. Stat. Ann. §§ 417.045 to 417-240 (Uniform Arbitration Act)
La.	La. Rev. Stat. Ann. §§ 9:4201 to 9:4217 (Louisiana Arbitration Law)
Miss.	Miss. Code Ann. §§ 11-15-1 to 11-15-37 (In General) Miss. Code Ann. §§ 11-15-101 to 11-15-143 (Arbitration of Controversies Arising from Construction Contracts and Related Agreements)
NC	N.C. Gen. Stat. §§ 1-569.1 to 1-569.31 (Revised Uniform Arbitration Act)
SC	S.C. Code Ann. §§ 15-48-10 to 15-48-240 (Uniform Arbitration Act)
Tenn.	Tenn. Code Ann. §§ 29-5-101 to 29-5-119 (General Provisions) Tenn. Code Ann. §§ 29-5-301 to 29-5-320 (Uniform Arbitration Act)
Tex.	Tex. Civ. Prac. & Code Ann. §§ 154.001 to 154.073 (Alternative Dispute Resolution Procedures) – specifically § 154.027 (Arbitration) Tex. Civ. Prac. & Code Ann. § 171.001 (Arbitration Agreements Valid) Tex. Civ. Prac. & Code Ann. §§ 171.001 to 171.098 (General Arbitration)