Arbitration Pitfalls
The Non-Paying Party

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Arbitration has long been viewed as a faster, more efficient and cheaper method of resolving disputes than state or federal court litigation. Yet recent literature suggests that the benefits of arbitration are not as great as many assume. Among other things, parties increasingly are expressing frustration with the high cost of arbitration.

This article discusses another issue unique to arbitration - one that is related to the cost of arbitration and that likely will be of increasing importance as that cost continues to rise. This issue - which has been characterized by author Richard DeWitt in his book *No Pay No Play*, as "the nonpaying party problem" - arises when one party (typically the respondent) is unable or unwilling to pay its share of arbitrator compensation and administrative fees.

Often, parties are required to deposit their share of estimated arbitration costs in advance of an arbitration hearing. If respondent does not pay its share of the required deposit, the arbitration forum administrator or the arbitrators themselves must determine what to do with the proceeding. While arbitrators will sometimes allow an arbitration proceeding to go forward, most arbitration rules permit arbitrators to suspend or terminate a proceeding if the full deposit is not paid. Thus, if respondent is unable or unwilling to pay its share of the deposit and if the arbitrators are unwilling to proceed until the full deposit is paid, claimant has two choices: (1) advance respondent's share of the required deposit itself; or (2) refuse to advance respondent's share and seek relief in court.

Option One: Advance the Fees

Claimant's first, and most straightforward, option is simply to advance the respondent's share of the arbitration fees, with the hope that claimant will recover the fees that it advances in a subsequent arbitration award. While this option allows the hearing to go forward, it entails significant up-front expense, which could be prohibitive in a large, complex case or for a claimant with limited resources.

This option also is risky. First, the claimant could lose. Second, the arbitrators could refuse to include fees in any award. Finally, even if claimant is awarded fees, there always remains the risk that claimant will not be able to recover, perhaps because the respondent is insolvent (which is all the more likely when respondent already has been unable to pay its share of the deposit).

Option Two: Seek Relief in Court

If claimant decides not to advance respondent's share of arbitration fees, or is unable to

advance such fees, claimant's only other option is to seek relief in court. The question then becomes what, if any, relief is available to claimant?

If claimant prefers to pursue its claims in arbitration, or already has expended resources conducting discovery and preparing for hearing and does not wish to begin anew in court, claimant might wish to seek a court order enforcing the parties' arbitration agreement and requiring respondent to pay its share of arbitration fees. Unfortunately for the claimant, 9th Circuit U.S Court of Appeals precedent presents a serious obstacle to obtaining such an order.

In *Lifescan, Inc. v. Premier Diabetic Services, Inc.*, 363 F.3d 1010 (9th Cir. 2004), the 9th Circuit held that a district court had exceeded its authority under the Federal Arbitration Act (FAA) by ordering respondent to pay arbitration fees. While Section 4 of the FAA (9 U.S.C. § 4) permits courts to compel arbitration if a party "fail[s], neglect[s], or refuse[s] to perform" pursuant to a valid and binding arbitration agreement, the 9th Circuit concluded that a respondent's nonpayment of arbitration fees does not necessarily constitute failure, neglect, or refusal to arbitrate. Like many arbitration agreements, the agreement at issue in *Lifescan* did not mention payment of fees. Instead, it provided only that the parties would arbitrate their disputes "in accordance with the then-current rules of the American Arbitration Association. (AAA.)" While AAA Rules provide that, unless the parties agree otherwise, arbitration fees "shall be borne equally by the parties," (AAA Rule 50), AAA Rules also grant arbitrators broad authority to interpret the rules, as well as to apportion fees. Thus, according to the 9th Circuit, when the respondent in *Lifescan* failed to pay its portion of the deposit, "[t]he arbitrators exercised their discretion in this case by allowing the arbitration to proceed on the condition that [claimant] advance the remaining fees." Because this ruling was "well within the discretion of the arbitrators," there was no basis for finding that respondent had failed, neglected or refused to arbitrate. Instead, "the arbitration … proceeded pursuant to the parties' agreement and the rules they incorporated."

While this holding is in keeping with a long and well-established line of federal case law that limits courts' ability to intervene in an arbitration proceeding, it limits a claimant's ability to force a non-paying respondent to return to arbitration. If the courts will not intervene by ordering respondent to pay its share of arbitration fees, claimant's only other avenue for pursuing its claims is to attempt to litigate those claims in court.

Here, too, claimant faces a serious obstacle. Namely, if claimant attempts to pursue its claims in court, respondent may seek a stay pending arbitration under section 3 of the FAA.

At first blush, one might assume that a non-paying respondent should not be allowed to invoke section 3. And, indeed, the 9th Circuit's decision in *Sink v. Aden Enterprises*, 352 F.3d 1197 (9th Cir. 2003), affirming the district court's conclusion that a nonpaying respondent was in default and was not entitled to a stay provides support for this line of thinking.

Importantly, however, the arbitrator in *Sink* previously had entered an order finding respondent in default of the arbitration proceeding by reason of its nonpayment. Thus, the 9th Circuit's decision left open the question of whether a court independently could determine that a nonpaying respondent was in default.

Judge Anna Brown addressed this open question in *Juiceme, LLC, et al. v. Booster Juice Limited Partnership, et al.*, 3:09-CV-01506-BR (D. Or. July 30, 2010). There, the arbitrators had not entered a default order against the nonpaying respondents, nor had they even been asked to consider the issue. Judge Brown therefore had to determine whether, absent an order of default by the arbitrators, she had jurisdiction to determine that respondents' nonpayment of arbitration fees constituted failure, neglect or refusal to arbitrate such that respondents were in default and not entitled to a stay pending arbitration.

As a starting point for this analysis, Judge Brown turned to the line of cases on which the 9th Circuit relied to support its decision in *Lifescan*. These cases hold that, where there is a valid and binding arbitration agreement, federal courts' jurisdiction is limited to issues involving a question of arbitrability, such as whether a party is bound by the arbitration agreement or whether a specific claim is subject to arbitration. Issues that do not involve a question of arbitrability must be decided by the arbitrator. These include whether prerequisites to arbitration have been completed, whether certain defenses – such as waiver and delay – are defenses to arbitrability, and whether claims subject to arbitration are barred by the statute of limitations.

Judge Brown concluded that "whether [the nonpaying respondents'] inability to continue to pay arbitration costs … constitutes a failure, neglect, or refusal to arbitrate … is similar to 'allegation[s] of waiver, delay, or a like defense to arbitrability' and to questions as to 'whether prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met.'" As such, she held that the issue was "a gateway dispute that [was] not … for the Court to decide," and accordingly granted the nonpaying respondents' motion to stay claimants' lawsuit "until [claimants] and [the nonpaying respondents] arbitrate [claimants'] claims or until an arbitrator decides whether [the nonpaying respondents'] inability to continue to pay its share of arbitration costs constitutes failure, neglect, or refusal to arbitrate…."

For any claimant in an arbitration proceeding where the respondent is unable or unwilling to pay its share of arbitration fees, the message is clear. If the arbitrators are unwilling to proceed without full payment of fees and claimant is not willing to advance respondent's share of arbitration fees, claimant must make a motion requesting that the arbitrator find the respondent to be in default. Absent such a default order, claimant may find itself in a legal limbo – unable to pursue its claims in arbitration due to suspension or termination of the proceeding, and unable to pursue its claims in court unless and until an arbitrator finds that respondent is in default in the arbitration.

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The Corner Office PROFESSIONALISM

Sometimes even the most mundane aspects of our profession can make an impact on those around us. Not only can these insignificant moments advance our professional agendas, they can end up being opportunities to showcase ourselves as professionals to our colleagues, to the courts, and even to the general public.

Appearing at trial assignment is one such moment. All you have to do is stand up, say "ready" or "not ready," maybe give a reason if you're not ready, and get a ruling, right? That is the minimum, the floor, but with a little effort, we can accomplish much more.

First, arrive early. Take your overcoat off. Then look for your opposing counsel, and greet him or her before the judge walks in. This may be the first time you have met in person. Tell him or her what you are going to report. See if you both can agree on the amount of court time needed. Allow a moment or two for rapport building, because it is good in itself, and with rapport established, professional courtesies come easier when you need them.

When your case is called, stand up, walk forward a couple of steps so you are seen clearly, and do what my fourth grade daughter was taught at school: assume the "dignity stance." The dignity stance is standing up straight, shoulders squared back, hands out front, perhaps holding a notebook. You are demonstrating through non-verbal communication that you have something important to say, and that you should command respect.

When you speak, be clear but natural, and give the court only the information it really needs. Address the court as "Your Honor," not "Judge" or "Sir" or "Ma'am." Speak in a formal manner. Do not utilize the "Matlock" approach of addressing the court. That time has passed. Having met previously with opposing counsel, your reports should hopefully coincide. The last thing you want to do is publicly disagree on small things like how much time you need, whether a morning or afternoon setting is more desirable, etc. After your brief and formal report, return to your seat, and try not to fully turn your back to the judge. The presiding judge may not know you very well. Making a good impression at trial assignment can establish credibility at future interactions with the judge.

The next time you are at trial assignment, look around the room. Whether you are in a civil trial setting, a family law court, an FED court, or a criminal proceeding, one thing should be very noticeable: how many people in the room are not lawyers or court staff, but members of the public, many representing themselves. At trial assignment, a member of the public often sees lawyers in action for the first time. Let's remember that in such times, we represent our entire profession. The brief moment that is trial assignment is also an opportunity to showcase yourself to the public; to demonstrate that your work is important, and that it is respectable and dignified. Make the most of your moment at trial assignment for yourself, but more importantly, as an officer of the court and a representative of a great and noble institution.