The Arbitration Newsletter

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The Arbitration Newsletter is published periodically by Whitaker Chalk Swindle & Schwartz PLLC, Fort Worth, Texas, to explore the rapidly developing law and practice of commercial arbitration both in the U.S. and other countries.[1]

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HOW TO HANDLE THE NON-PAYING ARBITRATION PARTY UNDER AAA'S COMMERCIAL ARBITRATION RULES

Pre-Paid Legal Services, Inc. v. Todd Cahill
2015 U.S. App. LEXIS 8684 (10th Cir. Okla. May 26, 2015)

This case presents a number of practical questions and answers regarding how to handle arbitrations under the AAA's Commercial Arbitration Rules in which one of the parties chooses not to pay the AAA-requested deposits.

Todd Cahill's employment contract, as a network marketing sales person, with Pre-Paid Legal Services, Inc. ("Claimant" or "Employer" or "Pre-Paid") required Cahill not to solicit or recruit the Employer's other sales associates for a period of two years after termination of Cahill's employment. He left the Employer, went to work for another network marketing company, and got sued in Oklahoma state court for alleged misuse of Pre-Paid's trade secret information and solicitation of Pre-Paid's remaining sales associates. Cahill removed the state court lawsuit to Federal District Court for the Eastern District of Oklahoma[2] and moved to stay the district court proceeding based on the Federal Arbitration Act ("FAA")[3] and pending arbitration of the Employer's claims. Pre-Paid did not object.[4] The federal district court granted Cahill's motion to stay and Pre-Paid filed its arbitration demand the next day[5] with the AAA pursuant to AAA's Commercial Arbitration Rules (the "Rules").

Pre-Paid paid its share of AAA's requested deposits for arbitration fees. Cahill refused to pay his share. AAA gave Pre-Paid the opportunity to pay Cahill's share of AAA's arbitration fees

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[1] Nothing in *The Arbitration Newsletter* is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of *The Arbitration Newsletter* is to inform generally. The application of the comments in *The Arbitration Newsletter* to specific questions and cases should be discussed with the reader's independent legal counsel.

[2] *Pre-Paid Legal Servs. v. Cahill*, 2014 U.S. Dist. LEXIS 52550 (E.D. Okla., Apr. 16, 2014).

[3] 9 U.S.C. §3.

[4] Cahill's motion to stay was filed on **August 24, 2012** and the federal district court adopted the magistrate's recommended grant of the motion to stay on **February 12, 2013**.

[5] February 13, 2013.

but Pre-Paid refused to pay Cahill's share. AAA made repeated requests of Cahill's attorney for Cahill's payment of his share of AAA's arbitration costs and expenses and warned Cahill's attorney that the arbitration proceedings would be "suspended" if Cahill did not pay as requested.[6] The arbitration panel (the "Panel") "suspended" the arbitration proceeding on June 27, 2013, and warned that if the deposits were not made by "a certain date," the arbitration would be "terminated." When that "certain date" came and went with no payment by Cahill, the Panel terminated the arbitration on July 10, 2013, as previously warned.[7] Six days later on July 16, 2013, Pre-Paid moved the federal district court to lift the stay of the district court proceedings. The district court magistrate recommended that Pre-Paid's motion be granted on March 31, 2014, and the district court so ordered on April 16, 2014. Cahill appealed the district court's order lifting the stay citing a violation of Section 3 of the Federal Arbitration Act.[8] Pre-Paid answered that the Tenth Circuit had no jurisdiction to hear Cahill's interlocutory appeal but if the Tenth Circuit decided it had jurisdiction, Pre-Paid asked the court to affirm the district court's lifting of the stay.[9]

The Tenth Circuit held that it had jurisdiction to hear Cahill's appeal and then affirmed the district court's lifting of the stay on the merits. The court held that an order lifting a stay has the same effect as "refusing a stay of any action under section 3 of this title [9 USC §3]," and, therefore, the court had jurisdiction based on 9 U.S.C. 16(a)(1)(A).[10] "The order lifting the stay here was effectively one 'refusing a stay'."[11] The court also cited cases from three other federal circuits that had "equated lifting a stay with 'refusing a stay'… ."[12]

The Tenth Circuit then construed 9 U.S.C. §3 because of the express reference to this section 3 in 9 U.S.C. §16(a)(1)(A).[13] The court recognized the U.S. Supreme Court's direction[14] that circuit courts not focus on "the underlying merits of an appeal from the denial of a stay in determining if they have jurisdiction" but rather to decide if the appeal is from a "refusal to stay" the litigation in favor of arbitration. *Carlisle* directed courts to focus on "the category of order appealed from" not on "the strength of the grounds for reversing the order."[15] The court found that Cahill's appeal was from a 9 U.S.C. §3 "refusal to stay" brought about by the district court's lifting of the stay. Therefore, the court had jurisdiction.[16]

The Tenth Circuit then reviewed the merits of the district court's order lifting the stay and held that 9 U.S.C. §3 did not require the district court to maintain its stay order under the facts and circumstances of this case. Two clauses in section 3 were examined by the court: (1) "stay the trial of the action until such arbitration **has been had** in accordance with the terms of the

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[6] 2015 U.S. App. LEXIS 8684 at [4].
[7] *Id.*
[8] 9 U.S.C. §16(a)(1)(A) ("refusing a stay of any action under section 3 of this title [9 USC §3]").
[9] 2015 U.S. App. LEXIS 8684 at [5].
[10] 2015 U.S. App. LEXIS 8684 at [5] – [15].
[11] 2015 U.S. App. LEXIS 8684 at [8].
[12] 2015 U.S. App. LEXIS 8684 at [9]-[10]; citing *GEA Group AG v. Flex-N-Gate Corp.*, 740 F.3d 411, 414 (7th Cir. 2014); *Dobbins v. Hawk's Enterprises*, 198 F.3d 715, 716 (8th Cir. 1999); and *Corpman v. Prudential-Bache Sec., Inc.*, 907 F.2d 29, 30 (3d Cir. 1990).
[13] "[R]efusing a stay of any action under section 3 of this title [9 USC §3]."
[14] *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 627-29 (2009).
[15] 556 U.S. at 668.
[16] 2015 U.S. App. LEXIS 8684 at [10] – [15].

[arbitration] agreement"; and (2) "providing the applicant for the stay is **not in default** in proceeding with such arbitration." (Emphasis added.)

The parties' arbitration agreement expressly adopted AAA's Commercial Arbitration Rules (the "Rules"). The Rules require that the "expenses of the arbitration … shall be borne equally by the parties, unless they agree otherwise …."[17] When Cahill refused to pay the AAA-requested deposits, after repeated notice and warning of suspension and termination of the arbitration,[18] the court concluded that the arbitration "**has been had** in accordance with the terms of the [arbitration] agreement."[19] The court also concluded, based on other cases cited, that Cahill's failure to pay constituted a breach of the parties' arbitration agreement and this breach precluded "any subsequent attempt by [Cahill] to enforce that agreement."[20] When Cahill refused to pay the AAA-requested deposits, after repeated notice and warning of suspension and termination of the arbitration, he was "in default" in the arbitration proceeding,[21] and, therefore, the district court was correct in lifting the stay.[22] Cahill argued that the Panel's decision to terminate the arbitration was not expressly based on "default" under 9 U.S.C. §3. This "default" determination should have been made by the Panel not the district court. But the Tenth Circuit disagreed that such a "default" finding had to be made by the Panel before the district court could lift the stay and distinguished the cases cited by Cahill. The Panel's termination of the arbitration "constituted a finding of default because it was the result of Mr. Cahill's failure to pay."[23] Cahill argued that the Panel did not know which party had not paid, but the court disagreed, and then observed that the record was clear to the district court (if not to the Panel), as to which party had not paid.[24]

OBSERVATIONS

1. Former AAA Commercial Arbitration Rules R-50 and R-54 (adopted by the parties' arbitration agreement) were central in this case regarding how the Panel and the AAA handled a party's failure to pay the requested deposits.

2. Current AAA Commercial Arbitration Rules R-53 through R-57 provide even more detailed procedures for handling the non-paying party.

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[17] R-54 ("Expenses"), AAA Commercial Arbitration Rules (Amended and Effective October 1, 2013); cited in this case and formerly R-50 ("Expenses"), Commercial Arbitration Rules (Amended and Effective September 1, 2007).
[18] R-57 ("Remedies for Nonpayment"), AAA Commercial Arbitration Rules (amended and effective October 1, 2013); cited in this case and formerly R-54 ("Suspension for Nonpayment"), Commercial Arbitration Rules (Amended and Effective September 1, 2007).
[19] 2015 U.S. App. LEXIS 8684 at [16] – [18] (emphasis added).
[20] 2015 U.S. App. LEXIS 8684 at [17]; citing *Brown v. Dillard's, Inc.*, 430 F.3d 1004, 1011 (9th Cir. 2005); *Sink v. Aden Enterprises*, 352 F.3d 1197, 1199 (9th Cir. 2003); *Garcia v. Mason Contract Prods., LLC*, No. 08-23103-CIV, 2010 WL 3259922, at *3 (S.D.Fla. 2010).
[21] There was no evidence in the record that Cahill claimed he was unable to pay the requested deposits, that he asked the Panel to modify the deposit payment schedule, or that he asked the Panel to order Pre-Paid to make his requested deposits. 2015 U.S. App. LEXIS 8684 at [18]-[19].
[22] 2015 U.S. App. LEXIS 8684 at [18] – [31].
[23] 2015 U.S. App. LEXIS 8684 at [29].
[24] 2015 U.S. App. LEXIS 8684 at [30]-[31].

3. R-57 ("Remedies for Nonpayment") of the current Commercial Arbitration Rules has six subsections that provide detailed, step-by-step guidance to arbitrators for how to handle the non-paying party.

4. The well-drafted pre-dispute arbitration agreement should include express provisions about what the arbitrator is empowered to do when a party refuses to pay its share of the arbitration expenses and costs.

5. In this case, the parties' arbitration agreement did not address nonpayment by a party, but it did adopt the AAA Commercial Arbitration Rules as part of the parties' arbitration agreement. This adoption language in the arbitration agreement gave the AAA and the Panel the power needed to deal with the non-paying party as they did in this case.

6. This case provides excellent commentary on 9 U.S.C. §§ 3 and 16 and emphasizes the interlocutory appeal rights provided by the Federal Arbitration Act.

7. Enormous amounts of time were consumed in this case in getting to resolution of the primary dispute between the parties. Pre-Paid filed its Oklahoma State Court case on August 14, 2012, which Cahill moved to federal district court. Cahill filed its motion to stay on August 24, 2012. Even with no objection from Pre-Paid, it took the federal district court from August 24, 2012 to February 12, 2013, to stay the litigation and compel arbitration. Pre-Paid filed its Demand for Arbitration on February 13, 2013, and the Panel terminated the arbitration for nonpayment of deposits on July 10, 2013. Pre-Paid moved to lift stay in the federal district court on July 16, 2013 and got an order lifting stay on April 16, 2014. The Tenth Circuit's decision affirming the trial court's lift of stay was filed on May 26, 2015, almost three years from the initial filing of the state court lawsuit!

8. This case provides additional guidance for interlocutory appeals under 9 U.S.C. §16, especially illustrating how a party can lose or waive interlocutory appeal rights.[25]

9. When faced with a non-paying party the arbitrator may want to consider whether the arbitrator has enough evidence to recite that the non-payment constitutes a waiver or breach or default under the terms of the parties' arbitration agreement.[26]

10. The Fifth Circuit in *Dealer Computer Services, Inc. v. Old Colony Motors, Inc.*, 588 F.3d 884, 887 and 889 (5th Cir. 2009) observed that the "payment of fees is a procedural condition precedent [for the arbitrator] that the trial court should not review."

11. The arbitrator should take timely, definitive, and considerate action to suspend **and** terminate the arbitration proceeding when faced with a recalcitrant non-paying party.[27]

12. The party who prays for a stay should be prepared to play in the stay!

[25] 2015 U.S. App. LEXIS 8684 at [14] fn6.
[26] 2015 U.S. App. LEXIS 8684 at [17] – [31]; [20] fn3.
[27] 2015 U.S. App. LEXIS 8684 at [26].