LITIGATOR'S CORNER

Dine & Dash Arbitration Style: *What Happens When One Side Doesn't Pay the Arbitrator*

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Ever since Congress enacted the Federal Arbitration Act, it has been the national policy of the United States to favor arbitration. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). Where an agreement contains an arbitration clause, there is little a party can do to resist or avoid arbitration; however, this strong presumption of arbitration may have a small kink that is allowing parties to end up in court, despite the presence of a valid arbitration clause. The Ninth Circuit's recent decision in *Tillman v. Tillman*, 825 F.3d 1069 (9th Cir. 2016), has caused some to question if there is a new way for parties to avoid the power of an arbitration clause: simply refuse to pay a party's share of the arbitrator's fees.

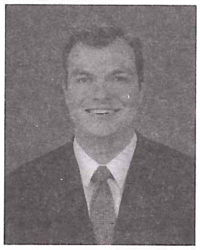
At first glance, *Tillman* reads like a plaintiff who successfully gamed the system. After Tillman sued her former law firm for legal malpractice, the law firm invoked an arbitration clause in her retainer agreement, and the court granted the law firm's motion to compel arbitration, staying the case until such time as the arbitration "has been had in accordance with the terms of the agreement," 9 U.S.C. § 3. Tillman eventually ran out of funds to pay the arbitrator. The arbitrator asked the law firm if it wanted to advance funds to cover the full costs of the arbitration, and the law firm declined. The arbitrator terminated the arbitration proceedings for failure to pay the fees, which Rule 57 of the AAA Commercial Arbitration Rules expressly allowed him to do. Notably, the arbitrator could have also (i) agreed to proceed at a reduced fee equal to whatever the law firm was paying, or (ii) suspended the arbitration period in order to give the plaintiff an opportunity to secure funding for the remainder of the case.

After the parties went back to the district court, the law firm sought to lift the stay and dismiss the case under Federal Rule of Civil Procedure 41(b) for failure to prosecute or obey a court order. The court found that Tillman was unable to pay and declined to dismiss the case under Rule 41(b). Although the court dismissed the case on other grounds, the Ninth Circuit reversed, holding that the stay should be lifted because the arbitration was technically "'had' in the sense that the parties engaged in arbitration until the arbitrator terminated those proceedings." Tillman, 825 F.3d. at 1073. Importantly, the Ninth Circuit held that a plaintiff cannot avoid arbitration by simply refusing to pay; rather, the plaintiff must convince the arbitrator or court that it is unable to pay for the arbitration. As described by the Ninth Circuit:

> If Tillman had refused to pay for arbitration despite having the capacity to do so, the district court probably could still have sought to compel arbitration under the FAA's provision allowing such an order in the event of a party's "failure, neglect, or refusal" to arbitrate. 9 U.S.C. § 4.

Tillman, 825 F.3d at 1075 (quoting 9 U.S.C. § 4) (emphasis added) (footnote omitted). Notwithstanding this apparent limitation, Tillman has led some to ask if the law firm should have simply paid Tillman's share of the arbitrator's fees.

As a threshold matter, *Tillman* suggests that a franchisor should at least consider the financial condition of a franchisee before moving to compel arbitration. The plaintiff in Tillman could not have claimed poverty early in the proceedings because she had recently obtained the proceeds of a wrongful death lawsuit and had hired counsel to defend against claims by an omitted heir. However, a franchisee experiencing genuine financial difficulty could attempt to oppose a motion to compel arbitration on the ground that



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the franchisee cannot afford the costs and fees of arbitration. This issue has come up when the franchisee claims that the arbitration provision is unconscionable because of the high AAA fees imposed. *See, e.g., Clark v. Renaissance W., LLC*, 307 P.3d 77, 78 (Ariz. Ct. App. 2013) (upholding trial court's determination that an arbitration agreement was substantively unconscionable because the arbitration would be "prohibitively expensive").

"If a franchisor is not prepared to advance the costs of arbitration, it runs the risk of losing the ability to arbitrate.

But even if a franchisee claims it is financially distressed, a court might nevertheless compel arbitration and leave it to the arbitrator to decide whether to proceed in light of the financial condition of one of the parties. *See, e.g., Grigsby v. DC 4400, LLC*, 2016 WL 7115903, at *5 n.3 (C.D. Cal. Dec. 5, 2016) (rejecting plaintiffs' argument that a motion to compel arbitration should be denied because the action "will inevitably return in light of their inability to pay"). As the District Court in *Grigsby* noted, an arbitrator may determine to reduce the amount of deposits required in advance or allow one party to pay the others' share. *Id.*

There are several other factors one should consider in determining how to react to the non-payment of the arbitrator's fees. First, the party bringing or defending the action needs to be clear about its goals in pursuing the dispute. If the issue is simply a matter of damages, then a franchisee's inability to pay arbitration fees is a good indicator that a franchisor might not be able to recover the full amount of any arbitration award. In this situation, litigating the dispute in federal or state court – or even deciding to forego a claim – might be a more cost effective avenue than arbitration. On the other hand, if the goal is to enforce some non-monetary contractual provision, then it may make sense for a franchisor to advance the arbitrator's fees and proceed with arbitration.

Second, the party should consider the advantages arbitration might offer in light of the goals of the dispute. One benefit of arbitration is the possibility that the arbitrator might have franchise experience. If the dispute turns on any of the many specialties and nuances of franchising, the parties might be better served by a knowledgeable arbitrator than a judge who may or may not have any experience in the franchise world. Another possible benefit depending on the circumstances is that arbitration allows parties to avoid a jury trial. Put another way, depending on the nature of the dispute, arbitration might be a better venue for resolving an otherwise meritorious case with challenging facts. Finally, arbitration often, though certainly not always, provides for a more streamlined resolution of the dispute, with quicker disposition, less discovery, and less expense. In fact, some arbitration provisions limit the number of experts and the amount of depositions and written discovery parties can conduct.

Finally, a franchisor should consider including language in its standard franchise agreement to address the issue of a franchisee failing to pay the required arbitration fees. For example, a franchisor might include a provision requiring that any fees advanced by the franchisor must be taken into consideration by the arbitrator when making its award, even if there is a prevailing party provision. Such a provision might contain an offset clause, so that if the franchisor ultimately is found at fault in the arbitration and monetary damages are awarded to the franchisee, any arbitration award is offset by the advanced fees. Additionally, a franchisor might include a provision addressing the number of required arbitrators. For instance, if a three-person panel is required, the panel could be reduced to one arbitrator in the event the franchisee establishes it cannot afford to pay the on-going fees.

The bottom line is that if a franchisor truly wants arbitration, it should be prepared to pay for it. If a franchisor is not prepared to advance the costs of arbitration, it runs the risk of losing the ability to arbitrate. ■