

STIFFING THE ARBITRATORS: THE PROBLEM OF NONPAYMENT IN COMMERCIAL ARBITRATION

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I. INTRODUCTION

There is a hole in our arbitral system. Despite being among the most efficient and prevalent means of resolving commercial disputes, and one generally favored by courts,³ arbitration is dangerously susceptible to the problem of nonpayment. Simply put, a respondent seeking to avoid liability may be able to “game” the system by refusing to pay its share of arbitration fees. All too frequently, this leaves the claimant without an effective remedy to hold the nonpaying respondent accountable.

Commercial arbitration is a creature of contract; the parties are arbitrating because they choose to be, either by including an arbitration clause in their original contract, or

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³ *See, e.g.*, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 321, 329 (2011) (noting that arbitration is an “efficient, streamlined procedure tailored to the type of dispute”); *see infra*, Section IV, discussing the federal and state public policy clearly favoring arbitration.

after a dispute developed, electing to avoid litigation by submitting their dispute to arbitration.⁴ Beyond saving time and money, and creating finality, arbitration also allows them to bring their battle behind closed doors.

Arbitration does, however, come with an up-front cost that does not exist in litigation: the arbitrators. Taxpayers pay for state and federal judges, but the parties themselves pay for their arbitrators.⁵ Sophisticated parties often understand this cost to be justifiable when they wish to take advantage of the benefits arbitration offers over litigation. Not only is arbitration private and often confidential, but when administered properly it is generally faster, less expensive and largely immune from appeal.⁶ While court filing fees are *de minimus*, any initial cost-savings quickly evaporate once the parties engage in months (or perhaps years) of document discovery, interrogatories, depositions, and motion practice before trial. And if the case does not settle on the courthouse steps, there is the looming prospect of greater delays and additional expenses if the loser appeals.⁷

⁴ In a growing number of states, the ultimate decision to arbitrate can be made at the election of only one party where there exists an enforceable unilateral arbitration agreement. Such clauses are invoked, if at all, after a dispute develops, by the party whom it favors. *See, e.g.,* *Cindy's Candle Co., Inc. v. WNS, Inc.*, 714 F. Supp. 973, 1989-2 Trade Cas. 721 F. Supp. 167 (N.D. Ill. 1989); *LaBonte Precision, Inc. v. LPI Industries Corp.*, 507 So. 2d 1202 (Fla. 4th DCA 1987); *Willis Flooring, Inc. v. Howard S. Lease Const. Co. & Associates*, 656 P.2d 1184 (1983); *Sablosky v. Edward S. Gordon Co., Inc.*, 73 N.Y.2d 133 (1989).

⁵ The parties also pay filing fees to arbitration providers such as the American Arbitration Association, the International Institute for Conflict Resolution and Prevention ("CPR"), JAMS and National Arbitration and Mediation ("NAM").

⁶ *See generally* *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 685 (2010) ("In bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes."); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) ("By agreeing to arbitrate ... [a party] trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration."); Paul J. Krause, *Disregarding Manifest Disregard*, 72 DEF. COUNS. J. 79, 83 (2005) ("Parties should have efficient, cost-effective and final arbitration decisions, subject only to a limited review by courts for well-defined errors"); Matthew Maggiamo, *The Savior of Aggregate Litigation: The Giving Green Tree*, 14 CARDOZO J. CONFLICT RESOL. 939, 972 (2013) (noting that arbitration is generally immune from appellate review).

⁷ At the federal level, litigants have a significant chance of facing appeal. Chris Guthrie, *Misjudging*, 7 NEV. L.J. 420, 456 (2007) (noting that about 20 percent of cases with definitive trial court judgments

Commercial arbitrators are typically experienced attorneys, former judges or industry leaders who are expected to use their knowledge and expertise when hearing and resolving disputes.⁸ To coin an overused maxim, “there’s no such thing as a free lunch,” so by agreeing to arbitrate commercial parties also agree to compensate their arbitrators for their time. This can involve a significant expenditure, especially if three arbitrators are selected. A trained arbitrator rightfully expends time and effort on matters such as (i) determining the proper scope of the pre-hearing exchange of documents and information; (ii) monitoring all pre-hearing activities; (iii) resolving pre-hearing disputes; (iv) reviewing the parties’ pre and post-arbitration written submissions; (v) attending and presiding over the evidentiary hearings; and (vi) deliberating and issuing a final award.

But what happens if one party refuses (or is otherwise unable) to pay the arbitrator? If the arbitrator then refuses to proceed, as is likely, should the dispute revert to court, in derogation of the prior agreement to arbitrate? Other questions arise: What are the paying party’s options if the arbitration is terminated due to nonpayment? By agreeing to resolve their disputes by arbitration (and not litigation), have the parties

generate appeals, with tried cases appealed at about twice the rate of non-tried cases); Alexandra B. Hess et. al., *Permissive Interlocutory Appeals at the Court of Appeals for the Federal Circuit: Fifteen Years in Review (1995-2010)*, 60 AM. U. L. REV. 757, 761 (2011) (outlining the type of enumerated and non-enumerated appeals of interlocutory orders permitted by 28 U.S.C. § 1292, the Interlocutory Appeals Act). At the state level, many states permit interlocutory appeals as of right. See Elizabeth A. McElaney, *A Unique Tool for the Massachusetts Practitioner - Single Justice Review of Interlocutory Orders*, 15 SUFFOLK J. TRIAL & APP. ADVOC. 233, 242–43 (2010) (noting that some states, like New York, allow a party to appeal almost any civil interlocutory order by right, creating “delay and expense in litigation” as well as “excessive appellate intrusion.”); While statistics on the percentage of arbitration awards that are appealed are far less precise, most experts believe they are considerably rarer. Ann C. Hodges, *Judicial Review of Arbitration Awards on Public Policy Grounds: Lessons from the Case Law*, 16 OHIO ST. J. ON DISP. RESOL. 91, 155 (2000) (stating that less than 1% of private sector arbitration awards are appealed to federal court, and of those, there is only about a 25% chance of overturning the award at the district court level).

⁸ Thomas H. Oehmke and Joan M. Brovins, *Arbitrator Selection and Service*, 97 AM. JUR. TRIALS 319 (2005) (“Like judges, arbitrators are empowered to decide cases; differently, however, arbitrators are usually engaged in other occupations before, during, and after serving as arbitrators. Often, arbitrators are purposely chosen from the same trade or industry as the parties and bring this special knowledge to the task of deciding.”).

irrevocably waived their right to proceed in court, except to confirm or vacate the arbitration award?⁹ If the arbitrator is now nowhere to be found because he or she resigned due to the nonpayment, does a court then have the authority to declare a default against the non-paying party? If so, should the court invoke jurisdiction and move past liability and schedule an inquest on damages?

Equally important, beyond these purely procedural questions, non-payment raises basic questions of fairness because, if unchecked, a party's failure to pay may create a situation where it actually benefits by its non-payment. If a non-payer sabotages an arbitration, is it fair that the paying party's only alternative is to file suit in court, thereby placing it in the very forum it purposely contracted to avoid? Further, should the non-payment be seen as a contractual default, specifically, a material breach of the arbitration clause? If so, what is the appropriate measure of damages and what is the appropriate forum in which to prove those damages?

There are no clear, uniform answers. Different arbitration providers promulgate their own rules and the few state and federal courts that have addressed the issue of arbitrator non-payment are not in accord. To bring clarity, we begin with an examination of the current rules of four preeminent alternative dispute resolution ("ADR") providers: the American Arbitration Association ("AAA"), JAMS, NAM, CPR, plus some analogous international rules. We follow with a review and analysis of the reported case

⁹ Generally, an agreement to arbitrate removes the parties' ability to proceed in court except for very limited purposes. *Network Capital Funding Corp. v. Papke*, 230 Cal. App. 4th 503, 518, 178 Cal. Rptr. 3d 658, 670 (2014) ("[T]he Arbitration Agreement creates the parties' obligation to submit all claims, disputes, and controversies to arbitration..."); *Minkowitz v. Israeli*, 433 N.J. Super. 111, 134, 77 A.3d 1189, 1203 (App. Div. 2013) ("We underscore this point: when binding arbitration is contracted for by litigants, the judiciary's role to determine the substantive matters subject to arbitration ends."); *Williams v. Int'l Offshore Servs., LLC*, 2011-1240 (La. App. 1 Cir. 12/7/12), 106 So. 3d 212 (La. Ct. App. 2012), *reh'g denied* (Dec. 28, 2012) (holding that once arbitration has commenced, courts are precluded from exercising jurisdiction).

law. Lastly, we conclude with a policy proposal: Where a commercial party fails to pay for its share of arbitrator compensation and the proceeding is terminated as a result, that, in and of itself, constitutes a default on the merits of the parties' underlying dispute, thereby entitling the paying party to proceed in court to an inquest on damages.¹⁰ This remedy should be available not only because it is fair and appropriate, but also to deter recalcitrant parties from looking to benefit by breaking their promise to pay for the cost of their arbitration. Simply put, stiffing an arbitrator should not become a viable strategy to destroy the parties' prior agreement to arbitrate or create the additional delay and costs that arbitration is intended to avoid.

II. ARBITRATION PROVIDERS' RULES ON FEES

When drafting their arbitration clause, parties may choose among a number of options to allocate fees, costs, and expenses.¹¹ The clause may provide that costs be split equally or in some other percentage. It may give the arbitrator the discretion to allocate costs between the parties or to award costs to the prevailing party.¹² But in practice, ADR clauses rarely address payment issues in detail.¹³ In an administered arbitration, in the

¹⁰ The same logic applies if one party fails to pay for the filing fees charged by the arbitration provider. In either case, the arbitration would likely be terminated.

¹¹ Typically, ADR providers will charge filing fees that are split evenly between both parties and vary depending on the size and nature of the dispute. The AAA, for example, offers comprehensive tables showing how fees are charged. See AMERICAN ARBITRATION ASSOCIATION FEE SCHEDULE, available at <https://www.adr.org/aaa/ShowPDF?doc=ADRSTAGE2025290> (last visited April 10, 2015). In addition to these administration fees, the parties face the larger cost of arbitrator compensation. Arbitrators have latitude to build their own fee structure, but they often require a retainer and charge an hourly rate similar to commercial attorneys.

¹² Alan S. Gutterman, *Payment of Fees and Costs of ADR*, 2 BUS. TRANSACTIONS § 14:13 (2014).

¹³ One proposal is that parties insert a clause into their contracts, explicitly stating that each party shall bear an equal share of the arbitrators' compensation and administrative charges. Such a clause would further state that the failure or refusal by one party to pay its share would constitute a waiver by that party of its rights to be heard, present evidence, cross-examine witnesses and assert counterclaims. See Richard J. DeWitt and Richard J. DeWitt III, *No Pay No Play: How to Solve the Non-Paying Party Problem in Arbitration*, AAA HANDBOOK ON ARBITRATION PRACTICE, 353–363 (2010).

absence of contractual guidance, the provider's rules usually govern payment of the costs for the arbitration.

The AAA's Commercial Arbitration Rules, amended and effective October 1, 2013, require the expenses of the arbitrators, witnesses, and the cost of any proof requested by the arbitrator, to be borne equally by the parties, unless they agree otherwise or unless the arbitrator assesses any portion of those expenses against a party in the final award.¹⁴ The specific AAA rule addressing "Arbitrator's Compensation" is silent with respect to who pays what,¹⁵ but unless the parties' arbitration agreement provides otherwise, the AAA bills each party on a 50-50 or pro-rata basis. A different rule, entitled "Remedies for Non-Payment," establishes the protocol when one party fails to pay AAA administrative charges or the arbitrator's compensation.¹⁶ Among other things,

Another proposal (favored by the authors) is for the clause to circumvent entirely the issue of whether the arbitrator will agree to continue to serve after one party fails to pay. The clause could state that a party who fails to pay automatically waives its right to contest liability on the underlying claim and submits to the jurisdiction of the court to hold an inquest on damages.

While these two (or similar) clauses would certainly be helpful, the reality is that, barring a sea change where such clauses become boilerplate, the overwhelming majority of arbitrator nonpayment cases involve (and will continue to involve) agreements containing no such language. This does not make the non-paying party's conduct any less egregious. Nor should it foreclose the availability of an appropriate remedy for the paying party. This is why judicially-enforced liability is crucial.

¹⁴ AAA CONSTRUCTION INDUSTRY Rule 54.

¹⁵ *Id.* at Rule 55.

¹⁶ *Id.* at Rule 57, which states:

If arbitrator compensation or administrative charges have not been paid in full, the AAA may so inform the parties in order that one of them may advance the required payment.

(a) Upon receipt of information from the AAA that payment for administrative charges or deposits for arbitrator compensation have not been paid in full, to the extent the law allows, a party may request that the arbitrator take specific measures relating to a party's non-payment.

(b) Such measures may include, but are not limited to, limiting a party's ability to assert or pursue their claim. In no event, however, shall a party be precluded from defending a claim or counterclaim.

(c) The arbitrator must provide the party opposing a request for such measures with the opportunity to respond prior to making any ruling regarding the same.

(d) In the event that the arbitrator grants any request for relief which limits any party's participation in the arbitration, the arbitrator shall require the party who is making a claim and who has made appropriate payments to submit such evidence as the arbitrator may require for the making of an award.

(e) Upon receipt of information from the AAA that full payments have not been received, the

it gives the paying party the option of advancing 100% of the administrative charges or arbitrator compensation, and then allows that party to ask the arbitrator to reimburse it via the final award.

JAMS takes a somewhat different approach. Its rules state the parties are “jointly and severally” liable to pay both the JAMS arbitration fees and arbitrator compensation.¹⁷ As with the AAA, the apportionment of such fees and compensation is subject to reallocation by the arbitrator in the final award. The CPR, and its Administrated Arbitration Rules, effective July 1, 2013, is similar to the AAA’s Commercial Arbitration Rules. Rule 17, “Arbitrator Fees, Expenses and Deposits,” requires that the parties be invoiced in equal shares.¹⁸ If the requested payments are not remitted, the arbitration “may be suspended or terminated unless the other party pays the non-paying party’s share subject to any award on costs.”¹⁹

arbitrator, on the arbitrator’s own initiative or at the request of the AAA or a party, may order the suspension of the arbitration. If no arbitrator has yet been appointed, the AAA may suspend the proceedings.

(f) If the arbitration has been suspended by either the AAA or the arbitrator and the parties have failed to make the full deposits requested within the time provided after the suspension, the arbitrator, or the AAA if an arbitrator has not been appointed, may terminate the proceedings.

¹⁷ JAMS Comprehensive Arbitration Rules and Procedures Rule 31(c) (effective July 1, 2014):

(c) The Parties are jointly and severally liable for the payment of JAMS Arbitration fees and Arbitrator compensation and expenses. In the event that one Party has paid more than its share of such fees, compensation and expenses, the Arbitrator may award against any other Party any such fees, compensation and expenses that such Party owes with respect to the Arbitration.

¹⁸ CPR Administered Arbitration Rules, Rule 17.2 (effective July 1, 2013):

The Tribunal shall determine the necessary advances on the arbitrator(s) fees and expenses and advise CPR, which, unless otherwise agreed by the parties, shall invoice the parties in equal shares. The amount of any advances to cover arbitrator fees and expenses may be subject to readjustment at any time during the arbitration. Such funds shall be held and disbursed in a manner CPR deems appropriate. An accounting will be rendered to the parties and any unexpended balance returned at the conclusion of the arbitration as may be appropriate.

¹⁹ *Id.* at Rule 17.3:

Although there are myriad international ADR treaties and providers,²⁰ the rules governing nonpayment are often similar to their domestic counterparts. The International Chamber of Commerce (“ICC”) requires that the fees and expenses of the arbitrators “be payable in equal shares” subject to readjustment at any time during the arbitration.²¹ The ICC will dismiss any claim if the parties fail to advance the costs, but “any party shall be free to pay any other party’s share” so its case can proceed to the arbitral tribunal.²² As one attorney has put it, “It does not so much matter who pays, but rather that the fees are in fact paid, in order for any claim to reach the tribunal.”²³ The paying party then must await the final award; if it prevails, the tribunal will order reimbursement from the nonpaying party.²⁴ This places a heavier financial burden on the paying party, effectively reducing one of arbitration’s attractions that both parties bear the costs.²⁵ A non-paying party in ICC arbitrations can use this strategy to delay or halt the arbitration by refusing

17.3 If the requested advances are not paid in full within 10 days after receipt of the request, CPR shall so inform the parties and the proceeding may be suspended or terminated unless the other party pays the non-paying party’s share subject to any award on costs.

²⁰ Many international arbitrations, particularly those dealing with foreign investments, are subject to the requirements of treaties, not merely private contractual terms. For further information on bilateral investment treaties (BITs), and their requirements, see generally Eustace Chikere Azubuike, *The Place of Treaties in International Investment*, 19 ANN. SURV. INT’L & COMP. L. 155 (2013); Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT’L L. & POL’Y 157 (2005); Giuseppe De Palo & Linda Costabile, *Promotion of International Commercial Arbitration and Other Alternative Dispute Resolution Techniques in Ten Southern Mediterranean Countries*, 7 CARDOZO J. CONFLICT RESOL. 303 (2006); Kelley Chubb, *The “State of Necessity” Defense: A Burden, Not A Blessing to the International Investment Arbitration System*, 14 CARDOZO J. CONFLICT RESOL. 531 (2013).

²¹ Int’l Comm. Rules of Arbitration, Article 36(5), effective January 1, 2012, states: “The amount of any advance on costs fixed by the Court pursuant to this Article 36 may be subject to readjustment at any time during the arbitration. In all cases, any party shall be free to pay any other party’s share of any advance on costs should such other party fail to pay its share.”

²² Int’l Comm., at Article 30(3).

²³ Lisa Bench Nieuwveld, *ICC Advance on Costs: Strategical Games*, 20-AUT INT’L L. PRACTICUM 114, 114 (2007).

²⁴ Michael Lazopoulos & Thomas Rohner, ‘Respondent’s Refusal to Pay its Share of the Advance on Costs’ (2011) 29 ASA BULLETIN 3, 549–73.

²⁵ *Id.*

to pay.²⁶

Whatever the applicable rules, practical business considerations are at play and the following hypothetical illustrates an all too common dilemma:

Party A pays, but Party B does not. The rules do not require one party to pay for or to front the other's 50% share, so Party A refuses to do so. The arbitrator refuses to move forward to the hearing phase because there are insufficient monies to pay for his or her time. As a result, the arbitrator suspends the arbitration and then, when neither party ponies-up the outstanding 50% share, the predicable happens, namely, the arbitrator terminates the arbitration. As a consequence, Party A is left with no viable alternative except to file papers in court (i) seeking to compel payment and/or (ii) seeking to litigate the dispute because the non-payment constituted a waiver of the arbitration; and/or (iii) seeking to hold Party B in default and scheduling an inquest for Party A to prove its damages.

Options (i) and (ii) provide no real benefit to Party A, so its papers ask the court to invoke (iii). In doing so, Party A asserts there is nothing unfair about granting this relief. First of all, Party B indisputably breached the contract by failing to pay for the arbitrator; second, in light of that breach, Party B destroyed Party A's ability to have the dispute heard and decided in arbitration; and finally, a judicial declaration of default is appropriate because otherwise Party B would be afforded a "second bite at the apple" by litigating the merits of the underlying dispute.

At the same time, Party A points out that, under the circumstances, it has nowhere else to turn because the arbitration proceeding it bargained for no longer exists. It asserts that if the court refuses to act, it would send a message to others that they too can nullify their prior

²⁶ Article 45 of the recently revised Stockholm Arbitration Rules provides that a "procedure, time and costs" arbitration agreement (or underlying rules) could clearly provide for the tribunal to issue judicially enforceable interim awards entitling that party to recover immediately advance deposits for costs, where the opposing party has refused to pay its *pro rata* share of those deposits."

The Korean Commercial Arbitration Board's International Rules provide immediate relief: a party who is forced to pay the whole of the advance on costs may request the tribunal to order the other party to pay its share in the form of an enforceable interim, interlocutory or partial award. See Benjamin Hughes, *The 'New' International Rules of Arbitration Should Encourage Foreign Parties to Submit Their Disputes to the Korean Commercial Arbitration Board*, 15 No. 2 IBA ARB. NEWS 32 (2010).

agreement to arbitrate disputes simply by failing to pay their arbitrator.²⁷

The simple solution is for the paying party to pony-up the outstanding 50% of the moneys as suggested by the AAA, CPR and ICC rules, and as mandated by JAMS. But what may be simple is not necessarily fair. Arbitrator compensation can involve significant sums of money, especially in complex commercial arbitrations involving three

²⁷ Recently, the authors represented a party in New York state court where these hypothetical facts actually played out. Specifically, the paying party in a construction arbitration filed a lawsuit asking for a default on liability after the underlying arbitration was terminated due to the respondents' failure to pay for the arbitrators.

The underlying facts were as follows: A general contractor entered into a subcontract with a subcontractor who agreed to perform certain roofing and related work at a New York City Housing Authority project. After commencing work, the subcontractor allegedly breached the subcontract by failing to perform as required. The general contractor served and filed a demand for arbitration with the AAA seeking damages arising out of the subcontractor's alleged failure to perform. The subcontractor appeared by counsel, served its own counterclaim, and actively participated in the selection of three arbitrators. The AAA confirmed the selections and sent invoices to the parties requesting that each pay 50% of the arbitrators' compensation. The general contractor paid its share; the subcontractor did not.

The AAA informed the parties that unless the arbitration expenses were paid in full, the Panel would have the right to suspend the arbitration until full deposits were received. Sure enough, the Panel executed a Suspension Order giving the parties 30 days "to comply with the deposit requirement, as directed by the AAA. In the event the deposits are not submitted, the Panel may elect to terminate the proceeding." Thereafter, the AAA sent an e-mail confirming the Panel's order and reminding the subcontractor of its failure to pay its share of arbitrator compensation. Still, the subcontractor did not pay. The Panel, refusing to proceed due to the insufficiency of funds, signed a Termination Order in accordance with AAA Construction Arbitration Rule 56. This ended the arbitration.

The general contractor, left without the ADR process it had intentionally bargained for in the subcontract, sought judicial intervention. It filed papers asking the court (i) to declare the subcontractor in default due to its failure to meet its contractual obligation to arbitrate and (ii) to order an inquest on damages.

The lower court denied the general contractor's application. An appeal ensued in which the general contractor asked the appellate court (i) to declare the subcontractor in default as a matter of law, and (ii) to remand the case to permit the general contractor to proceed to an inquest to prove its damages. The Appellate Division, First Department, declined to do so, and issued a summary decision that did not address the policy arguments raised in the general contractor's briefs. *See* *Whitestone Constr. Co., Inc. v. Varied Constr. Corp.*, 118 A.D.3d 418 (1st Dep't. 2014). Rather, the First Department ruled that (i) declaring a default is an issue for the arbitrator, not the courts, and (ii) the applicable rules (in this case, the Construction Industry Rules of the American Arbitration Association) bar defaults for nonpayment.

The First Department's reasoning is difficult to follow, because the applicable AAA rule does not provide that there can be no default for nonpayment of an arbitrator's fees. Instead, it states that ". . . to the extent the law allows, a party may request that the arbitrator issue an order directing what measures might be taken in light of a party's nonpayment. Such measures may include limiting a party's ability to assert or pursue their claim. In no event, however, shall a party be precluded from defending a claim or counterclaim." *See* AAA Construction Industry Arbitration Rules Amended and Effective October 1, 2009 at R-56(b). As the authors see it, the court's holding only makes sense if the arbitrator is still around to declare a default and then also agrees to preside over the remainder of the arbitration—something that is highly unlikely to occur with private arbitrators who rightfully expect to be paid for their time. Practically speaking, the court's decision left the claimant without a palatable remedy, and actually rewarded the respondent for gaming the system.

arbitrators. For many small or mid-sized businesses, this is a unworkable burden. Simply put, why should one party have to pay 100% of the compensation when the parties previously agreed to an equal split? Furthermore, under basic contract law, doesn't the failure to pay constitute a material breach of the agreement to arbitrate, thereby entitling the paying party to declare the non-paying party in default? And if the paying party elects not to advance the fees of the other party and the arbitrator then terminates the arbitration, the only recourse is for the paying party to file suit in court. In that case, fairness dictates that the court not turn a blind eye to what happened in arbitration. It should *not* permit the non-paying party a "second bite at the apple" by allowing it to defend the underlying claims on their merits. Rather, the failure to pay should be seen as the default it is. Since the parties are now necessarily in court in light of that very same default, the court should do what it ordinarily does when a defendant defaults in a breach of contract claim: allow the non-defaulting party to proceed to an inquest on damages.²⁸

III. VARYING JUDICIAL AND PUBLIC POLICY APPROACHES TO NONPAYMENT

One would expect a healthy universe of judicial opinions and scholarly articles considering issues of nonpayment in arbitration. But this is not so. Even states known as centers of litigation – New York, California, Illinois – have only a small sampling of state and federal cases where judges attempt to sort out nonpayment. The few articles

²⁸ Generally, a defaulting defendant is nonetheless entitled to appear at the inquest on damages to present testimony and evidence and cross-examine the plaintiff's witnesses. *Amato v. Fast Repair, Inc.*, 15 A.D.3d 429 (2nd Dep't. 2005). A trial court's refusal to allow the defaulting defendants to introduce evidence concerning damages at the inquest violates their right to participate in the determination of damages. *Conteh v. Hand*, 234 A.D.2d 96 (1st Dep't 1996); *see generally* David D. Siegel, *Practice Review*, 182 SIEGEL'S PRAC. REV. 3 ("The default establishes liability, but not damages; hence there must be an inquest on damages, and at the inquest the defendant is entitled to appear and contest. If he does, he is entitled to cross-examine the plaintiff's witnesses."). The same protocol should govern when a party defaults in arbitration; it should still be permitted to appear and challenge the claimant's entitlement to damages. *See, e.g.*, AAA Commercial Rule 57(b).

exploring the issue are by practitioners rather than scholars. Similarly, a few cases discuss the issue in detail, and most of those are in the context of consumer or employee arbitration rather than an arbitration provision negotiated by (and agreed to) by two sophisticated commercial parties.

Courts tend to avoid the issue in a number of ways. In *Dealer Computer Services, Inc. v. Old Colony Motors, Inc.*, the parties were prepared to arbitrate, but Old Colony was not prepared to pay its share of the arbitration fees.²⁹ When invoiced by the arbitration provider for \$26,900 for the final hearing, Old Colony claimed it did not have the funds to pay and Dealer Services was asked to cover the bill. Dealer Services refused and filed suit to compel arbitration with the costs split evenly. The federal district court ordered Old Colony to pay both shares, but the Fifth Circuit reversed, holding that the procedural arbitrability doctrine required that “the arbitrator, not the courts, should decide certain procedural questions which grow out of the dispute and bear on its final disposition.”³⁰ Thus, the question on fee splitting was essentially returned to the arbitrators because the proceeding had never been officially terminated.³¹

Similarly, the New York case *Brandifino v. CryptoMetrics, Inc.* involved a dispute arising out of an employment agreement where the employer failed to pay the arbitrator’s compensation as required by the applicable arbitration rules (and the parties’ arbitration agreement).³² The former employee filed a special proceeding asking the court to stay the arbitration so that he could sue the employer in court. Instead, perhaps because the underlying arbitration had been suspended and not yet terminated, the court gave the

²⁹ *Dealer Computer Servs., Inc. v. Old Colony Motors, Inc.*, 588 F.3d 884 (5th Cir. 2009).

³⁰ *Id.* at 887.

³¹ A similar result was reached in *JuiceMe, LLC v. Booster Juice LP*, 730 F. Supp. 2d 1276, 1285 (D. Or. 2010) (finding that waiver was an issue for arbitrator to decide).

³² *Brandifino v. CryptoMetrics, Inc.*, 896 N.Y.S.2d 623 (Westchester Co. 2010).

employer “one last chance to express its intent to arbitrate in accordance with the parties’ agreement.”³³ There is no additional reported case law on this dispute, presumably because the employer paid up or the case settled.

In *Sink v. Aden Enter, Inc.*, the arbitrator held a non-paying respondent to be in default and terminated the arbitration.³⁴ Sink sued Aden in federal court for breach of an employment agreement, which contained an arbitration clause. The district court stayed the suit and referred the action to arbitration, but Aden failed to pay its share of the fees. Consequently, the ADR provider suspended the arbitration. Sink then pursued his claims in federal court. Later, Aden experienced a change of heart and offered to pay its share of the arbitration expenses if the court ordered the parties back to arbitration.

The Ninth Circuit affirmed the district court’s denial of this request, holding that Aden had waived its right to arbitrate by materially breaching its contractual obligation to pay arbitration fees. The court also ruled that the respondent’s failure to pay its required arbitration costs was a default in proceeding with the arbitration under §3 of the FAA. The court pointed out that compelling arbitration could “allow a party refusing to cooperate with arbitration to indefinitely postpone litigation.”³⁵ In other words, a party seeking to delay and frustrate the process could refuse to pay, be brought to court, and then claim remorse and ask to go back to arbitration only to stiff the arbitrators yet again. Accordingly, the court permitted the claimant to pursue its claims in court. While the holding in *Sink* might seem to be a victory for the claimant, the parties ended up exactly where they had bargained *not* to be: in court, meaning that, “neither party [in *Sink*]

³³ *Id.* at 625.

³⁴ *Sink v. Aden Enter, Inc.*, 352 F.3d 1197 (9th Cir. 2003).

³⁵ *Id.* at 1201.

obtained the benefit of their bargain.”³⁶ Moreover, Sink faced additional costs and delays trying to compel arbitration and later preparing papers for court.

In consumer or employee disputes in which a corporate respondent fails to pay its share of the required arbitration fee, most courts have held that the claimants may bring the claim in court instead.³⁷ In this way, they follow the logic of *Brandifino, Dealer Services* and *Sink* by treating a party’s failure to pay the arbitration fee as a waiver of arbitration. But what about a situation where both parties are commercial entities, without the possible concerns over bargaining power in the consumer and employee contexts? The problem would shift to what has been described as “using non-payment of deposits strategically as a means of gaming the arbitration process.”³⁸ This recognizes that party providers often give the paying party the option 100% of the required deposit with the understanding that such sums could be reimbursed as part of the final award. This is not only contrary to what the parties primarily agreed to, but “having to advance a non-paying adversary’s deposit imposes an unfair burden... [which can] deplete a party’s resources and ability to prosecute its case... [and] involves substantial risk that the non-

³⁶ Richard DeWitt & Rick DeWitt III, *No Pay No Play: How to Solve the Nonpaying Party Problem in Arbitration*, 60 DISP. RESOL. J. 27 (Feb.–Apr. 2005).

³⁷ For example, in *Stowell v. Toll Bros.*, No. 06-cv-2103, 2007 WL 30316 (E.D. Penn. 2007), the plaintiff brought sexual discrimination and other claims against her former employer, Toll Brothers. Stowell’s employment contract contained an arbitration agreement. However, after the dispute was filed with the AAA, Toll Brothers failed to pay the filing fee and the AAA consequently declined to administer the arbitration. As a result, Stowell filed an action in court, and Toll Brothers petitioned the Court to compel arbitration. However, the court refused to do so, holding that Toll Brothers waived its right to arbitrate when it failed to pay the arbitration filing fee. *See also* *Brown v. Dillard’s Inc.*, 430 F.3d 1004, 1006 (9th Cir. 2005) (denying an employer the contractual right to compel an employee’s participation in arbitration after the employer refused to participate in the employee’s prior attempt to initiate arbitration); *Boulds v. Dick Dean Econ. Cars, Inc.*, 300 S.W.3d 614, 621 (Mo. Ct. App. 2010) (same, finding waiver). *See generally* Christopher R. Drahozal & Samantha Zyontz, *Private Regulation of Consumer Arbitration*, 79 TENN. L. REV. 289, 333 (2012); Thomas J. Lilly, Jr., *Participation in Litigation As A Waiver of the Contractual Right to Arbitrate: Toward A Unified Theory*, 92 NEB. L. REV. 86, 123 (2013).

³⁸ Richard J. DeWitt and Richard J. DeWitt III, *No Pay No Play: How to Solve the Non-Paying Party Problem in Arbitration*, 60 DISP. RESOL. J. 27 (Feb.–Apr. 2005); *see also* Richard J. DeWitt and Richard J. DeWitt III, *No Pay No Play: How to Solve the Non-Paying Party Problem in Arbitration*, AAA HANDBOOK ON ARBITRATION PRACTICE, 353–363 (2010), a later version of the article.

paying party will not be able to pay the amount advanced or any eventual award.”³⁹

Commercial arbitrations involving three arbitrators and ten or more hearings often engender fees totaling upwards of \$50,000 per party. This serves as an immediate reminder to the paying party that it had contractually agreed to pay only its fair share.

One court that has dealt directly with the nonpayment dilemma is the Supreme Court of Mississippi. In *Sanderson Farms, Inc. v. Gatlin*, it ruled that a party who refused to pay its share of filing fee and arbitrator’s expenses had breached the parties’ arbitration agreement and, therefore, had waived its right to arbitrate and to contest liability.⁴⁰

The case involved a poultry corporation’s contract with a poultry farmer. The corporation refused to pay half of the arbitration filing fee and administration costs, even though the arbitration provision provided that “the cost of such arbitration will be divided among the parties to the arbitration.”⁴¹ The court ruled that by failing to pay its half of the required arbitration fees under the contract, Sanderson Farms had breached the arbitration provision and therefore waived its right to compel its protections.⁴² The court also held that a party may waive its right to arbitration by refusing to pay fees and costs that are a part of the arbitration agreement because its refusal is “inconsistent with the right to arbitrate.”⁴³

However, not all courts agree with this approach. In *Lifescan, Inc. v. Premier Diabetic Service*, the parties submitted their dispute, pursuant to their contract, to the

³⁹ *Id.* at 28.

⁴⁰ *Sanderson Farms, Inc. v. Gatlin*, 848 So. 2d 828 (Miss. 2003).

⁴¹ *Id.* at 835.

⁴² *Id.* at 838. *See generally* 6 Bruner & O’Connor Construction Law § 21:92; Corey D. Hinshaw & Lindsay G. Watts, *A Review of Mississippi Law Regarding Arbitration*, 76 MISS. L.J. 1007, 1040 (2007) (“In *Sanderson Farms, Inc. v. Gatlin*, the court held waiver may be express or implied and may be inferred by the conduct of the parties.”).

⁴³ *Id.* at 837.

AAA.⁴⁴ Premier failed to pay arbitration fees, and the arbitrators gave Lifescan the option of advancing the fees. Lifescan refused. Predictably, the arbitrators then refused to proceed without Premier's payment of arbitration fees and suspended the proceedings. Lifescan petitioned the district court to direct Premier to pay its pro-rata share of the fees or, in the alternative, to order judgment on liability if Premier failed to pay.

The court granted Lifescan's petition and ordered Premier to pay its *pro rata* share of the fees; it also held that Premier's failure to pay amounted to its failure, neglect, or refusal to arbitrate. However, the Ninth Circuit Court of Appeals reversed and directed the district court to dismiss the petition, holding that §4 of the FAA gives district courts limited roles in arbitrations.⁴⁵ After examining the AAA Rules, the court rejected the notion that Premier had failed, neglected or refused to arbitrate, on the ground that the Rules provided that the arbitrators "may" require a deposit as it deems necessary. Therefore, the arbitrators had discretion as part of their award under the AAA Rules to change the allocation of fees, and Premier had not failed, neglected, or refused to arbitrate.

Clearly, different courts look at these situations in different ways, creating a lack of uniformity. Under *Lifescan*, the failure to pay all arbitration fees is not a revocation, default or waiver of arbitration because *Lifescan* holds that such behavior does not constitute a breach or default under an arbitration agreement under the applicable rules. *Lifescan* shows that, in addition to being costly and time consuming, requesting a court to

⁴⁴ *Lifescan, Inc. v. Premier Diabetic Servs., Inc.*, 363 F.3d 1010 (9th Cir. 2004).

⁴⁵ *See, DVC-JPW Investors v. Gershman*, 5 F.3d 1172, 1174 (8th Cir. 1993) ("Under [the FAA], federal courts play a limited role in reviewing the decisions of arbitrators and a district court may only vacate arbitration decisions under the narrow set of circumstances set forth in the statute."; *accord* *Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117, 120 (2d Cir. 1991); *Moseley, Hallgarten, Estabrook & Weeden, Inc. v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988).

enforce an arbitration agreement for nonpayment of fees may not be a viable solution if the underlying provider rules are discretionary regarding a party's commitment to pay fees. This is a starkly different approach from courts like *Sanderson*, which uphold the principle of waiver if one party to a bilateral agreement does not contribute its fair share of fees.

IV. LIABILITY AS A MATTER OF PUBLIC POLICY

For the past century, courts have promoted the arbitration of commercial disputes. States follow the direction of the federal courts in giving broad support to the FAA, adopting policies that “favor and encourage arbitration as a means of conserving the time and resources of the courts and the contracting parties.”⁴⁶ Congress enacted the FAA in 1925 “to reverse the long-standing judicial hostility to arbitration agreements...and to place arbitration agreements upon the same footing as other contracts.”⁴⁷ New York courts, for example, give strong weight to the parties' decision to arbitrate by ensuring they participate, by confirming the award, and by facilitating the collection of judgments.⁴⁸

As the case law confirms, when a party fails to pay its share of the arbitration fees, there are essentially two options: the court can face the situation head-on and try to fashion appropriate relief or it can throw up its hands and punt. The latter is a particularly unacceptable result when the arbitration proceeding was terminated due to one party's nonpayment. It also, of course, leaves the paying party in the lurch. The

⁴⁶ *D'Agostino v. Forty-Three E. Equities Corp.*, 842 N.Y.S.2d 122 (1st Dep't 2007) (quoting *Nationwide v. Investors*, 37 N.Y.2d 91, 95 (1975)).

⁴⁷ *Id.*

⁴⁸ 23 *Carmody-Wait 2d* § 141:9; *see also* *N.Y.C. Dept. of Sanitation v. MacDonald*, 215 A.D.2d 324 (1st Dep't 1995), order *aff'd*, 664 N.E.2d 1218 (1996); *Oxbow Calcining USA Inc. v. American Indus. Partners*, 948 N.Y.S.2d 24 (1st Dep't 2012).

authors submit that when the judiciary fails to act, this undermines the arbitral process. It is also anathema to our national and state public policy favoring arbitration and, in the long run, it will deter parties from utilizing arbitration as an alternative to litigation.

It is crucial that the court system plays this important role of a backstop. Parties will fail to play by the rules of arbitration only when they believe they can do so without consequence. And so we come to the public policy ramifications of nonpayment. If the arbitrator terminates the arbitration due to nonpayment, what remedies are there? Sadly, if courts conclude they are powerless to hold accountable those who broke their promise to arbitrate by failing to pay their arbitrators, well-behaving parties are without an equitable remedy. Requiring the non-breaching party to file a lawsuit where the breaching party can defend the underlying claims on the merits gives the breaching party a “free pass” and disregards its prior breach. Going back and filing a second arbitration is a non-starter as one can assume the non-payer will continue to refuse to pay. And procuring a court order simply directing the non-paying party to “pay-up” falls far short of affording an appropriate remedy following the material breach of contract. The wisdom of a lawsuit merely to force the nonpaying party to pay the arbitrators is “uncertain at best.... [T]his option is both time-consuming and costly, with no guarantee of success.”⁴⁹

Practically, dealing with a non-paying party is easier when that party is the claimant. If claimant does not pay its share of the expenses, “then it is eminently fair to suspend the arbitration until the claimant makes such payment, or, if payment is not made within a certain time, to dismiss the claimant’s case. A claimant should not be permitted

⁴⁹ Steven C. Bennett, *What to Do When A Party Fails to Pay Its Portion of Arbitration Fees*, PRAC. LAW., June 2013, at 57, 60.

to hold a case open and waste the arbitrator's and other party's time if it is not able or willing to pay its share of the cost for the proceeding that it initiated."⁵⁰ In reality, however, the non-paying party is almost always the respondent.

Commercial arbitration differs markedly from consumer or employment arbitration, so there is no reason or need to protect the "Davids" from the "Goliaths." When two commercial entities freely agree to arbitrate disputes and one of them thereafter is responsible for the termination of the arbitration, there is nothing unfair about a court holding that party in default. The non-paying party should be deemed to have waived its right to arbitration and its opportunity to litigate liability on the merits. The non-paying party still has the right to attend the inquest and contest damages, but it should not be permitted to sabotage the arbitration and then proceed to court to litigate both liability and damages.

IV. CONCLUDING THOUGHTS AND PRACTICAL GUIDANCE

The idea of default liability may be unpalatable for some judges who may conclude that they are without authority to do anything other than confirm or vacate arbitration awards. Given that mindset, what can attorneys do, in practical terms, to minimize the potential damage caused by a nonpaying party?

First, as noted *supra*, attorneys drafting contracts with arbitration clauses can anticipate this pitfall by providing that the failure to pay fees constitutes a material default entitling the paying party to proceed in court to an inquest on damages if the arbitrators refuse to move forward. Second, in jurisdictions where courts are (or may be) unwilling to provide relief in the form of an inquest on damages, counsel ought to prepare

⁵⁰ Mitchell L. Marinello & Alison T. Schwartz, *What to Do When a Party Refuses to Pay its Share of Arbitration Costs*, 18 DISP. RESOL. MAG. 29, 30 (Winter 2012).

the client for the possibility that, in the face of extreme intransigence by the other side, the client may need to advance all of the fees and costs if the arbitration is to proceed.

Third, the boldest, and the authors' preference, is that where the arbitration proceeding indisputably has been terminated due to nonpayment, there is nothing offensive or improper about a court simply applying common law breach of contract principles to allow the party who played by the rules to proceed to an inquest on damages. In a commercial dispute, where the parties voluntarily agree to arbitrate and one party's failure to pay compromises the arbitration, liability is the appropriate remedy because it holds the nonpaying party fully accountable. ADR providers and courts should work together to ensure that, as a cultural and legal norm, nonpayment will not be a successful strategy for a party to sabotage an arbitration.