Stiffing the Arbitrators: The Problem of Nonpayment in Commercial Arbitration

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I. Introduction

Commercial arbitration is a creature of contract; the parties are there because they choose to be, either including an arbitration clause in their written agreement or, after a dispute developed, electing to avoid litigation all together.³ Often, beyond saving time and money and embracing finality, the incentive is to bring their battle behind closed doors, often before an arbitrator with expertise in the subject matter of their dispute.

Arbitration also comes with an up-front cost non-existent in litigation: the arbitrators. Taxpayers pay for their state and federal judges, but the parties themselves pay for their arbitrators.⁴ This is a justifiable and worthwhile expense to sophisticated

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³ 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 (Alaska 1983); Sablosky v. Edward S. Gordon Co., Inc., 73 N.Y.2d 133 (1989).

⁴ The parties also pay filing fees to arbitration providers such as the American Arbitration Association (“AAA”), the International Institute for Conflict Resolution and Prevention (“CPR”), JAMS and National Arbitration and Mediation (“NAM”).
parties who 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 and less expensive and largely immune from appeal.\(^5\) While court filing fees are \textit{de minimus}, the initial cost-savings evaporate quickly when the parties begin paying their attorneys for years of document discovery, interrogatories, depositions, motion practice and the like before the arrival of their day in court. And if the case does not settle on the courthouse steps, there is the looming prospect of significant additional delay and the expenditure of even more money if the loser appeals.\(^6\)

Commercial arbitrators are typically experienced attorneys, former judges and industry leaders who are expected to bring their knowledge and expertise to bear in hearing and resolving disputes.\(^7\) To coin an overused maxim, “there’s no such thing as a


\(^6\) At the federal level, litigants have a significant chance of facing appeal. Chris Guthrie, Misjudging, 7 N. EV. L.J. 420, 456 (2007) (noting that about 20 percent of cases with definitive trial court judgments 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 have even more liberal policies for permitting 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 more rare. 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).

\(^7\) Thomas H. Oehmke and Joan M. Brovins. 97 AM. JUR. TRIALS 319 (2005) (“Like judges, arbitrators are empowered to decide cases; differently, however, arbitrators are usually engaged in other occupations
free lunch,” so by selecting arbitration commercial parties agree to compensate one or three arbitrators who are not expected merely to show-up and hear the proofs. Rather, a great deal of time and effort is properly expended 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 the 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 irrevocably waived their right to proceed in court, except to confirm or vacate the arbitration award? 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 very well

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create a situation where it actually benefits by its non-payment. If an arbitration has been sabotaged by the non-payer, is it fair that the paying party’s only alternative is to file suit in court, thereby placing it in the very forum it 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 damages?

There are no clear, uniform answers. Different arbitration providers promulgate their own rules and the few state and federal courts that actually have addressed the issue of arbitrator non-payment are not in accord. We begin with an examination of the current rules of four preeminent alternative dispute resolution (“ADR”) providers: the AAA, JAMS, NAM, CPR, plus some analogous international rules. We follow with a review and analysis of the reported case 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. This remedy, we assert, should be available not only because it is fair and appropriate, but also to deter recalcitrant parties from looking to game the system by breaking their promise to pay for the cost of their arbitration. Simply put, stiffing an arbitrator should not become a viable strategy (i) to destroy the parties’ prior agreement to arbitrate and/or (ii) to create the additional delay and costs that arbitration is supposed to avoid.

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9 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.
II. Arbitration Provider’s Rules on Fees

When drafting their arbitration clause, the parties may choose among a number of options to allocate fees, costs, and expenses. 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. But in practice, ADR clauses rarely address payment issues in detail. So in the absence of contractual guidance, in an administered arbitration, 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

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10 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 Jan. 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.

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

12 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).

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. For example, 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.
The specific AAA rule addressing “Arbitrator’s Compensation” is silent with respect to who pays what, 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. Among other things, 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.

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13 AAA Construction Industry Rule 54.
14 Id., Rule 55.
15 Id., 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 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.

16 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
As with the AAA, the apportionment of such fees and compensation is subject to reallocation in the final award.

The CPR, and its Administered Arbitration Rules, effective July 1, 2013, are similar to the AAA’s Commercial Arbitration Rules. Rule 17, “Arbitrator Fees, Expenses and Deposits,” requires that the parties be invoiced in equal shares.17 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.”18

Although, there are myriad international ADR treaties and providers,19 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.20

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17 Rule 17.2:

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.

18 Rule 17.3:

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.

19 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. Vandevelde, 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).

20 ICC 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
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.\textsuperscript{21} 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.”\textsuperscript{22} The paying party then must await the final award; if it prevails, the tribunal will order the nonpaying party to reimburse it.\textsuperscript{23} This places a heavier financial burden on the paying party, effectively reducing one of arbitration’s attractions that both parties bear the costs.\textsuperscript{24} A non-paying party in ICC arbitrations can use this strategy to delay or halt the arbitration by refusing to pay.\textsuperscript{25}

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 predictable happens, namely, the arbitrator terminates the arbitration. As a consequence, Party A is left with no

\begin{itemize}
  \item \textsuperscript{21} ICC, Article 30(3).
  \item \textsuperscript{23} Michael Lazopoulos & Thomas Rohner, 'Respondent’s Refusal to Pay its Share of the Advance on Costs' (2011) 29 ASA BULLETIN 3, 549–573.
  \item \textsuperscript{24} \textit{Id.}
  \item \textsuperscript{25} 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, \textit{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).
\end{itemize}
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 agreement to arbitrate disputes simply by failing to pay their arbitrator.26

26 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
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 required is not necessarily the most fair. Arbitrator compensation can involve significant sums of money, especially in complex commercial arbitrations involving three arbitrators. For many small or mid-sized businesses, this is a substantial 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

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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 Construction Company, Inc. v. Varied Construction Corp., 118 A.D.3d 418, 987 N.Y.S.2d 56 (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 rightly expect to be paid in full for their time. Practically speaking, the court’s decision left the general contractor without a palatable remedy, and actually rewarded the subcontractor for gaming the system.
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.  

III. Judicial and Public Policy Approaches

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. Few articles, mostly by
practitioners, explore the issue. Similarly, a paucity of 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

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 one party was
not prepared to pay its share of the arbitration fees. 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. It refused and filed suit in court to
compel arbitration with the costs split evenly. The federal district court ordered Old

\footnote{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, 790 N.Y.S.2d 510 (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, 650 N.Y.S.2d 723 (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).}

\footnote{Dealer Computer Services, Inc. v. Old Colony Motors, Inc., 588 F. 3d 884 (5th Cir. 2009).}
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.”

Thus, the question on fee splitting was essentially returned to the arbitrators because the proceeding had never been officially terminated.

Similarly, 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). 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 employer “one last chance to express its intent to arbitrate in accordance with the parties’ agreement.” 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. Sink sued Aden in federal court for breach of an employment agreement containing 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, the respondent had a change of heart and offered to pay its share

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29 Id. at 887.
30 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 Id. at 525.
33 Sink v. Aden Enter, Inc., 352 F.3d 1197 (9th Cir. 2003).
of the arbitration expenses if the court ordered the parties back to arbitration.

The 9th Circuit affirmed the trial court’s denial of this request, holding that the respondent 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.” 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. As Richard J. DeWitt and Richard J. DeWitt III have written, “neither party [in Sink] obtained the benefit of their bargain.”

Moreover, the claimant faced additional costs and delays trying to compel arbitration and later preparing papers for court.

In consumer or employee disputes where 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. In this way, they follow the logic of Brandifino, Dealer

34 Id. at 1201.
36 For example, In Stowell v. Toll Brothers, 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
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 Brandifino court cited the DeWitt article, which observed “the problem as a party using non-payment of deposits strategically as a means of gaming the arbitration process.”37 The article recognizes that party providers often give the paying party the option 100 percent of the required deposit with the understanding that such sums could be reimbursed as part of the final award. It correctly points out that “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-paying party will not be able to pay the amount advanced or any eventual award.”38

Indeed, a paying party might not want to advance a nonpaying party’s costs because, simply put, it is not what the parties agreed to, and further, 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

38 Id. at 28.
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.  

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.” 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. The court also held a party may waive its right to arbitration by its refusal to pay fees and costs which are a part of the arbitration agreement because such a refusal is “inconsistent with the right to arbitrate.”

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

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39 *Sanderson Farms, Inc. v. Gatlin*, 848 So. 2d 828 (Miss. 2003).
40 *Id.* at 835.
41 *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.”)
42 *Id.* at 837.
43 *Lifescan, Inc. v. Premier Diabetic Servs., Inc.*, 363 F.3d 1010 (9th Cir. 2004).
neglect, or refusal to arbitrate. However, the Ninth Circuit reversed and directed the District Court to dismiss the petition. The Ninth Circuit held that §4 of the FAA gives district courts limited roles in arbitrations. 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 court found that the non-paying party was not in violation of the agreement to arbitrate because the arbitrators had discretion under the AAA Rules to change the allocation of fees.

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 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 very different approach from courts like Sanderson that 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 last century, the arbitration of commercial disputes has been promoted by our courts. States follow the direction of the federal courts in giving broad support to the Federal Arbitration Act (“FAA”), adopting policies that “favor and encourage arbitration as a means of conserving the time and resources of the courts and the contracting
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.” 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.

As the reported cases confirm, when a party fails to pay its share of the arbitration fees, there are essentially two options: the court can deal with 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 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.

That the court system plays this important role of a backstop is critical. 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

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45 Id.
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 simply 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.”

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 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.” 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.

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

We recognize that the idea of default liability may be unpalatable for some judges who may conclude they are without authority to do anything other than confirm or vacate arbitrate 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 the client for the possibility that, in the face of extreme intransigence by the other side, the client may have 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 having a court apply 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 agreed to arbitrate their disputes and the nonfeasance of one party destroys that right, it is the appropriate next step because it circumvents the problem where the arbitrator has terminated the
arbitration. Nonpayment poses a potentially serious threat to arbitration. ADR providers and courts must work together to ensure that, as a cultural and legal norm, nonpayment will not be a successful strategy to sabotage an arbitration and avoid liability.