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To Pay or Not to Pay: A Lesson from the Pre-Paid Legal Services v Todd Cahill

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Non-payment of the share of an advance on costs in arbitration has consequences on an arbitration agreement, arbitration proceedings and a possibility for the parties to have recourse to courts. The consequences vary and they heavily depend on national laws, applicable arbitration rules, circumstances of the case and the relief sought. The complexity of these cases can be shown through an analysis of a recent decision rendered by the Tenth Circuit in case between Pre-Paid Legal Services, Inc. ("Pre-Paid") and Todd Cahill [2015 WL 3372136 (C.A.10 (Okla.))] on May 26, 2015 ("the Pre-Paid case" or "the Decision"). The focus of this post will be on the decision on the merits in the Pre-Paid case, although the jurisdictional issue is also an interesting lecture.

Facts

Mr. Cahill is a former employee of Pre-Paid, who left to join another network marketing company. Pre-Paid alleges that he began to misuse trade secret information, contact other Pre–Paid associates, and solicit them to join his new place of employment. On August 14, 2012, Pre-Paid commenced court proceedings against Mr. Cahill. However, Mr. Cahill filed a motion to stay the district court proceedings due to an arbitration agreement in the employment contract. The motion for a stay was granted. Pre-Paid moved its claims to another forum – arbitration panel. In February 2013, it commenced arbitration proceedings before American Arbitration Association ("AAA").

Pre-paid paid its share of deposit while Mr. Cahill failed to do so. Due to this failure, the arbitration proceedings were suspended in June 2013, and after another unsuccessful warning to the parties that if deposits are not paid, the arbitration will be terminated – the tribunal finally decided to terminate the proceedings in July 2013.

Pre–Paid then moved to lift the stay of district court proceedings. On April 16, 2014, the district court granted the motion and lifted the stay. Mr. Cahill appealed the district court's decision.

The Tenth Circuit's Decision

The Tenth Circuit affirmed the district court's lifting of the stay, and stated that this was in accordance with the purpose of arbitration "to provide a cost-effective and efficient means of resolving a claim". When such purpose "is thwarted by a party's default in failing to pay the required fees[,] the Court believes that the paying party's right to have its dispute adjudicated and not to be unreasonably held at the mercy of a nonpaying party outweighs the strong presumption in

favor of arbitration."

This signals the change of policy in today's arbitration world, where the presumption in favour of arbitration is not that strong any more, at least not when it serves only one party. Such change should certainly be welcomed. However, the reasoning which the Tenth Circuit provided was tailor-made for the circumstances of this particular case. Therefore, the interested parties should take all the particularities into account when deciding to pay or not to pay deposit, or, in case of the non-defaulting party, to make recourse to a court. Some of these particularities are analysed below.

The Tenth Circuit based its decision on the merits on Section 3 of the FAA according to which it thoroughly analysed two phrases: "[i]f any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration […] the court in which such suit is pending […] shall […] stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration."

"[U]ntil such arbitration has been had in accordance with the terms of the agreement"

Since the arbitration was at the moment of making of the Decision already terminated, this requirement for a stay was, according to the Tenth Circuit, "removed":

> *"The AAA determined the arbitration had gone as far as it could due to Mr. Cahill's repeated refusal to pay the fees. Under the AAA rules, the panel terminated the proceedings. As such, the arbitration 'ha[d] been had in accordance with the terms of the agreement.'"*

In other words, since the arbitration was not any more pending, the stay could be lifted.

However, the Tenth Circuit went even further by stating that such a conclusion is in accordance with the practice which finds non-payment of a share of deposit to be a material breach of arbitration agreement. This, however, seems not to fit the analysis under this requirement. Namely, even though a non-payment may be considered to be a breach, such failure will still be (and was) treated *in accordance* with the AAA rules. The AAA Rules provide for deposits to be made in equal shares. They also state that if such payment did not take place, "the AAA may so inform the parties in order that one of them may advance the required payment." The parties were invited more than once to make the full payment of deposits, and they were also informed of the possible consequences if the payments remained unpaid – the suspension or termination of the proceedings.

Therefore, despite Mr. Cahill's failure to pay, the arbitration was in accordance with the terms of the agreement until the termination. If one considers that the non-payment, as a material breach of arbitration agreement, interferes with this requirement, then from that moment arbitration is no longer "*in accordance with the terms of the agreement*". This opens a possibility for non-defaulting parties to make recourse to court or to make a motion for lifting a stay already at that moment. Such a possibility would render the institute of substitute payment obsolete. For that reason, the discussion on material breach fits more in the analysis of the second requirement which needs to be satisfied in order not to lift a stay.

"[I]n default in proceeding with such arbitration"

The Tenth Circuit found lifting the stay alternatively permissible on this basis as well since "*Mr. Cahill was 'in default in proceeding with [the] arbitration'*" due to his failure to pay the fees.

The Tenth Circuit mainly dealt with an issue who should decide the "question of default": the court or the arbitrators. When explaining that there is no need to have a formal finding of arbitrators on default, the court distinguished two cases in which the Ninth and the Fifth Circuit put the decision on payment of fees in the hands of arbitrators [*Lifescan, Inc. v. Premier Diabetic Services, Inc., 363 F.3d 1010 (9th Cir.2004), Dealer Computer Services, Inc. v. Old Colony Motors, Inc., 588 F.3d 884 (5th Cir.2009)*].

The Tenth Circuit stated that, firstly, in both *Dealer* and *Lifescan*, the arbitrators had asked the party that had already paid its share of arbitration fees to pay the fees of the other party, who had refused to pay. The party that had paid asked the district court to order the other party to pay. The circuit courts decided to leave the issue of how to allocate fee payment to the AAA, which had already decided to ask the paying party to advance the fees for both sides.

In the Pre-Paid case, the Tenth Circuit emphasized that the AAA did not ask Pre–Paid to advance Mr. Cahill's fees, but it terminated the arbitration. However, the Tenth Circuit observed itself that "Pre–Paid *declined* to pay Mr. Cahill's share of the fees" (emphasis added). Also, the arbitration panel suspended the arbitration, warning *both* parties that if the deposits were not paid by a certain date, the arbitration would be terminated. This would also be the only possible procedure according to the AAA Rules under which "the AAA may […] inform *the parties* [that the payments are not made] in order that one of them may advance the required payment."

The Tenth District also stated that the relief sought was different than the one in the *Dealer* and *Lifescan*. Namely, Pre–Paid did not ask the court to order Mr. Cahill to pay, but it requested it to lift the stay. It follows that the relief which is sought – specific performance or lifting a stay – can, even in factually similar cases, result with opposite decisions.

Secondly, the Tenth Circuit pointed out that in both *Dealer* and *Lifescan* the arbitration was suspended, rather than terminated, so the parties conceivably could have continued with arbitration. In the Pre-Paid case, the arbitration was terminated, and there is no indication the AAA has left open the possibility for the proceedings to continue. Nevertheless, the court failed to notice that nothing prevented the parties to re-initiate arbitration.

Perhaps, the Tenth Circuit was discouraged to acknowledge this by Mr. Cahill's behaviour. As it stated itself:

> "Mr. Cahill originally sought a stay of the district court proceedings to pursue arbitration. But then he failed to meet the AAA's fee requirements. Now he seeks to keep the stay in place for more arbitral proceedings, which he thwarted in the first place."

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