Trio of Cases Help Protect a Plaintiff's Right to a Jury Trial

when a Defendant Fails to Timely Pay Arbitration Fees

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If a defendant is even one day late on paying their arbitration fees, it completely waives the right to arbitrate.

Relatively recently, the legislature passed two laws to protect consumers and employees in arbitrations where defendants fail to comply with their payment obligations. Effective January 1, 2020, Code of Civil Procedure sections 1281.97 and 1281.98 place hard deadlines for the payment of arbitration fees. Very recently, in late 2022, a trio of California appellate cases interpreted section 1281.97 and 1281.98 for the first time. The holdings are excellent for the plaintiff-side attorney. This is particularly true in employment actions and elder abuse cases.

In short, if a defendant fails to timely pays an arbitrator's initial fees, the defendant completely forfeits any right to arbitration. The law has no exceptions and is very harsh and unforgiving for a noncompliant defendant.

It is crucial that the attorney for the consumer and employee understand these laws and assert their right to a jury trial when the defense is late on its arbitration payment obligations.

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What are Sections 1281.97 and 1281.98?

Under section 1281.97, the arbitrator is required to "immediately" provide an invoice for any fees and costs required before the arbitration can proceed. Unless there is an express provision in the arbitration agreement stating otherwise, the invoice is due upon receipt. (Code Civ. Proc., § 1281.97(a)(2).) If the defendant fails to pay that invoice within 30 days, "the drafting party is in material breach of the arbitration agreement, is in default of the arbitration, and waives its right to compel arbitration." (Id. at §1281.97(a)(1).)

The term "drafting party" is defined as "the company or business that included a predispute arbitration provision in a contract with a consumer or employee. The term includes any third party relying upon, or otherwise subject to the arbitration provision, other than the employee or consumer." (Code Civ. Proc., § 1280.)

The only material difference between section 1281.97 and 1281.98 is that section 1281.97 applies to the start of the arbitration while 1281.98 applies to payments required to continue an arbitration already in progress. Under section 1281.98(a)(1), if the defendant fails to pay the fees and costs required to continue an arbitration proceeding within 30 days, then the defendant waives its right to arbitrate.

When the defendant does not pay the invoice on time, the plaintiff may "withdraw the claim from arbitration and proceed in a court of appropriate jurisdiction," or "[c]ompel arbitration in which the drafting party shall pay reasonable attorney's fees and costs related to the arbitration." (§ 1281.97(b); see also § 1281.98(b) [stating similar remedies].)

Moreover, should the plaintiff withdraw the claim from arbitration and proceed in court, the court must impose sanctions against the defendant in the form of the reasonable attorney's fees and costs as a result of the material breach. (Id. at § 1281.97(d); §1281.98(c)(2); § 1281.99(a).)

While monetary sanctions are mandatory, the court may also impose additional sanctions, including: 1) evidence sanctions prohibiting the drafting party from conducting discovery in the civil action; 2) a terminating sanction; or 3) a contempt sanction. (Id. at § 1281.99(b).)

The legislative history behind both sections was due to a concern that "[a] company's failure to pay the fees of an arbitration service provider in accordance with its obligations contained within an arbitration agreement or through application of state or federal law or the rules of the arbitration provider hinders the efficient resolution of disputes and contravenes public policy." (Stats. 2019, ch. 870, § 1 [S.B. 707] at subd. (c).) Private contracts that violate public policy are unenforceable and are void. (Id. at subd. (a); see also Civ. Code, §§ 1668, 3513.)

Furthermore, "[a] company's strategic non-payment of fees and costs severely prejudices the ability of employees or consumers to vindicate their rights. This practice is particularly problematic and unfair when the party failing or refusing to pay those fees and costs is the party that imposed the obligation to arbitrate disputes." (Stats. 2019, ch. 870, § 1 [S.B. 707] at subd. (d).) The California Legislature sought to codify the holding in the 9th Circuit decision in *Sink v. Aden Enterprises, Inc.* (2003) 352 F.3d 1197. In *Sink*, the Ninth Circuit held that under federal law, an employer's failure to pay arbitration fees as required by an arbitration agreement constitutes a material breach of that agreement and results in a default in the arbitration. In short, the legislature found that "a company's failure to pay arbitration fees pursuant to a mandatory arbitration provision constitutes a breach of the arbitration agreement and allows the non-breaching party to bring a claim in court." (Stats. 2019, ch. 870, § 1 [S.B. 707] at subd. (f).)

Gallo v. Wood Ranch USA, Inc.

In *Gallo v. Wood Ranch USA, Inc.* (2022) 81 Cal.App.5th 621, 630, a server sued her employer for gender and religious discrimination. The trial court granted the employer's motion to compel arbitration based on a signed arbitration agreement. (Id. at p. 631.) The parties agreed on an arbitrator affiliated with the AAA. (Ibid.) The AAA sent an invoice for an initial administrative fee of $300, which the plaintiff quickly paid but the employer did not. (Id. at p. 632.) AAA then issued late penalties where the fee was now $1,900. (Ibid.) AAA even warned the employer about sections 1281.97 and 1281.98. (Ibid.)

The employer still failed to pay the fee. (Ibid.) Apparently, these letters were all sent to the law firm partner, who never forwarded the correspondence to his client or his own accounting department. (Ibid.) Finally, the employer paid the fee 36 days after the 30-day period had expired. (Ibid.)

The trial court granted the plaintiff's motion to vacate the prior order compelling arbitration and awarded $2,310 in sanctions. (Id. at p. 632.) The employer appealed, arguing that section 1281.97 conflicted with the Federal Arbitration Act and was therefore preempted. (Id. at p. 633.) Of course, the FAA preempts any state rule that discourages against arbitration on its face, such as prohibiting arbitration of certain categories of claims. (Ibid.) The FAA also preempts facially neutral state laws that disfavor arbitration by imposing procedural hurdles to arbitration. (Ibid.) The entire purpose of the FAA was to promote and enforce arbitration agreements. (Ibid.)

The Court of Appeal disagreed and affirmed the trial court order. (Ibid.) In doing so, the Court of Appeal noted that the "mere fact that application of section 1281.97 in this case deprives [the employer] of the arbitral forum that it initially invoked does not warrant the conclusion that section 1281.97 is preempted by the FAA." (Id. at p. 644.) Rather, section 1281.97 "define the procedures governing the

date by which the party who drafted an agreement to arbitrate against an employee or consumer must pay the initial fees and costs to arbitrate, and specify the consequences of untimely payment." (Ibid. [emphasis in original].) These are procedural statutes under the California Arbitration Act that the Gallo court found were the type "that have been repeatedly found not to be preempted by the FAA . . ." (Ibid.)

Even more importantly, the FAA's entire goal was to provide an expedited and cost-efficient vehicle for resolving disputes. (Ibid.) Therefore, sections 1281.97 and 1281.99 actually "facilitate arbitration by preventing parties from insisting that a dispute be resolved through arbitration and then sabotaging that arbitration by refusing to pay the fees necessary to move forward in arbitration." (Ibid. [emphasis in original].) Therefore, section 1281.97 "in no way frustrates the FAA's goals of honoring the parties' intent or safeguarding arbitration as a means of expediting the resolution of their dispute." (Id. at p. 645.)

Espinoza v. Superior Court

Espinoza v. Superior Court (2022) 83 Cal.App.5th 761 differed from *Gallo*, 81 Cal.App.5th, supra at p. 621 in two important ways. First, the delay in payment was far more brief and harmless. Second, the trial court ruled against the employee and in favor of the employer, finding substantial compliance with the statute. Still, the Court of Appeal found that substantial compliance was not an exception to section 1281.97. An employee filed an employment complaint against the defendant in the trial court, asserting claims for disability discrimination and retaliation. The trial court granted the defendant's motion to compel arbitration. Notably, in doing so, the trial court found that "the FAA governs the terms of the parties' agreement." (Id. at p. 770.)

The arbitrator sent the parties an initial invoice for an administrative fee. (Ibid.) Thirty-one days after the due date for administrative fee, the plaintiff emailed the arbitration provider and asked if the defendant had paid the fee. (Ibid.) The arbitrator confirmed that it had not yet received payment. One week later, the defendant made the payment. (Ibid.)

The defendant attributed the delay in payment to a clerical error and a short delay from the employer from issuing the check for payment. (Ibid.)

The employee filed a motion under section 1281.97 for an order lifting the litigation stay, allowing her claims to proceed in court, and imposing monetary and evidentiary sanctions on defendant under section 1281.99. (Ibid.) The trial court denied the motion, finding that the employer was not in material breach because it had substantially complied with its payment obligations and the delay did not prejudice the employee. (Id. at p. 771.)

On a writ petition, the Court of Appeal reversed. (Ibid.) The Court of Appeal recognized that even the employee conceded that "the delay in payment was inadvertent, brief, and did not prejudice plaintiff." (Ibid.) However, "section 1281.97 contains no exceptions for substantial compliance, unintentional nonpayment, or absence of prejudice." (Ibid.) Sections 1281.97 and 1281.98 require strict enforcement. (Ibid.)

In fact, the legislative history even considered and rejected the argument that 1281.97 and 1281.98 would unfairly penalize defendants for minor errors or innocent mistakes over an arbitration administrative fee that is typically a few hundred dollars. (Id. at p. 757.) Particularly in employment cases, while a company may view the delay of paying a such a fee as a minor and immaterial mistake, the "ensuing delay associated with this minor error could be significant to the employee, who may not be able to pay bills, rent or other expenses that could result in the loss of their residence, or damage to their credit rating, while the dispute remains unresolved." (Assem. Com. on Judiciary, Analysis of Senate Bill No. 707 (2019–2020 Reg. Sess.) as amended May 20, 2019, p. 8.)

Therefore, "[a]lthough strict application may in some cases impose costs on drafting parties for innocent mistakes, the Legislature could have concluded a brightline rule is preferable to requiring the nondrafting party to incur further delay and expense establishing the nonpayment was intentional and prejudicial." (Espinoza, supra, 83 Cal. App.5th at p. 759.)

De Leon v. Juanita's Foods

Unlike *Espinoza*, supra, 83 Cal.App.5th at p. 770 and *Gallo*, 81 Cal.App.5th, supra at p. 621, *De Leon v. Juanita's Foods* (2022) 85 Cal.App.5th 740, 745 involved the continuing of arbitration rather than the initiation of arbitration. Thus De Leon involved section 1281.98 rather than section 1281.97.

In *De Leon*, the plaintiff filed a complaint relating to his employment with a staffing agency and the worksite. The staffing agency filed a motion to compel arbitration based on its arbitration agreement with the plaintiff, which extended to the worksite defendant. (Id. at p. 746) The worksite defendant joined in the motion, which the trial court granted over the plaintiff's opposition. (Ibid.)

Per the arbitration agreement, JAMS was selected as the arbitration provider. (Ibid.) JAMS sent invoices to both employers for $1,300 each, which were timely paid by both defendants. (Ibid.) The parties thereafter selected a JAMs arbitrator and started arbitration proceedings. (Ibid.) Later, JAMS sent $5,000 invoices to each defendant that were a "deposit for services." (Id. at p. 747.) The staffing agency paid the new invoice, but the worksite failed to pay the outstanding fees within 30 days. (Ibid.) The worksite paid the fees very shortly after the plaintiff informed JAMS that he intended to file a motion vacating the order to compel arbitration. (Ibid.)

The trial court granted the plaintiff's motion and the Court of Appeal affirmed. (Ibid.) The worksite argued that unlike in *Espinoza* and *Gallo*, the worksite timely paid the initial fees to initiate arbitration and that the parties

had already started to engage in the arbitration process. (Id. at p. 752.) The worksite also blamed the plaintiff for aggressively fighting the initial motion to compel, which delayed proceedings for two years, a period far longer than any delay caused by the slightly late payment. (Ibid.) The worksite argued that the trial court engaged in a "hyper-technical reading" of section 1281.98 and argued that the plaintiff suffered no prejudice by the late payment. (Ibid.)

The Court of Appeal rejected these arguments, noting that "the language of section 1281.98 clear and unambiguous." (Ibid.) Indeed, section 1281.98 "establishes a simple bright-line rule that a drafting party's failure to pay outstanding arbitration fees within 30 days after the due date results in its material breach of the arbitration agreement." (Id. at p. 753.) Even though the De Leon court stated that the clear language of the statute was sufficient to reject the worksite's arguments, the legislative history also supported that the worksite had completely waived its right to arbitration by not paying the continuing arbitration fees. (Ibid.)

Lessons for the Plaintiff-Side Attorney

Plaintiff attorneys who have never worked as defense attorneys may not be aware of how payments work on the defense side.

On the plaintiff side, the accounting department or administrative personnel will quickly and timely pay outstanding invoices and fees. That's simply not how most defense firms work. Defense firms will often have invoices processed through their financial and accounting department to then be billed to the corporation or insurance carrier. Instead of paying the vendor or debtee directly, the corporation or insurance carrier will instead submit a written check back to the defense firm. The defense firm is then responsible for forwarding that check. It is uncommon for defense firms to directly front or advance payment.

This inefficient process often causes delays in payments. Even with these three published new cases, tardy payments by the defense will happen. 30 days is a very short amount of time to have bills paid on the defense side.

Of course, most plaintiffs are much better off in civil court than in arbitration. However, application of section 1281.97 or section 1281.98 necessarily requires an error by the defense. Seeking to pursue claims in civil court under these sections will drive an enormous wedge between the defendant and its attorneys, which only works in the plaintiff's benefit. So not only does the plaintiff have a better forum for her claims, but there will now be tension on the defense side.

Most commonly, the defense attorneys will be, at least in part, responsible for the error. While sections 1281.97 and 1281.98 are harsh and unforgiving as shown by the trio of cases above, these are still relatively new statutes that not commonly known. Even if the defense attorney is not directly responsible for the late payment by timely submitting the bill to her client, there may be a failure to advise the client of the unforgiving nature of these sections. Faced with the likelihood of having to work for free or write-off bills due to their own errors, it would not be surprising if the firm recommends to the client to attempt to engage in an early settlement.

Logistically, the plaintiff's attorney should request an invoice for administrative fees from the arbitration provider. Under section 1281.97(a)(2), the arbitration provider is supposed to provide the bill "immediately." As soon as the arbitration provider submits the bill, the plaintiff's attorney should calendar 31 days out. On the 31st day, the plaintiff's attorney should ask the arbitration provider if the defendant has paid the bill. If not, the plaintiff's attorney should immediately state its intent to withdraw the claim from arbitration and proceed in civil court under section 1281.97(b)(1). Again, there are no exceptions to section 1281.97. Payment even one day late completely waives a defendant's right to arbitration.

Even if the defense timely pays the initial arbitration fees, the plaintiff's attorney should follow the same process for any future invoices under section 1281.98. Sections 1281.97 and 1281.98 are powerful weapons for a plaintiff attorney to seek to pursue her claims in civil court. Take advantage of them.

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