

Consequences of Breaching the Arbitration Agreement

Judge Abraham J. Gafni (Ret.)

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Parties often sign a Dispute Resolution Agreement (DRA) expecting that it will establish procedures before the dispute arises. But what if one party refuses to comply with the agreement, including, in particular, paying the necessary arbitration fees? Will the other party, having been - frustrated in its attempt to arbitrate, be relieved of its obligations under the agreement?

These issues were recently considered by the Supreme Court of New Jersey in *Roach v. BM Motoring*, (A-69 September Term 2015, 077125, March 9, 2017).

In *Roach*, two plaintiffs had purchased used automobiles from defendants. Each plaintiff had signed a DRA that provided for resolution of disputes through arbitration to "be conducted in accordance with the rules of the American Arbitration Association [AAA] before a single arbitrator, who shall be a retired judge or attorney. Dealership shall advance both party's (sic) filing, service, administration, arbitrator, hearing, or other fees, subject to reimbursement by decision of the arbitrator."

Each of the plaintiffs filed a demand for arbitration with the AAA expecting that defendants would advance the applicable arbitration fees. Initially, defendants did not respond to these demands. Subsequently, they asserted that they were under no obligation to proceed with the arbitration because the AAA was not an appropriate arbitral forum. As a result, the AAA refused to administer these claims, particularly as its fees were not being paid.

Following multiple proceedings before the AAA and lower courts, the matter reached the Supreme Court of New Jersey.

The court was faced with the following questions:

- Was the AAA a proper arbitral forum under the DRA?
- If the AAA was a proper arbitral forum, was the defendants' failure to pay the fees a material breach of the DRA?

In considering these issues, the court reviewed basic guidelines regarding arbitration agreements:

- Arbitration agreements are governed by general principles of contract law and may be invalidated by applicable contract defenses;
- They are to be given their plain and ordinary meaning;
- Courts must discern the intent of the parties;
- An ambiguous provision must be construed against its drafter;
- If a material term is breached, the nonbreaching party is relieved of its obligations under the agreement; and
- Criteria for determining materiality of a breach include a duty of good faith and fair dealing

Was the AAA a proper arbitral forum?

Defendants asserted that the AAA was not a proper forum as the DRA only required that an arbitration be conducted before a retired judge or attorney in accordance with the **rules** of the AAA but not that the AAA was to **administer** the arbitration. They were willing to arbitrate the dispute, but objected to AAA administration because of its significantly higher costs.

The Supreme Court of New Jersey rejected this argument based upon several considerations.

The court recognized that under the DRA, the arbitration must be conducted before a single arbitrator or retired judge. However, as the AAA maintains a national roster of such qualified individuals, "the filing of an arbitration claim with the AAA is not inconsistent with" this requirement of the DRA.

Moreover, it noted that the DRA calls for the parties to arbitrate "in accordance with the rules" of the AAA; and, that AAA Commercial Arbitration Rule R-2, "specifies that parties who agree to arbitrate in accordance with AAA rules consent to AAA—administered arbitration". It concluded, therefore, "that arbitration in accordance with the AAA rules permits arbitration by the AAA" or, "at the very least, left open to question the proper forum."

In addition, the decision to file with the AAA should have come as no surprise to the defendants. "By requiring that arbitration be conducted pursuant to the AAA's rules, defendants reasonably should have expected that customers would file claims directly with the AAA".

Finally, even if the DRA was ambiguous, it should be strictly construed against defendants as its drafter, especially because it has "indicia of being a contract of adhesion in that plaintiffs lacked equal 'bargaining power' in agreeing to its terms."

Accordingly, as "a plaintiff's choice of forum is entitled to preferential consideration," the court would "not disturb the plaintiffs' reasonable choice to arbitrate with the AAA."

Was the defendants' failure to pay the AAA fees a material breach of the agreement to arbitrate under the DRA?

Recognizing that this issue had never been addressed in New Jersey, the court turned for guidance to courts in the U.S. Court of Appeals for the Ninth and Tenth Circuits. Those courts held that permitting a party to refuse to fulfill its obligations under an arbitration agreement, including - payment of arbitration fees, would constitute a material breach as it would allow one party to

frustrate the aggrieved party's attempts to resolve its claims. In effect a "perverse incentive scheme" would be created which might encourage a party "to refuse to participate in properly initiated arbitration proceedings," in the hope that the frustrated plaintiff would abandon its claims, as in *Brown v. Dillard's*, 430 F. 3rd 1004, 1012, (9th Cir. 2005). If one party repeatedly failed to cooperate with the arbitration, the other would be required to file a potentially unending cycle of motions seeking court orders directing such cooperation.

The New Jersey court similarly found that, "A failure to advance required fees that results in the dismissal of the arbitration claim deprives a party of the benefit of the agreement. Therefore, the failure to advance fees 'goes to the essence' of the DRA and amounts to a material breach".

In addition, the court found that defendants had not satisfied their "duty of good faith and fair dealing."

In particular, the court noted that initially, despite repeated opportunities, defendants failed to respond to the arbitration demands of either plaintiff. This compelled plaintiffs to file complaints in the courts. Only then, **for the first time**, did the defendants assert that the DRA did not contemplate using the AAA, and that they "consistently do not arbitrate before the AAA because of 'the excessive administrative fees.'"

What obviously disturbed the court was that "had there truly been a dispute regarding the proper forum, defendants should have alerted plaintiffs within a reasonable time."

In short, the court found that the failure to pay the fees and to respond to the plaintiffs' demands for arbitration until complaints were filed was "not only problematic, but also did not comport with the standards of good faith and fair dealing." It rejected a scenario under which "a company could ignore an arbitration demand and, if the claimant did not abandon the claim, later compel arbitration." Having found such a material breach, the court concluded that the defendants were precluded from seeking to enforce the arbitration provision, and the case should continue in the courts.

One important note. The court clarified that it was not establishing a bright-line rule under which every refusal or failure to respond to a written arbitration demand within a reasonable period would constitute a material breach of an arbitration agreement that would preclude its enforcement by the non-responsive party. This determination would have to be made "on a case-by-case basis after considering the agreement's terms and the conduct of the parties".

The holding in *Roach* provides a warning to parties upon whom a demand for arbitration is made. If there is a reasonable belief that arbitration is not authorized under the circumstances, a response to the party making the demand should not be delayed, and the basis for the objection should be set forth promptly. Otherwise, the objecting defendant may find that it has committed a material breach so that the alternative arbitration procedure it may in fact desire (such as arbitration in a different venue, under different rules, or by a different administrative organization) may be lost and court proceedings will be ordered. •

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