The high cost of arbitration – no longer a bar to justice?

Arbitration agreements that split the costs of arbitration between the parties can have a chilling effect on due process

By Jim P. Mahacek

[*Editor's Note: The author served as appellate counsel for the consumers in the matter discussed below.*]

Doctors, brokerage houses, banks, auto dealers and lawyers routinely demand that clients sign arbitration agreements without regard to the client's ability to afford the cost of arbitration. But now, a California appellate court has reopened the door to fundamental due process.

The problem

Here is the premise. A financial giant that provides essential services to consumers has a standard contract requiring a disgruntled consumer to arbitrate any disputes rather than going to court. But behind the scenes, the financial giant knows that the consumer cannot afford the high cost of arbitration and thus the corporation can avoid ever answering for its misconduct. The courts will enforce the arbitration agreement. The arbitration service demands to be paid a substantial up-front fee and refuses to proceed without a substantial "estimated" payment of the costs of arbitration. The financial giant refuses to pay more than one-half of the up-front fee. Without full payment, the arbitration service refuses to proceed. The average consumer never has a forum to present his case – no matter how meritorious.

The remedy

In *Roldan v. Callahan and Blaine*, (2013) __Cal.App.4th __, Division 3 of the Fourth District Court of Appeal has now provided one solution for this recurring problem: If the consumer does not have the financial means to pay for arbitration, then the financially superior party must exercise a choice: (1) pay for the arbitration itself or (2) waive arbitration and proceed to trial.

A look at the history of arbitration

If we turn back the clock to the day of the Magna Carta, we remember that the English King's law was absolute and unforgiving. But it did not always achieve fairness, so the English developed a new system of equity: the Court of Chancery. From the concept of equity came the companion notion that parties should be able to resolve their disputes outside the formal legal system, i.e., arbitration, if they so agreed. How did the courts have the power to enforce arbitration agreements? They hit on a fundamental mode of relief: the equitable concept of "specific performance." That's right – the King's courts would order parties to specifically perform their arbitration agreements – for it was the equitable thing to do.

The United States quickly approved the concept. The Congress adopted arbitration under the Federal Arbitration Act and the Supreme Court has interpreted that act broadly. Every state in the Union followed suit – although exact enforcement procedures vary. And in California we find a statutory basis of arbitration in Code of Civil Procedure section 1280 et seq. The Legislature requires Courts to enforce arbitration agreements unless grounds exist to hold them unenforceable as other contracts. But the Legislature did not directly address what happens if one of the parties cannot afford arbitration. So today's question arose.

From the judicial perspective, the Supreme Court found that California has a strong public policy in favor of arbitration. (*Moncharsh v. Heily & Blase* (1992) 2 Cal. 4.) The problem is that a factual premise that may well have existed in 1992 is no longer necessarily true today. *Moncharsh* discussed the concept that arbitration is generally faster and more cost-efficient than a judicial proceeding. We quarrel not with the concept that arbitration is generally faster – but we can question whether it is more cost-efficient.

In the days preceding *Moncharsh,* arbitration was most often conducted by the American Arbitration Association or some similar non-profit organization. And following its charter, it strove to keep costs low and often used non-lawyers to conduct the arbitration in a "fairness" setting. After all – arbitrators are free to ignore the law and rules of evidence in their search for an equitable result. Hearings were short – most lasting less than one day.

The death of "inexpensive" arbitration

But what has happened in the last 25 years? The concept of quick, relatively informal, equitable hearings has given way to today's modern "alternative dispute

resolution" provider programs. We now find arbitrators who are legally trained – a very high percentage being former judges or highly experienced lawyers. The old concept of a relatively modest arbitration fee to walk in the door is now supplemented by the providers not only charging that initial fee – but the arbitrators charging anywhere from $600 to over $1,200 dollars per hour!

The proceedings themselves have taken on a new character. Retired judges and attorneys have now understandably brought their training and experience to the halls of arbitration. The process now tends to resemble a bench trial rather than an informal equitable hearing. Legally trained arbitrators feel comfortable basing the process "in the law." The concept that arbitration does not require the arbitrators to follow the law nor apply rules of evidence is honored more in its breach than its application. Legal principals such as "motions for summary judgment"– a decidedly non-equitable concept – have established a strong beachhead in the arbitrator's arsenal. As we examine "cost efficiency" it does not stretch the imagination to note how a financially superior party can use this expensive process to ply its might in the arbitration office just like it did in the judicial court room. Even though the arbitrator can ignore the law if he/she finds no contested issue of fact, few do. From the financially superior party's point of view, it is worth the try.

Let us then look at the hearing. No longer is it a fairness hearing – but has all the trappings of a bench trial. Something akin to the same formalities apply, and the hearings often drag on for days, if not more – all with the arbitrator's time clock ticking at $600 to $1,200 per hour. Pre briefs; trial briefs; and extensive post-hearing briefs – all with attendant costs occur with uncommon frequency. Cost containment? Scarcely a thought. After all, the parties agreed to arbitration.

Yet in court, the costs are now dramatically less. The people pay the judicial officer's salary; motion fees are rarely cost prohibitive; and an indigent consumer can always seek and receive *in forma pauperis* status, incurring no judicial costs at all.

Today's facts: Good facts do make good law

So we set the stage for the *Roldan* case. Attorney Richard Quintilone represented several indigent persons living in a "Section 8" housing complex replete with toxic mold problems. As a solo practitioner, he was overwhelmed by the demands of the case, so he convinced his elderly clients to also hire the law firm of Callahan and Blaine (Callahan.) Callahan's role was to fund the upcoming expensive costs associated with expert witnesses and the like, as well as supply its expertise in complex litigation cases, including toxic mold. Callahan's own retainer agreement contained an arbitration clause on page eight; a clause that the Appellate Court said was "…to say the least, awkwardly incorporated into the nine page retainer agreement."

The matter proceeded, and Callahan's clients would later allege that Callahan attempted to pressure them into an unfair settlement so it could avoid paying the expensive costs of going to court. The Court noted that Callahan unsuccessfully attempted to withdraw from the case and then unsuccessfully sought to have the Court appoint a *guardian ad litem* for all of the clients.

Callahan's three clients finally accepted settlements totaling $292,300. After the settlement, the clients sued Callahan on a variety of legal theories including elder abuse and breach of fiduciary duty. Callahan filed a petition to compel arbitration – which the trial court granted.

The arbitration provider would not proceed without a substantial up-front payment. While Callahan agreed to pay one-half of the up-front costs, the clients could not afford to pay a proportionate share. The court case could not proceed because this matter was now in arbitration.

Both parties moved to break the stalemate. Callahan sought an order dismissing the case due to the clients' failure to pay their share of arbitration fees. The trial court denied this request. The clients asked the Court to require Callahan to pay the arbitrator's fees because they could not afford it. The trial court also denied this motion, thus leaving in place the *status quo* of stalemate. The clients appealed.

Justice Rylaarsdam recognized the core problem. If the clients could not afford arbitration, then they would have no forum in which to present their complaints. This concept flew in the face of the principle that financial indigence should never bar a party from having a forum. (Gov. Code, § 68630, subd. (a.) *Martin v. Superior Court* (1917) 176 Cal. 289; *Gutierrez v. Autowest, Inc*. (2003) 114 Cal.App.4th 77.) Equity must frown. While not critical to the final answer, the Court noted that Callahan knew that the clients were indigent when they signed the arbitration agreement, failed to explain its consequences to them, could never have reasonably expected the clients to proceed in arbitration, and took affirmative action (the Court's words) to take advantage of the situation it created by moving to dismiss their claims in toto.

Today's solution does not require the Court to find the arbitration "unconscionable." All the court must do is examine the anticipated costs of the arbitration and the financial ability of the client to pay such costs. If the court finds that the client cannot afford to pay his/her share, then the court simply shifts the payment obligation to the financially superior party.

State and federal precedent

While some case law exists that would authorize the court to hold the arbitration "unconscionable" under these facts and thus not enforce it, such a remedy is somewhat draconian in light of California's public policy supporting arbitration and the equitable principles of specific performance. So *Roldan* took a middle

ground that was consistent with the principle of arbitration but would provide them a forum. Let the party seeking arbitration pay for it or waive arbitration. This was a remedy our court embraced.

Roldan did not totally write on unprecedented grounds. In *Spencer v. Omnibus Industries* (1975) 44 Cal.App.3d 971, the court discussed an arbitration agreement between consumers and a contractor. The clause was buried on a back page and the court stated it would be surprised if 1 in 1,000 read it or understood it. So it totally voided the arbitration clause although the up-front fee was only $75.

Here Callahan's retainer was some nine single-spaced pages; the arbitration provision was on page eight, and this was the only page that Callahan did not have its clients separately initial or sign.

Next we can examine *Parada v. Superior Court* (2009) 176 Cal.App.4th 1554. Again the consumers claimed an inability to pay – a plea the court found compelling. Thus the court reversed an order compelling arbitration based on unconscionability grounds because the consumers could not afford arbitration.

We also find the same result in *Cinel v. Christopher* (2002) 203 Cal.App.4th 759. The whole issue of payment became convoluted so the trial court vacated an arbitration order and proceeded to jury trial. The Court of Appeal affirmed.

Nor can a valid plea be made that the Court is illegally rewriting the parties' arbitration agreement. California jurisprudence has a rich base of precedence that courts can and regularly do modify arbitration agreements to validate arbitration itself while negating the unfair elements of a particular agreement. Under California law, if the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. (*Civ.Code*, §1670.5(a); *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 114; *Murphy v. Check 'N Go of Calif., Inc.* (2007) 156 Cal.App.4th 138, 141, see also *Ontiveros v. DHL Express* (*USA*), *Inc.* (2008) 164 Cal.App.4th 494.)

Would this remedy be negated by federal courts? Probably not. The U.S. Supreme Court recognized the issue in *Greentree Financial Corporation-Alabama v. Rudolph* (2000) 531 U.S. 79, and impliedly suggested that some remedy must be found. It could not reach the heart of the issue because the consumers had failed to provide a factual basis for their indigence claim nor as to the high cost of arbitration in today's world.

More directly the 9th Circuit Court of Appeal did recognize the issue in *Lifescan, Inc. v. Premier Diabetic Services, Inc.* (9th Cir 2003) 363 F.3rd 1010. Part-way through an arbitration, one side ran out of funds. The financially superior party insisted that arbitration proceed with the non-paying party prohibited from attending. The arbitrators refused and stated that if the financially superior party wished to proceed, it must pay the costs of concluding the proceedings.

The Ninth Circuit, relying in part on California statutory law, found that there was nothing wrong with the arbitrators shifting the cost of arbitration to the financially superior party.

The equitable conclusion

So we reach today's result. If a financially superior party wants arbitration, it can have it – it need only pay for it. If it chooses not to pay – it need only proceed as any other litigant in a real courtroom.

The power to compel arbitration remains in the hands of the party seeking arbitration. Now the financially superior party needs simply make a choice: (1) pay for arbitration or (2) go to trial. This new arrow provides a remedy that even conservative trial judges reluctant to declare arbitration clauses unconscionable for financial reasons can fairly embrace. The door to justice remains open.


Mahacek

Jim P. Mahacek is a Certified Appellate Specialist and former Orange County Trial Lawyers "Business Trial Lawyer of the Year." He is a frequent lecturer at bar association meetings and discusses both appellate and trial procedures. He may be reached at JMahacek@gmail.com.