Employer permitted to litigate claims against employee subject to arbitration agreement

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September 03 2015

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In *Prepaid Legal Services, Inc v Cahill*(1) a US federal appellate court recently allowed an employer to litigate claims against a former employee that were subject to an arbitration agreement because the employee – who had previously obtained a stay of the litigation in favour of arbitration – refused to pay his share of the arbitration costs. The decision is significant for international arbitration practitioners because it confirms that the liberal US policy favouring arbitration does not allow recalcitrant respondents to game the system.

Facts

The underlying dispute in *Prepaid Legal Services* concerned alleged breaches of a former employee's employment contract. An employer alleged that a former salesman had violated his employment agreement by misusing the employer's trade secrets and soliciting its other salespersons after he left the company.

To address the alleged misconduct, the employer sued the former employee in federal court. The former employee subsequently moved to stay the litigation pursuant to Section 3 of the Federal Arbitration Act because the employer's claims were subject to an arbitration clause in the employment contract.

Section 3 of the act provides that courts may stay claims asserted in court that are subject to an arbitration clause until the arbitration is concluded. The federal trial court granted that application and stayed the litigation pending resolution of the arbitration.

Following the court order compelling arbitration, the employer commenced arbitration against the employee under the Commercial Arbitration Rules of the American Arbitration Association (AAA). Rule R-54 of the AAA rules requires the parties to bear the costs of the arbitration equally.

While the employer paid its share of the costs, the employee repeatedly failed to do so after multiple requests. Consequently, after inviting the employer to advance those costs, which the employer declined to do, the tribunal suspended the arbitration and the AAA terminated the proceedings.(2)

Decision

After the arbitration had been terminated, the employer returned to the court that had initially stayed the court proceedings in favour of arbitration and moved to lift the stay so that it could litigate its claims against the employee. The employee opposed the motion on the grounds that the employer should have paid his share of the arbitral costs so that the arbitration could proceed. Both the trial court and a federal appellate court disagreed with the employee and permitted the employer to proceed with its litigation.

The employee appealed the lifting of the stay, arguing that the appellate court had jurisdiction to hear the appeal under Section 16(a)(1)(A) of the Federal Arbitration Act, which allows appeals of orders "refusing a stay of any action under section 3" of the act. Section 3 requires the grant of stays "until such arbitration has been had in accordance with the terms of the agreement", as long as "the applicant for the stay is not in default in proceeding with such arbitration". The employer argued that because the appeal was of an order lifting a previously granted stay rather than an order denying a stay, the court had no jurisdiction to hear the appeal under Section 16(a)(1)(A). The court rejected this argument, holding that there is no meaningful distinction between these situations.(3)

After determining that it had jurisdiction over the appeal, the appellate court affirmed the lifting of the stay under Section 3 of the Federal Arbitration Act on two separate bases expressly set forth in Section 3 itself. Those bases are that a stay should remain in place only:

- until the arbitration has been concluded "in accordance with the terms of the [arbitration] agreement"; or
- as long as the stay applicant is "not in default in proceeding with such arbitration".

The court found that the arbitration had "been had in accordance with the terms of the agreement"(4) because the agreement required the arbitration to be held under the AAA rules, which required the employee to pay his share of the costs. The AAA rules also permit the AAA or tribunal to terminate proceedings if a party refuses to pay its share of costs, which is what occurred. Consequently, when the tribunal terminated the proceedings because the employee had failed to pay its share of the costs, the arbitration concluded in accordance with the parties' agreement.(5)

The appellate court also found that lifting the stay was proper because the employee had defaulted in proceeding with the arbitration as he had refused to pay its share of the costs in accordance with the AAA rules.(6) That default led to the termination of the arbitral proceedings, which justified a lifting of the stay.(7)

Comment

The United States has a well-established policy of favouring the arbitration of disputes as a means of "reduc[ing] 'the costliness and delays of litigation'",(8) which "is even stronger in the context of international transactions".(9) That well-established policy generally requires courts to resolve "any doubts concerning the scope of arbitrable issues... in favor of arbitration",(10) particularly where international commercial transactions are at issue.

However, as *Prepaid Legal* confirms, the US policy favouring arbitration is not limitless and does not shield recalcitrant respondents from avoiding claims altogether by staying litigation in favour of arbitration and then refusing to participate in the very arbitration they sought. In short, while US courts favour arbitration, they look unfavourably on gambits such as that used by the employee in this case in an effort to avoid claims altogether.

Endnotes

(1) *Prepaid Legal Servs, Inc v Cahill,* 14-7032, 2015 WL 3372136 (10th Cir May 26 2015).

(2) Rule R-57(e) of the AAA rules permits the arbitrators or the AAA to suspend the proceedings for non-payment, and Rule R-57(f) permits the arbitrators or the AAA to terminate proceedings that have been suspended for non-payment.

(3) *Prepaid Legal Servs* at 1290.

(4) *Id* at 1294.

(5) *Id*.

(6) *Id*.

(7) *Id* at 1295.

(8) *Campaniello Imports, Ltd v Saporiti Italia SpA* 117 F 3d 655, 665 (2d Cir 1997) (quoting *Genesco, Inc v T Kakiuchi & Co* 815 F 2d 840, 844 (2d Cir 1987)).

(9) *Id* (quoting *Deloitte Noraudit v Deloitte Haskins & Sells* 9 F 3d 1060, 1063 (2d Cir 1993)).

(10) *Moses H Cone Mem Hosp v Mercury Constr Corp* 460 US 1, 24 (1983).