ARIZONA
ADR
FORUM

WINTER 2018

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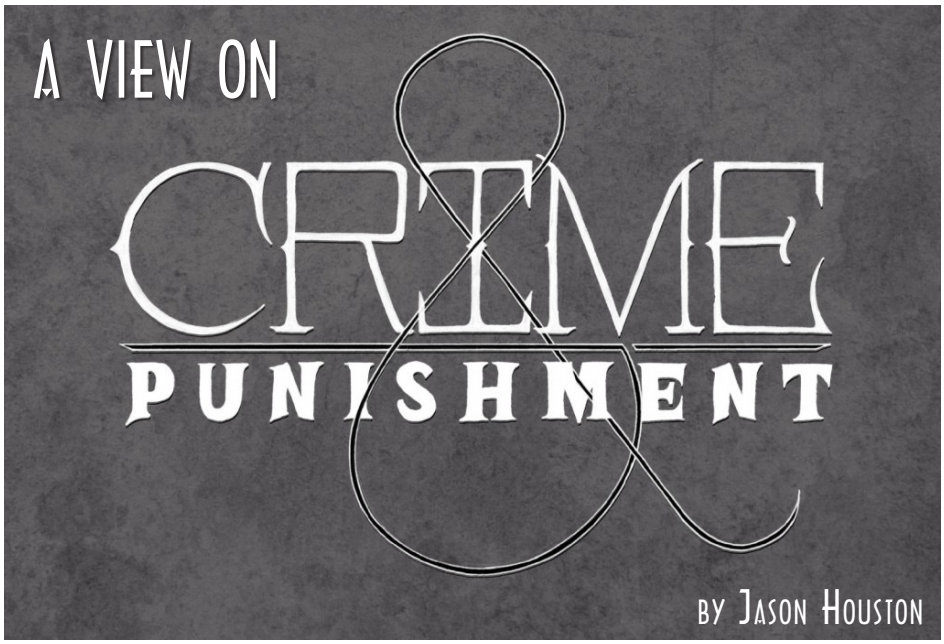


Does Art Imitate Life

I've been maintaining for years that US kids mimic what they see on TV and video games. It wasn't that long ago when media types were going around laughing, "Does art imitate life, or does life imitate art!" Only when it became too obvious the answer was the former, did such Sunday barbecue banter quickly fade from popular discussion.

One example from my case studies I like to point up is a video game called *Grand Theft Auto*. If you've never played this, it's a skill-based game where a single operator of a handset maneuvers a 1979 Cadillac Fleetwood, which is already pre-set, speeding dangerously through city traffic. It runs into buildings, police cars, ambulances, other vehicles, mows down pedestrians, careens down sidewalks, across yards, through fences, red lights, etc. without mishap. Only when the operator isn't quick enough with his handset, does the Cadillac crash. Then the driver gets out, assaults the driver in another 1979 Cadillac, throws him into the street, then blasts off in that car, and the game starts over. Anybody who lives in LA and turns on the mid-day news is likely to see a helicopter chasing a car down some freeway, speeding through traffic, running cars and police off the road, driving the wrong way, running red lights, etc. before either running out of gas or becoming disabled. Welcome to Grand Theft Auto: The Real Deal.

Jason Houston is a family court mediator and civil arbitrator in private practice and serves on the California State Bar's Mandatory Fee Arbitration Panel. He is a member of the *Maricopa Lawyer* Editorial Board.

STATE BAR OF ARIZONA

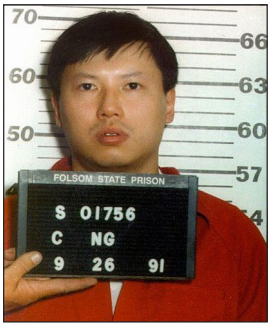
EDITOR | THOM COPE

We welcome comments about this newsletter and invite you to suggest topics or submit an article for consideration. Email the Editor, Thom Cope at tcope@mcrazlaw.com

A VIEW ON CRIME & PUNISHMENT

Welcome to Canada

Canada learned a priceless lesson with the Charles Ng case in 1985. The Asian-born Ng was wanted for the torture and murders of several people in Wilseyville, a small mountain community in Calaveras County, in northern California. He fled to Canada and eventually came into the custody of the Canadian authorities on an unrelated offense. When advised Ng was wanted for crimes that carried the death penalty, Canada refused to hand him over, since they don't believe in the death penalty. While Ng did his time in a Canadian prison, Canadian authorities fidgeted on whether to release him to US custody when he got out, or allow him to remain in Canada indefinitely. Finally US negotiators implemented the argument that if Canada sticks by its rule, any dangerous murderer is safe in Canada: and once the word got out, there'll be a stampede. The Canadians finally recognized their folly and released Ng to California prosecutors. In 1999 Ng was sentenced to death by lethal injection.



CHARLES NG

Deterrent vs. What's Fair is Fair

There was a time (pre 1949) when criminal courts used punishment for violent crime as a deterrent Now, to the detriment of society, that standard has all but blurred with time. The latest example is one Leslie Van Houten, one of Charles Manson's girls, who participated in the most heinous murder spree of the last century. Van Houten was originally sentenced to death, until the US Supreme Court overturned the death penalty in 1972, and she was re-sentenced to life in prison. On September 6, 2017, after 21 attempts, Van Houten was finally granted parole.


LESLIE VAN HOUTEN

Today, these same courts' interest is with extracting their pound of flesh in a proportion directly equal to the crime committed, and the deterrent incentive has faded from importance. And the courts are continually allowing violent offenders, often sentenced to life, out of prison early. The result? Roughly 90% reoffend within the first year. Not only do these lax systems fail, the physical and mental toll on the victims and their families has already become a life sentence of its own, and far worse than anything the offender has to go through – yet judges and prosecutors rarely consider the victims in releasing dangerous offenders, for whose behavior no cures are known. ADR

The opinions expressed herein are those of the author and do not reflect the opinions of the State Bar of Arizona or the ADR Section.

SIRRAH / WUNDERLICH

In early August 2017, our Supreme Court upended a long established and vital feature of construction law, a feature involving cases brought based upon the implied warranty of workmanship and habitability.

by David C. Tierney

The Court turned away from thirty (30) year old precedents and has now allowed the second purchasers of homes, (who sue only on an implied warranty theory for construction defects) **to be awarded their reasonable attorneys' fees**. While one might think that this would be addressed in the **Construction Law Section's** newsletter, this abrupt change in the law is likely to bring a new volume of cases before arbitrators – and both the advocates and arbitrators (and mediators) need to take note of the change in the law – and the change in the dynamics of arbitrable construction defect cases.

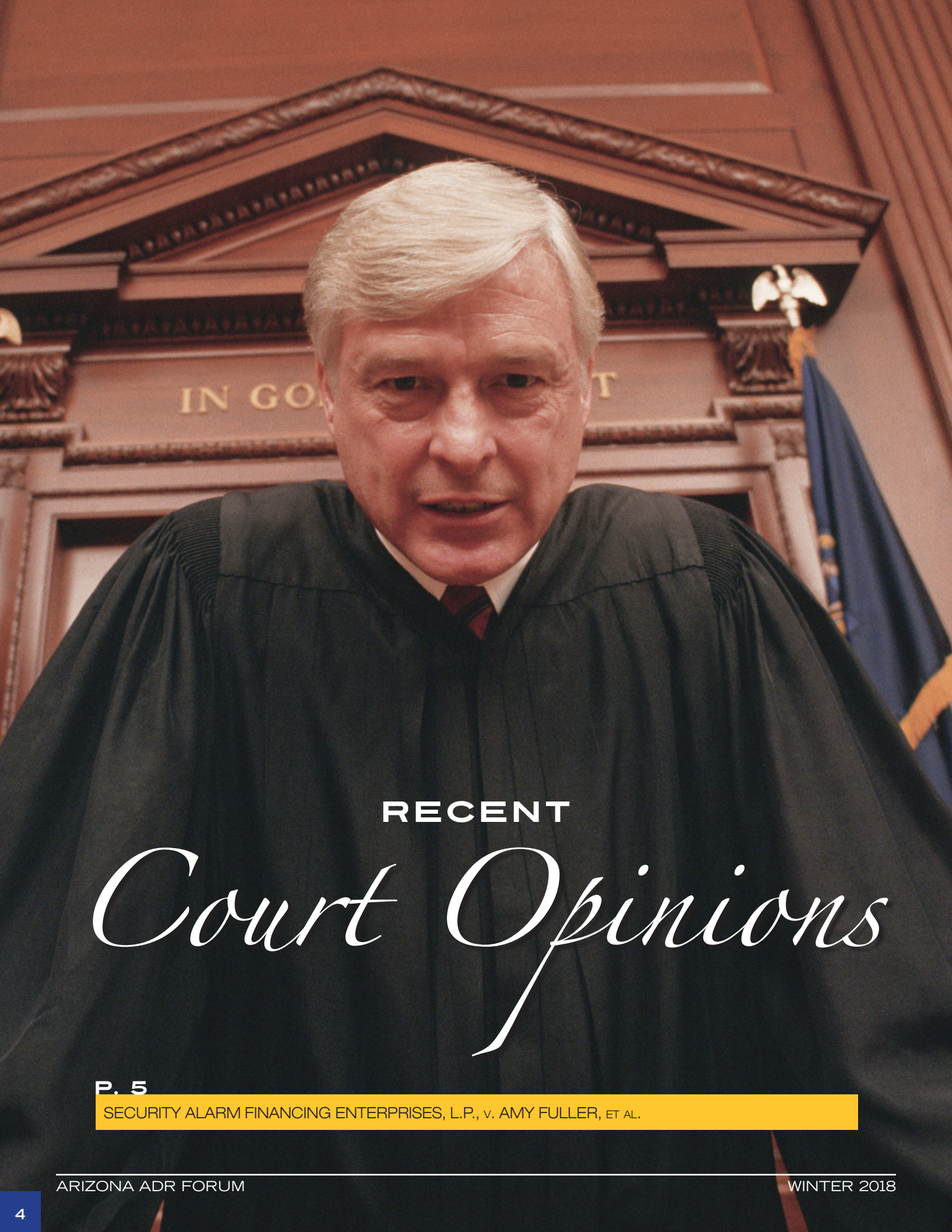
First, here are the details on Justice Timmer's eight (8) page Decision in *Sirrah Enterprises LLC v. Wunderlich*, CV16-0156 PR (8/9/17), a Division One case appealed from Yavapai County with lawyers from Tempe, Prescott, and Phoenix arguing this important case before all seven (7) justices of our Supreme Court.

In *Barmat v. John and Jane Doe Partners A-D*, 155 Ariz. 519, 747, P.2d 1218 (Ariz. 1987), the Supreme Court (Feldman J.) had held that implied contracts **based in the existence of a professional relationship** are tort, not contract based, ergo NO ATTORNEY'S FEES are to be allowed under § 12-341.01). In *Sullivan v. Pulte Homes Corp.,* 231 Ariz. 53, 62, 63, 290 P.3d 446 - 456 (Ariz. 2012), the Court of Appeals (citing *Barmat)* had held that a second purchaser suing on the implied warranty of workmanship and habitability was suing on a "contract implied **in law**", not a contract implied **in fact** (citing *Barmat)*. Thus, the *Sullivan* court refused § 12-341.01 legal fees for all second purchasers. However, Judge Timmer in *Sirrah* has now disapproved *Sullivan's* very important holding and has stated that the implied warranty inserts ("imputes") a covenant into an express and written (construction) contract (which covenant can then be enforced by subsequent purchasers). Judge Timmer then says that § 12-341.01 "therefore authorizes a fee award for the successful party because the claim 'arises out of' that express contract".

While there is likely "much joy in mudville" among second purchasers as a result of this *Sirrah* decision, the implications are large for owners (and thus for General Contractors – and for their subcontractors). For the plaintiffs' lawyers who take on large construction defect cases, it has always been a tough challenge to convince second purchasers to **join** such cases. After all, a second purchaser can "win" approximately $25,000 or $30,000 for repairs, only to see that sum gobbled up by deducts for their share of the attorneys' fees for the case awarded to the plaintiffs' lawyers. Those with original contract based claims (first purchasers) would get fees awarded to them **in addition** to the cost of repairs, but second purchasers (under *Sullivan*) would not get their legal fees and those fees would eat up most of the sum awarded for repairs. By the time plaintiffs' counsel had subtracted legal fees from the sum awarded to second purchasers on the merits for defects, the second purchaser stood to receive very little (certainly far less than the first purchaser plaintiff). This is now radically changed.

This change in the law will make it easier for second purchaser plaintiffs to see **value in joining** in construction defect lawsuits. The construction defect cases will be "bigger" (involving more plaintiffs). That likely means that more cases will not resolve in mediation. That impacts what number of those cases will be coming to arbitrators.

So as an arbitrator, you need to know of this very significant new *Sirrah* opinion, so that you can properly react to the claims and the evidence being put before you. Additionally, you need to know of what may well prove to be a new dynamic in the assembling and processing of large construction defect cases. Certainly, owners will be bulking up insurance coverage, general contractors will be spending more on lawyers, and subs can expect to get hit by general contractors for even larger sums than in past years, under this change in the law regarding legal fees for second purchasers under implied warranty claims. The big question also looms in the background: Will the *Sirrah* reasoning alter **other** implied contract situations in which legal fees may now be demanded?



RECENT *Court Opinions*

SECURITY ALARM FINANCING ENTERPRISES, L.P., V. AMY FULLER, ET AL.

IN THE
ARIZONA COURT OF APPEALS
DIVISION ONE

SECURITY ALARM FINANCING
ENTERPRISES, L.P.,
Plaintiff/Appellee,

v.

AMY FULLER, et al.
Defendants/Appellants.

No. 1 CA-CV 16-0255

Appeal from the Superior Court in Maricopa County
No. CV2015-007680
The Honorable Christopher T. Whitten, Judge

JURISDICTION ACCEPTED; RELIEF GRANTED

COUNSEL

Baskin, Richards, PLC, Phoenix
By William A. Richards, Nicole C. Davis
Counsel for Plaintiff/Appellee

Limon-Wynn Law, PLLC, Tempe
By Monica A. Limon-Wynn
Counsel for Defendants/Appellants

OPINION

Presiding Judge Diane M. Johnsen delivered the opinion of the Court, in which Judge Patricia K. Norris and Judge Jennifer B. Campbell joined.

J O H N S E N, Judge:

¶1 The superior court denied a motion to dismiss in favor of arbitration under the Federal Arbitration Act, holding the moving parties waived their right to compel arbitration by failing to raise it as an affirmative defense in their answer. Exercising our discretion to accept special action review and applying federal law, we hold there was no waiver and reverse the order denying the motion to dismiss.

FACTS AND PROCEDURAL BACKGROUND

¶2 Security Alarm Financing Enterprises, L.P. filed a complaint alleging contract and tort claims against several former employees and their new employer. The complaint alleged breach of contract, misappropriation of trade secrets, unfair competition and tortious interference with business expectancies. In answering the complaint, Amy Fuller, Molly Griffis, and Carlee and Darryl Reeves (collectively "Appellants") did not raise any affirmative defense concerning arbitration.

¶3 Security acknowledges that 29 days after Appellants answered the complaint, their counsel contacted Security to raise the existence of arbitration agreements Appellants each had signed when they started work with Security. (The arbitration agreements were stand-alone contracts separate from the confidentiality agreements on which Security's contract claims were based.) Each of the identical three-page arbitration agreements specified that it "is governed by the Federal Arbitration Act, 9 U.S.C. § 1 et seq.," and that it would apply "to any dispute arising out of or related to" the employee's "employment with . . . [Security] . . . or termination of employment." Appellants asked whether Security would agree to arbitration; a month later, Security responded that it would not agree. Four days after receiving Security's response, Appellants moved to dismiss the complaint and to compel arbitration. The superior court denied the motion, finding Appellants waived their right to compel arbitration by failing to cite the arbitration agreement as an affirmative defense in their answer. Appellants then appealed.

DISCUSSION

A. Jurisdiction.

¶4 This court derives its jurisdiction wholly from statute. *See Garza v. Swift Transp. Co.*, 222 Ariz. 281, 283, ¶ 12 (2009). Generally speaking, an order denying a motion to dismiss is not reviewable by appeal because it is not a final judgment. *See Brumett v. MGA Home Healthcare, L.L.C.*, 240 Ariz. 420, 426, ¶ 4 (App. 2016).

¶5 Appellants, however, suggest Arizona Revised Statutes ("A.R.S.") section 12-2101.01(A)(1) (2017) grants this court jurisdiction over the denial of their motion to dismiss and to compel arbitration.[1] That statute grants the court of appeals jurisdiction to hear an appeal from "[a]n order denying an application to compel arbitration made under § 12-1502 or 12-3007." But Appellants did not move to compel arbitration under either A.R.S. § 12-1502 (2017) (adopted from the Uniform Arbitration Act) or A.R.S. § 12-3007 (2017) (adopted from the Revised Uniform Arbitration Act). Indeed, Arizona's versions of the Uniform Arbitration Act and the Revised Uniform Arbitration Act expressly do not apply to arbitration agreements, such as the one at issue here, between an employer and its employee. A.R.S. §§ 12-1517 (2017), -3003(B)(1) (2017). Instead, Appellants moved to compel arbitration under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16 (2017), which the arbitration agreement expressly adopted. Because Appellants did not move to compel arbitration under A.R.S. §§ 12-1502 or -3007, and because no other statute grants this court appellate jurisdiction, we lack jurisdiction to consider Appellants' appeal from the order denying their motion.

¶6 Alternatively, Appellants ask us to treat their appeal as a petition for special action. In our discretion and pursuant to A.R.S. § 12-120.21(A)(4) (2017), we may exercise special action jurisdiction "under appropriate circumstances." *Phillips v. Garcia*, 237 Ariz. 407, 410, ¶ 6 (App. 2015). Special action jurisdiction is proper when a party has no "equally plain, speedy, and adequate remedy by appeal," Arizona Rule of Procedure for Special Actions 1(a), and in cases "involving a matter of first impression, statewide significance, or pure questions of law," *State ex rel. Pennartz v. Olcavage*, 200 Ariz. 582, 585, ¶ 8 (App. 2001).

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[1] Absent material revision after the relevant date, we cite a statute's current version.

¶7 Appellants have no adequate remedy by appeal from the order denying their motion to compel arbitration. *See Yarbrough v. Montoya-Paez*, 214 Ariz. 1, 2 (App. 2006) (accepting special action jurisdiction of order transferring venue). Further, the primary issue presented here is a question of law, namely, what a party must show to establish that an adversary has waived a right to arbitration under the FAA. As presented, this dispute "require[s] neither factual review nor interpretation." *Orme School v. Reeves*, 166 Ariz. 301, 303 (1990). It likewise is an issue of first impression in this state. *See State ex rel. Thomas v. Duncan*, 216 Ariz. 260, 262, ¶ 5 (App. 2007).

¶8 Accordingly, we exercise our discretion to accept special action jurisdiction to determine whether the superior court erred by denying Appellants' motion to dismiss and to compel arbitration.

B. Denial of the Motion to Compel Arbitration.

¶9 We review the denial of a motion to compel arbitration *de novo*. *Sun Valley Ranch 308 Ltd. P'ship v. Robson*, 231 Ariz. 287, 291, ¶ 9 (App. 2012). Further, whether conduct amounts to waiver of the right to arbitrate is a question of law we review *de novo*. *In re Estate of Cortez*, 226 Ariz. 207, 210, ¶ 3 (App. 2010).

¶10 The parties disagree about whether Arizona law or federal law governs waiver of a right to arbitration under the FAA. Depending on the circumstances of a particular case, which law applies may make a difference because the legal standards governing waiver may not be precisely the same. In arguing that Appellants waived arbitration by failing to plead it in their answer, Security relies on our decision in *Cortez* as "controlling." *See* 226 Ariz. at 211, ¶ 6 ("An assertion that arbitration is mandatory is an affirmative defense to a complaint. It is well established that any defense not set forth in an answer or pre-answer motion to dismiss is waived." (Citation omitted.)). Security argues that under Arizona law, Appellants' failure to plead arbitration was sufficient by itself to constitute waiver. By contrast, under the FAA, conduct inconsistent with an intent to arbitrate by itself is not sufficient to establish waiver; at a minimum, the court also must consider whether the party opposing arbitration has suffered prejudice by the other party's inconsistent acts. *Compare Richards v. Ernst & Young, LLP*, 744 F.3d 1072, 1074 (9th Cir. 2013) (waiver requires showing of prejudice), *with Zuckerman Spaeder, LLP v. Auffenberg*, 646 F.3d 919, 922 (D.C. Cir. 2011) (potential prejudice is among circumstances to be considered).

¶11 Two respective provisions of the FAA guide analysis of challenges to a party's right to compel arbitration. First, under 9 U.S.C. § 2, a written arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The cases make clear that the inquiry under § 2 of whether an arbitration agreement is "valid, irrevocable, and enforceable" is governed by state law, i.e., the law pertaining to "revocation of any contract." *See, e.g.*, *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 686 (1996) (state law governs general issues concerning the validity, revocability and enforceability of contracts); *Perry v. Thomas*, 482 U.S. 483, 492, n.9 (1987); *Hudson v. Citibank (S.D.) NA*, 387 P.3d 42, 47 (Alaska 2016). Thus, when an Arizona court determines the validity or enforceability of an arbitration agreement under the FAA, it applies Arizona common law pertaining to contracts. *See, e.g.*, *WB, The Bldg. Co. v. El Destino, LP*, 227 Ariz. 302, 308, ¶ 14 (App. 2011).

¶12 But the issue here is not whether Arizona contract-law principles invalidate the arbitration agreements Security asked Appellants to sign. The issue is whether Appellants waived their right to enforce those agreements. That issue is resolved not under state-law principles pursuant to § 2 of the FAA, but under federal-law principles dictated by the other provision in the FAA applying to challenges to arbitration, 9 U.S.C. § 3. Under § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties 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.

¶13 Pursuant to 9 U.S.C. § 3, a state court must order arbitration so long as the moving party "is not in default in proceeding with such arbitration." This provision, as a matter of federal law, governs the determination of whether a party has "default[ed]" by waiving the right to seek arbitration under an otherwise enforceable agreement. *See Ehleiter v. Grapetree Shores, Inc.*, 482 F.3d 207, 217 (3d Cir. 2007); *Marie v. Allied Home Mortg. Corp.*, 402 F.3d 1, 13 (1st Cir. 2005) (citing cases); *S & H Contractors, Inc. v. A.J. Taft Coal Co.*, 906 F.2d 1507, 1514 (11th Cir. 1990) ("Our

determination of whether S & H waived its right to arbitration, as opposed to whether the contract is void under Alabama law, is controlled solely by federal law."); *Cornell & Co. v. Barber & Ross Co.*, 360 F.2d 512, 513 (D.C. Cir. 1966) ("Once having waived the right to arbitrate, that party is necessarily 'in default in proceeding with such arbitration.'"); *Hudson*, 387 P.3d at 47; *see also Barber & Ross Co. v. Cornell & Co.*, 242 F. Supp. 825, 826 (D.D.C. 1965) (moving party was "in default" because "the litigation machinery had been substantially invoked . . . by the time . . . an intention to arbitrate was communicated"). In the face of these authorities, Security cites no case holding that waiver of a right to arbitrate under the FAA is governed by state-law principles under § 2 of the FAA rather than by federal-law principles under § 3.[2]

¶14 Accordingly, turning to the federal law of waiver under the FAA, the Ninth Circuit Court of Appeals has held that waiver of a right to arbitration under 9 U.S.C. § 3 requires a showing of "(1) knowledge of an existing right to compel arbitration; (2) acts inconsistent with that existing right; and (3) prejudice to the party opposing arbitration resulting from such inconsistent acts." *Richards*, 744 F.3d at 1074. Many other circuit courts impose the same requirements. *See, e.g., Shy v. Navistar Int'l Corp.*, 781 F.3d 820, 827-28 (6th Cir. 2015) ("Both inconsistency and actual prejudice are required."); *In re Checking Account Overdraft Litig.*, 754 F.3d 1290, 1294 (11th Cir. 2014); *Wheeling Hosp., Inc. v. Health Plan of the Upper Ohio Valley, Inc.*, 683 F.3d 577, 586-87 (4th Cir. 2012); *Ehleiter*, 482 F.3d at 222 ("[P]rejudice is the touchstone for determining whether the right to arbitrate has been

[2] Because state law does not apply, we need not decide whether, as Security argues, *Cortez* and Arizona law require denial of a motion to compel arbitration brought by a party that has answered the complaint without reserving the right to arbitrate. We note, however, that evidence in *Cortez* established far more than a mere failure to plead arbitration as an affirmative defense; the defendant there also "participated substantially in the litigation and thereby exhibited additional conduct inconsistent with enforcing the [arbitration] agreement." 226 Ariz. at 211, ¶ 6; *see City of Phoenix v. Fields*, 219 Ariz. 568, 575, ¶ 30, n.4 (2009) (party may waive arbitration by "participat[ing] substantially in litigation without promptly seeking an order from the court compelling arbitration"). Further, Security incorrectly argues that application of 9 U.S.C. § 3 to this case "illogically presumes in the first instance" that *Cortez* "somehow adopted a state waiver standard that would violate requirements of the FAA." The FAA was not at issue in *Cortez*, and our decision in that case did not mention the federal statute.

waived."); *Seguros Banvenez, S.A. v. S/S Oliver Drescher*, 761 F.2d 855, 862 (2d Cir. 1985). Other courts have held that while prejudice is not required, it is a factor to be considered in determining whether waiver has occurred. *See, e.g., Zuckerman Spaeder*, 646 F.3d at 922 (potential prejudice is among circumstances to be considered); *St. Mary's Med. Ctr. of Evansville, Inc. v. Disco Aluminum Prods. Co., Inc.*, 969 F.2d 585, 590 (7th Cir. 1992) ("If prejudice is relevant, even if not dispositive, the district court should consider it just as it should consider any other relevant factor."); *Hudson*, 387 P.3d at 47-48.

¶15 In interpreting a federal statute, in the absence of guidance by the United States Supreme Court, Arizona courts will look first to a "clear rule" issued by the Ninth Circuit Court of Appeals if that rule appears just. *Weatherford ex rel. Michael L. v. State*, 206 Ariz. 529, 532-33, ¶¶ 8-9 (2003). When other courts are divided on an issue of federal substantive law, following Ninth Circuit precedent "furthers federal-state court relationships" and promotes "predictability and stability of the law." *Id.* at 533, ¶ 9.

¶16 On this question, we adopt the Ninth Circuit rule for the additional reason that it has the benefit of clarity and certainty. As interpreted by the Ninth Circuit, waiver under 9 U.S.C. § 3 requires proof that the party seeking arbitration knew of an "existing right to compel arbitration," it nevertheless committed "acts inconsistent with that existing right," and those inconsistent acts caused prejudice to the party opposing arbitration. *Richards*, 744 F.3d at 1074. In applying this standard, we keep in mind that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983).

¶17 Applying 9 U.S.C. § 3 to the facts of this case, we conclude Appellants did not waive their right to arbitration of Security's claims against them. To be sure, Appellants were aware of the arbitration agreement, at least constructively, and they undeniably did not raise arbitration as an affirmative defense in their answer. But they contacted Security to commence the arbitration process within a month of answering the complaint. Most significantly, Security has not shown it was prejudiced by Appellants' delay.

¶18 In support of its argument to the contrary, Security contends it went to the trouble of preparing its initial disclosure statement under

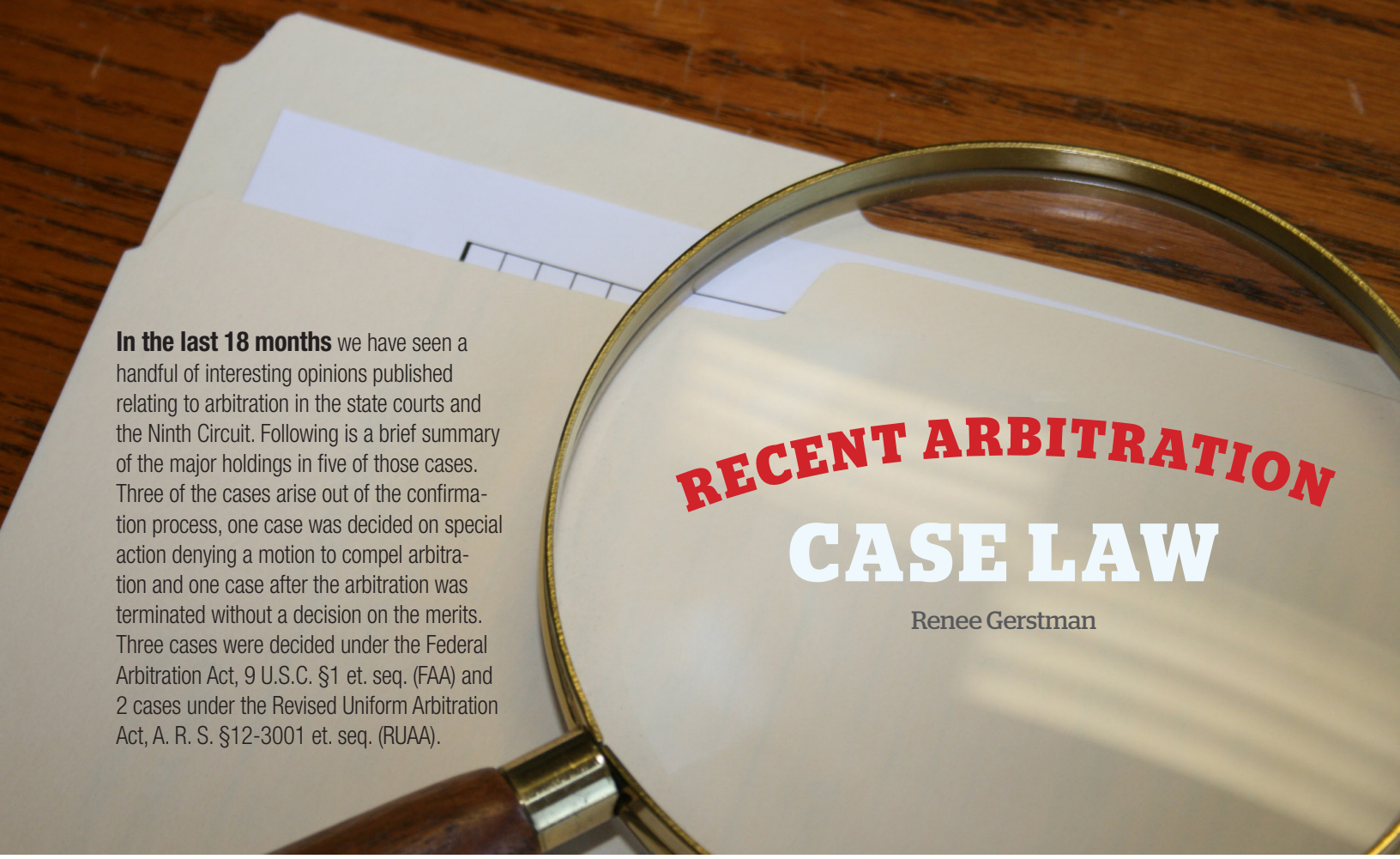
Arizona Rule of Civil Procedure 26.1 before the court ruled on Appellants' motion to dismiss. But Security's complaint against Appellants also named other defendants with which Security has no arbitration agreements. Having chosen to join all the defendants in a single action, Security accepted the possibility that its claims would have to proceed on dual tracks, one through the superior court and the other through arbitration. Under both state and federal principles, in these circumstances, enforcement of parties' rights "*requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Moses H. Cone*, 460 U.S. at 20; *Forest City Dillon, Inc. v. Superior Court*, 138 Ariz. 410, 412 (App. 1984). Accordingly, Appellants' failure to cite the arbitration agreement in their answer did not compel Security to prepare a disclosure statement in support of its claims; Security was obligated to prepare that disclosure for the other defendants regardless of any purported waiver by Appellants.

¶19 Nor did Appellants unfairly benefit by receiving a copy of the disclosure statement Security provided to the other defendants. The arbitration agreements Appellants signed at Security's request expressly grant the parties "the right to conduct adequate civil discovery." Security further argues it suffered prejudice because Appellants twice asked for extensions of time to respond to the complaint, but it does not state how the delay caused injury to the company. Moreover, the delay at issue here is the 29 days after answering the complaint it took Appellants to raise the arbitration agreement, not any delay before they filed their answer. For the same reasons, Security's contention that it was prejudiced by its pre-litigation efforts to "deliver[] cease and desist letters" to Appellants and in "framing its litigation strategy" is unfounded.

¶20 In sum, Security makes no showing that it was prejudiced by Appellants' failure to cite the arbitration agreement in their answer or by the subsequent 29-day delay before Appellants first raised the issue of arbitration. Accordingly, the superior court erred by denying Appellants' motion to compel arbitration.

CONCLUSION

¶21 Accepting special action jurisdiction, we grant relief by reversing the superior court's order denying Appellants' motion to dismiss and to compel arbitration.



RECENT ARBITRATION CASE LAW

Renee Gerstman

In the last 18 months we have seen a handful of interesting opinions published relating to arbitration in the state courts and the Ninth Circuit. Following is a brief summary of the major holdings in five of those cases. Three of the cases arise out of the confirmation process, one case was decided on special action denying a motion to compel arbitration and one case after the arbitration was terminated without a decision on the merits. Three cases were decided under the Federal Arbitration Act, 9 U.S.C. §1 et. seq. (FAA) and 2 cases under the Revised Uniform Arbitration Act, A. R. S. §12-3001 et. seq. (RUAA).

RS Industries, Inc. and Sun Mechanical Contracting, Inc. v. J. Scott and Beverly Candrian
240 Ariz. 132, 377 P.3d 329 (2016).

The RS Industries case involves a challenge to an arbitrator's authority to award attorney fees. The losing party (RS Industries) challenged the arbitrator's award of over $1,000,000 in attorney's fees and $200,000 in costs, claiming that the arbitrator exceeded his authority in awarding fees and costs and asked the court to vacate that portion of the award pursuant to A.R.S. §12-3023(A)(4). The court disagreed, finding that the arbitrator had the authority to award attorney's fees and costs under A.R.S §12-3021(B) as well as the language of the arbitration agreement, and that RS Industries' arguments that the arbitrator applied the wrong law in awarding fees went to the correctness of the ruling and not the arbitrator's power to issue the ruling and, thus, the award is not subject to vacatur on that ground.

RS Industries also challenged court's award of costs to Candrian in the confirmation hearing process. The court in upholding the expenses awarded by the trial court held that an award of fees under A.R.S. §12-3205 is not as limited as is an award of costs under A.R.S. §12-341 to those specific costs delineated in A.R.S. §12-322.

Tillman v. Tillman
825 F. 3d 1069 (9th Cir. 2016)

This case arising under the Federal Arbitration Act addresses what happens when an arbitration is terminated without entry of an award due to inability to pay arbitration fees and costs. Plaintiff's federal court action was stayed pending arbitration in accordance with an arbitration clause. The arbitration proceeded, but was terminated by the arbitrator without entry an award when plaintiff ran out of funds to pay for her share of the arbitration proceedings. The district court lifted the stay and refused to dismiss the case for failure to prosecute her claim, finding after review of the evidence that Plaintiff lacked the financial capacity to pay her share of the arbitration. The district court nonetheless dismissed the case, reasoning that under §1 of the FAA, it lacked the authority to hear claims that would have been subject to the arbitration agreement.

The Ninth Circuit reversed and remanded with instructions to allow the plaintiff to continue her case in court. The court reasoned that even though no ruling on the merits was entered in the arbitration, the arbitration "had been had in accordance with the agreement" under §3 of the FAA, that there is no language or provision of the FAA that requires dismissal of the case, and that in the absence of any statutory directive, the district court erred in dismissing the case.

Move, Inc. v. Citigroup Global Markets, Inc.
840 F.3d 1152 (9th Cir. 2016)

This case arising under the FAA discusses timeliness of a motion to vacate an arbitration award issued by a FINRA panel. The Ninth Circuit concluded that the motion to vacate made years after the three month time limit passed was not untimely because the FAA is subject to equitable tolling. The court also vacated the award, finding that the arbitrator should have been disqualified.

More than 4 years after issuance of an award, the claimant (losing party) learned that the chairperson of the panel was not a licensed attorney and lied about his qualifications. The Ninth Circuit found that the doctrine of equitable tolling applies to the FAA. Neither party raised whether claimant satisfied the substantive requirements of equitable tolling and the court found that issue was waived, but noted that they agreed with the district court's findings on that issue. The court also found that the arbitrator's actions violated §10(a)(3) of the FAA (misbehavior by which the rights of any party have been prejudiced) such that the claimant was denied the right to a fair hearing and vacated the award.

Security Alarm Financing v. Fuller
(1-CA-CV16-0255 07-06-2017)

Division One of the Court of Appeals accepted special action jurisdiction to address waiver of the right to arbitration under the Federal Arbitration Act (FAA). At issue was whether the failure to plead the right to arbitration in the answer constitutes a waiver. The court, applying federal law, concluded that waiver of a right to arbitration under §3 of the FAA requires a showing of: (1) knowledge of an existing right to compel arbitration; (2) acts inconsistent with that existing right and (3) prejudice to the party opposing arbitration arising from such inconsistent acts. Applying this standard to the facts, the court found that although the defendants were aware of the arbitration provision and did not raise it in their answer, they did seek commence arbitration within 30 days thereafter and the plaintiff did not show any prejudice by its failure to plead the defense in the answer.

The opinion also addressed why federal rather than state law applied to the question at hand of wavier of the right to arbitrate under the FAA. A distinction was drawn between the application of state law under §2 of the FAA to determine whether an arbitration agreement under the FAA is enforceable and valid and the issue of waiver that was before the court in this case. Under §2 of the FAA, courts look to state law contract principles to determine the validity, revocability and enforceability of contracts. The question of waiver, on the other hand, falls under §3 of the FAA which is governed by federal law.

Hamblen and Youngs v. Winslow Memorial Hospital, Inc.
(CV-16-0260-PR 07-21-2017)

The separability doctrine in the arbitration context refers to the distinction drawn between challenges specifically to the validity of the arbitration agreement and challenges to the contract as a whole or to another provision in the contract.Under the separability doctrine, an arbitration clause is considered an agreement independent and separate from the principal contract. A challenge to the validity or enforceability of a contract as a whole does not prevent enforcement of a specific agreement to arbitrate. The court will only inquire into whether a valid arbitration provision exists based on a challenge specifically to the arbitration clause itself. A claim that the entire contract was fraudulently induced is subject to arbitration.

In this case, the Arizona Supreme Court addressed the applicability of the separability doctrine to post-arbitration confirmation proceedings and whether the doctrine precludes court litigation of arbitrable claims when the agreement's arbitration provision was not specifically challenged, even though the arbitrator found grounds for rescinding the entire agreement.

At issue was the employer's attempt, in this employer/employee dispute, to confirm the award rescinding the contract and lift the stay to allow it to pursue tort claims that were not raised in the arbitration. The parties agreed that the arbitrator's award should be confirmed but disagreed on whether the employer should be allowed to proceed with tort claims against the employee that were not raised in the arbitration process. The court concluded that the separability doctrine applies in the post-confirmation process and that once the dispute was correctly referred to arbitration, the employer was required, in accordance with the terms of the arbitration provision, to present in the arbitration proceedings all counterclaims permissive or otherwise that arose out of the employment contract.

The court provided practitioners with additional guidance regarding drafting of arbitration provisions commenting that the separability doctrine is presumed in a broad arbitration provision even if the arbitrator finds the contract void or voidable unless (1) the parties have provided otherwise in their contract; (2) the parties stipulate to a bifurcated procedure to allow the later litigation of claims in court if the arbitrator finds the entire contract void or voidable; or (3) the party opposing arbitration establishes that the arbitration clause itself is unenforceable.

The court also pointed out that although the parties had not waived the non-applicability provisions of Revised Uniform Arbitration Act, A. R. S. §12-3001 e. seq. (RUAA) or Uniform Arbitration Act, A.R.S. 12-1501 et. seq. (UAA) to disputes between employers and employees the parties had voluntarily opted in to the RUAA and UAA and therefore limited their analysis to Arizona law and specifically did not address whether the agreement falls within Congress's Commerce Clause powers and the dispute covered by the FAA.

from the editor

by Thom Cope

As always, this edition could not have been possible without the sterling efforts of section members responding to my call for articles. Thanks to all of you who contributed to the success of this newsletter. Again I encourage everyone with an idea for an article to contact me at any time. Or if you have published somewhere else, we can re-publish it for the benefit of our section members.

Also, there would be not be a newsletter without the assistance of the State Bar staff. Thanks to them as well.

I hope everyone is having a terrific new year! Be Well.

Thom Cope