



Avoiding arbitration costs and arbitrator fees

MUST THE CONSUMER PAY FOR REQUIRED ARBITRATION?

A GUIDE TO THE CODE OF CIVIL PROCEDURE SECTION 1284.3, SUBD. (b)(1)

It is nearly impossible for a consumer to contract for anything that does not require a pre-dispute, consumer arbitration agreement. Consumer arbitrations include disputes involving medical malpractice, employment, health insurance, goods, services and other matters. This article provides a guide to:

- Statutory and other limitations on neutral arbitrator fees;
- Court decisions finding unconscionable arbitration provisions requiring financially challenged consumers to pay arbitration costs and fees;
- Court decisions and contracts that shift contractually required administrative charges and arbitrator fees from the consumer to the nonconsumer party;
- Court decisions requiring the matter to be tried in court and terminating the arbitration because the consumer is unable to pay arbitration costs and/or fees;
- Statutory waivers of private arbitration company (PAC) administrative charges for indigent consumers; and
- Consumer arbitrations hosted by PACs that require no arbitrator fees payable by the consumer.

With minor exceptions, codes and cases provide a myriad of confusing arbitration-fee terminology, which makes it difficult to determine whether their application is to a private arbitration company's (PAC) administrative charges and/or to an arbitrator's fees and expenses. A striking exception can be found in the California Code of Civil Procedure section 1284.3, subd. (b)(1), where it discusses PAC charges "exclusive of arbitrator fees." The reader should be alert to the confusion within the codes and cases.

Defining a consumer arbitration and the consumer party

The definitions of "consumer arbitration" and "consumer party" are set

forth in the "Ethics Standards for Arbitrators in Contractual Arbitration" [hereinafter "standard(s)"], as follows:

Standard 2 (d) defines "consumer arbitration" as an "arbitration conducted under a predispute arbitration provision contained in a contract that meets the" following criteria:

- (1) "The contract is with a consumer party . . . [defined in subd. (e)];
- (2) "The contract was drafted by or on behalf of the nonconsumer; and
- (3) "The consumer party was required to accept the arbitration provision in the contract."

Standard 2 (e) defines "consumer party" as "a party to an arbitration agreement who, in the context of the arbitration agreement," is any of the following:

- (1) One who acquires or leases goods or services typically for personal, family or household needs including financial, insurance and other goods and services defined in Civil Code section 1761;

Civil Code § 1761, subd. (a) states: "Goods" means tangible chattels bought or leased for use primarily for personal, family, or household purposes"

Civil Code § 1761, subd. (b) states: "Services means work, labor, and services furnished in connection with the sale or repair of goods."

- (2) An insurance plan enrollee, subscriber or insured in a health-care service plan under Health and Safety Code section 1345 or health-care insurance plan under Insurance Code section 106;
- (3) Medical-malpractice claimant; or
- (4) Employee or applicant in a dispute with an employer or prospective employer.

These standards were promulgated and periodically amended by the California Judicial Council since 2002, as required by section 1281.84 of the Code of Civil Procedure. The standards can be found as the last major section of the

California Rules of Court (www.courts.ca.gov). Note that the cited standards specifically exclude "public or private sector labor-relations" arbitrations.

A second definition of "consumer" can be found in Civil Code section 1761, subd. (d): "Consumer" is "an individual who seeks or acquires, by purchase or lease, any goods or services for personal, family, or household purposes."

Arbitrator fees limited by code and standards

Unless an arbitration contract provides otherwise, the fees and expenses for a neutral arbitrator are to be shared equally by the parties. (Code Civ. Proc., § 1284.2)

Section 1284.2 is a default rule for sharing arbitrator fees and expenses. It does not, however, prevent a court from finding unconscionable a contractual provision requiring a consumer party of limited means to pay a share of the neutral arbitrator's fees and expenses. To hold otherwise would deny the consumer party a forum in which to vindicate their rights. (See *Penilla v. Westmont Corporation, et al.* (2016) 3 Cal.App.5th 205, 220 [207 Cal.Rptr.3d 473].)

The limitation on unreasonable costs set forth in the California Consumers Legal Remedies Act prevails over the equal allocation of arbitrator fees and expenses required by section 1284.2. (*Gutierrez v. Autowest, Inc.* (2003) 114 Cal.App.4th 77, 101 [7 Cal.Rptr.3d 267].)

Code Civ. Proc. section 1284.3, subd. (a), prohibits arbitrators from ordering a losing consumer party to pay the fees and costs incurred by a prevailing non-consumer party.

Standard 16, subd. (a), prevents arbitrators from charging a fee that is contingent on the outcome of a consumer arbitration.

Before accepting a consumer arbitration appointment, a proposed neutral arbitrator, or responsible private arbitration company (PAC), is to provide written terms and conditions of the neutral arbitrator's compensation "and any special fees for cancellation, research, and preparation time, or other purposes." (Standard 16, subd. (b))

Party arbitrator fees and expenses required by a pre-dispute arbitration agreement are to be paid entirely by the party selecting and retaining the party arbitrator. (Standard 2, subd. (q)) Party arbitrator fees and expenses cannot be shifted to the nonconsumer party; however, the use of party arbitrators can be waived by stipulation of the parties.

Consumer's financial limitations and the U.S. Supreme Court

The U.S. Supreme Court has addressed the issue of a person's inability to arbitrate a dispute because of unaffordable and prohibitive arbitration costs. *Green Tree Financial Corp. Ala. v. Randolph* (2000) 531 U.S. 79, 121 S.Ct. 513, for example, allows a trial court hearing to determine a party's financial ability to pay arbitration costs.

Where "a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing likelihood of incurring such costs." (*Id.* at p. 92.) Unfortunately for Randolph, she did not provide proof of her financial limitations at the trial level, and the Supreme Court denied her claim of poverty.

For a California discussion of *Green Tree*, see *Prada v. Superior Court (Monex Deposit Company)* (2009) 176 Cal.App.4th 1554, 1574-1576 [98 Cal.Rptr.3d 743]. Westlaw has nearly 1700 divergent cases that cite *Green Tree* and evaluate a consumer's financial hardship claim on a case-by-case basis.

In *American Express, Co. v. Italian Colors Restaurant* (2013) 133 S.Ct. 2304, a class of small business vendors sued American Express for exorbitant service fees and statutory remedies. The arbitration agreement had a class-action waiver, but the plaintiffs sought class representation so they could pool

their resources to hire an economist. They argued the expense of an expert to prove their individual claims far exceeded the potential recovery of any one of the class members. The Court upheld the waiver and stated: [T]he fact that it is not worth the expense involved in *proving* a [consumer's] statutory remedy does not constitute the elimination of the *right to pursue* that remedy." (*Id.* at pp. 2310-2312.) [Italics in original. Bracket added.] "... the FAA's command to enforce arbitration agreements trumps any interest in ensuring the prosecution of low-value claims." (Fn. 5.)

For the California Supreme Court's critique of *Italian Colors*, see *Sonic-Calabazas A, Inc. v. Moreno* (2013) 57 Cal.4th 1109, 1153-1157 [163 Cal.Rptr.3d 269] *Sonic II*. Our high court held a fee-sharing contractual provision that is found unconscionable does not violate the Federal Arbitration Act (FAA), and, therefore, does not violate the holding in *Italian Colors*.

Consumer's financial limitations support unconscionability

Specific California appellate decisions have held unconscionable pre-dispute arbitration provisions that require a financially challenged consumer to share in paying arbitration costs and fees. Proof of unconscionability requires *both* procedural and substantive unconscionable elements. The former focusing on an adhesion agreement causing surprise or oppression due to unequal bargaining power, and the latter focusing on one-sided contract terms or overly harsh results toward the consumer party.

Proof of unconscionability

For a consumer to prove the unconscionability of an adhesive arbitration agreement requiring the consumer to pay unaffordable arbitration costs and fees requires the following declarations, evidence and testimony at a hearing on a petition to compel arbitration:

- The expected arbitration costs and fees;

- The consumer's financial limitations;
- The consumer's inability to pay the expected costs and fees;
- Hardship to the consumer if forced to pay the expected costs and fees; and
- For consumers alleging indigence, proof that the consumer obtained a forma pauperis superior court fee waiver.

California case law

For California case decisions concerning the *unconscionability* of pre-dispute arbitration provision requiring a financially challenged consumer to pay arbitration costs and fees, see:

- *Patterson v. ITT Consumer Financial Corp.* (1993) 14 Cal.App.4th 1659, 1656 [18 Cal.Rptr.2d 563] – An arbitration agreement should not require excessive costs relative to the amount of potential recovery, and such an agreement is substantively unconscionable. [To secure recovery of \$2000, a fee of \$850 was contractually required to commence the arbitration procedure and found to be substantively unconscionable.]

- *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 113 [99 Cal.Rptr.2d 745] – An arbitration provision requiring the employee to pay arbitration costs and fees was found to be procedurally and substantively unconscionable. Employer held to pay all employee's costs, including arbitrator fees and forum costs, that are unique to arbitration of certain employment disputes. Such payment is to be made by the employer regardless of the income of the employee, in that the employee sought unwaivable statutory rights. This cost/fee shifting requirement is a "categorical" approach and applies only to specific employment arbitrations.

- *Little v. Auto Stiegler, Inc.*, (2003) 29 Cal.4th 1064, 1085 [130 Cal.Rptr.2d 892] – Arbitration cost-shifting requirement in *Armendariz* extended to arbitrations for wrongful discharge in violation of public policy. FAA found to not preempt state arbitration cost sharing standards.

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• *Gutierrez v. Autowest, Inc.* (2003) 114 Cal.App.4th 77, 97 [7 Cal.Rptr.3d 267] – Case-by-case determination of consumer affordability required when a consumer sues under a consumer protection statute and claims that unaffordable payment of arbitration fees in the contract are unconscionable. “We decline to adopt the *Armendariz* categorical approach that would shift all unique arbitral costs to the non consumer party.” (*Id.* at p. 97.) “We conclude that where a consumer enters into an adhesive contract that mandates arbitration, it is unconscionable to condition that process on the consumer posting fees he or she cannot pay.” (*Id.* at p.89.)

• *Independent Association of Mailbox Center Owners, Inc. v. Superior Court* (2005) 133 Cal.App.4th 396, 417 [34 Cal.Rptr.3d 659] – Remanded to trial court to determine appropriate fee allocation, if any, to enable franchisees to go forward in arbitration of unwaivable statutory claims. The court applied the cost shifting requirements developed in consumer and employment cases to the subject franchise arbitration agreement. (*Id.* at pp. 415-416.)

• *Boghos v. Certain Underwriters at Lloyds of London* (2005) 36 Cal.4th 495, 508 [30 Cal.Rptr.3d 787] – The court recognized that a consumer’s inability to afford contracted arbitration fees and costs may be substantively unconscionable, if based on evidence by the consumer of an inability to pay. However, *Boghos* refused to extend the cost/fee-shifting rule set out in *Armendariz*, *supra*, to common law claims of breach of [insurance] contract and tort.

• *Parada v. Superior Court (Monex Deposit Co.)* (2009) 176 Cal.App.4th 1554, 1580-1582 [98 Cal.Rptr.3d 743] – Arbitration cost provision found to be substantively unconscionable, where declaration of consumer showed an inability to pay arbitration costs, including arbitrator fees.

• *Sonic-Calabasas A. Inc. v. Moreno* (2013) 57 Cal.4th 1109, 1144-1145 [163 Cal.Rptr.3d 269] *Sonic II* – “To state it simply: it is subjectively unconscionable to require a consumer to give up the right to utilize the judicial system, while

imposing arbitral forum fees that are prohibitively high.”

• *Sanchez v. Valencia Holding Co., LLC*, (2015) 61 Cal.4th 899, 920 [190 Cal.Rptr.3d 812] – Basic ruling found arbitration fees can be unaffordable for non-indigent as well as indigent consumers, and the courts are not precluded from using the unconscionability doctrine on a case-by-case basis to protect consumers against fees that unreasonably limit access to arbitration. However, in evaluating this plaintiff’s wealth, the Court found plaintiff had financial resources to pay required arbitration fees.

• *Penilla v. Westmont Corp., et al.* (2016) 3 Cal.App.5th 205 [207 Cal.Rptr.3d 473] – Arbitration provision imposing unaffordable arbitration fees that substantially deters a consumer from asserting a claim is substantively unconscionable. The *Penilla* court opined “a person who earns \$50,000 annually, supports a family, and has a claim requiring two days of hearings would likely be substantially deterred by having to advance 20 percent of his or her annual salary before arbitrating a claim.” (*Id.* at p. 221.) Note that *Penilla* included several plaintiffs with varied monthly incomes. The court found none of the plaintiffs financially capable of paying the arbitration fees required by the contract.

Costs and fee waivers after case ordered to arbitration

After a party is compelled into arbitration by court order and is unable to pay the arbitrator fees, upon return to court, cases have held the matter can proceed in trial and/or the other party can pay the arbitrator fees. It should be noted that two of the below cited cases involve attorney retainer contracts, where the client sued the attorney for malpractice, the attorney obtained an order compelling arbitration, and the client claimed inability to pay arbitration costs. See:

• *Cinel v. Christopher* (2012) 203 Cal.App.4th 759 [136 Cal.Rptr.3d 763] – Case compelled to arbitration. Arbitrator would not render award on merits due to

failure of “all” parties to pay arbitrator’s fees. Case returned to court, and, based on vestigial powers, court set matter for trial. Confirmed in *Cinel v. Barna* (2012) 206 Cal.App.4th 1383 [142 Cal.Rptr.3d 329].

• *Roldan v. Callahan & Blaine* (2013) 219 Cal.App.4th 87 [161 Cal.Rptr.3d 493] – Several elderly, indigent plaintiffs obtained superior court filing fee waivers and filed legal malpractice complaint against law firm for its negligence in settling plaintiffs’ toxic waste lawsuit. Law firm petitioned and court compelled arbitration pursuant to arbitration agreement within the law firm’s retainer contract with plaintiffs. Plaintiffs moved court to order law firm to advance entire up-front arbitration forum costs, which trial court denied.

On remand, if any plaintiff is found unable to pay “the cost of arbitration,” defendant law firm “can elect to either pay that plaintiff’s share of the arbitration cost and remain in arbitration or waive its right to arbitration of that plaintiff’s claim” and the matter will proceed in court. (*Id.* at p. 96.)

• *Tillman v. Tillman (Rheingold)* (9th Cir. 2016) 825 F.3d 1069 – Client’s exhaustion of arbitration fees during arbitration allows the legal malpractice complaint to proceed as a district court trial matter.

Arbitrator set a time limit for client plaintiff to advance arbitrator fees for additional arbitration days. Client could not afford to pay the additional fees, and arbitrator terminated the arbitration without making an award on the merits. The trial court dismissed the case. Ninth Circuit held client’s “arbitration terminated before the merits were reached or any award issued, allowing her case to proceed in district court,” as the only way client’s claims could be adjudicated.

For Kaiser arbitrations, arbitrator fees and expenses can be paid by Kaiser

A Kaiser member can obtain waivers of arbitration expenses and arbitrator fees for tort and medical malpractice claims. Full payment is then shifted to

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Kaiser. Waivers are obtainable by following *all* requirements of Rules 13 *and/or* 15 of “Rules for Kaiser Permanente Member Arbitrations.” The rules and required forms can be obtained from the Office of the Independent Administrator (OIA) (www.oia-kaiserarb.com), an independent administrator for Kaiser’s arbitration process.

Rule 13, in essence, requires the complaining Kaiser member to complete a fee waiver form that shows paying a \$150 filing fee to the OIA *and* expected arbitrator fees and expenses would cause an “extreme hardship.” The form is to be submitted to the OIA, and the OIA must approve the waiver.

To qualify for an “extreme hardship” waiver, an applicant has an option to check a box on the application form that states:

Your income is not enough to pay for the common necessities of life for you and the people in your family, plus also pay for the filing fee and the fees and expenses of the Neutral Arbitrator.

Upon the OIA granting waiver based on extreme hardship, the \$150 filing fee is waived and Kaiser is required to pay the arbitrator’s hourly fees and arbitration expenses.

Rule 15, in essence, requires the submission of two forms to the OIA. One form states the Kaiser member *waives any objection* to Kaiser paying a single neutral arbitrator’s hourly fees and expenses. On the second form for claims over \$200,000, the Kaiser member *waives the right to utilize a party arbitrator* required by the contract. This rule does not require proof of extreme hardship nor is OIA approval required.

Implicitly, Rule 15 requires Kaiser to also waive its right to a party arbitrator. Like the Rule 13 waiver, a waiver under Rule 15 requires Kaiser to pay the arbitrator’s hourly fees and arbitration expenses.

Administrative charges and fees

A predispute arbitration agreement may require a specific, private arbitration company (PAC) to administer the arbitration and/or to apply its arbitration

procedural rules. Parties can also stipulate to the use of a particular PAC and its arbitration procedural rules. The procedural rules set forth in Code Civ. Proc. section 1280 et seq. apply if no procedural rules are required by an arbitration agreement or stipulated to by the parties.

A PAC charges for multiple services, and those charges differ from the daily and/or hourly fees charged by a neutral arbitrator. It is wise to discuss potential PAC charges with the PAC before commencing arbitration, as some are waivable or, perhaps, negotiable.

In California, the predominant PACs with arbitration procedural rules are JAMS and American Arbitration Association (AAA). Other PACs, such as ADR, Judicate West and ARC, may have arbitration procedural rules to be followed under certain conditions.

PAC administrative fee waiver for indigent consumer

For an indigent consumer, PAC administrative fees and charges, “exclusive of arbitrator fees,” for “consumer arbitrations” are waivable under Code Civ. Proc., § 1284.3, subd. (b)(1). The code defines an “indigent consumer” as a person whose gross monthly income is less than 300 percent of federal poverty guidelines. (For the latest federal poverty guidelines, see <https://aspe.hhs.gov/poverty-guidelines>.)

Subdivision (b)(2) of section 1284.3 requires a chosen PAC to “provide written notice of the right to obtain a waiver of ‘fees’ to a consumer or prospective consumer” in all matter of communication with the consumer. The PAC is required to provide a form to be completed by the consumer, under oath, stating monthly income, household family members and other related matters. (Subd. (b)(3)) The PAC can shift its administrative charges and fees (not arbitrator fees) that would otherwise be payable by an indigent consumer party to a nonconsumer party. (Subd. (b)(1))

Neither a PAC nor arbitrator can require a consumer who loses an arbitration to pay the prevailing party’s arbitrator fees and costs. (Subd. (a))

No fees charged to indigent consumers at AAA and JAMS

Both AAA and JAMS have consumer arbitration rules that require a non-indigent “consumer” to pay a small administrative charge. [No charge for indigent consumer.] The consumer is *not* charged a neutral arbitrator’s fee. The entire neutral arbitrator’s fee is paid by the nonconsumer business party.

AAA consumer arbitrations

The definition of “consumer” set forth in Civil Code section 1761, quoted above, is used by the AAA as its definition to allow a reduced administration filing fee of \$200 for a non-indigent consumer (or fee waiver for an indigent consumer) and free unlimited neutral arbitrator services for “consumer” arbitrations. AAA defines a “consumer agreement” in its “Consumer Arbitration Rules.” See Rule R-1, stating:

The AAA defines a consumer agreement as an agreement between an individual consumer and a business where the business has a standardized systematic application of arbitration clauses with customers and where the terms and conditions of the purchase standardized, consumable goods or services are non-negotiable or primarily non-negotiable in most or all of its terms, conditions, features or choices. The product must be for personal or household use.

The rule then lists several categories of consumer agreements subject to the rule, which includes insurance policies. Many uninsured motorist provisions require the use of AAA arbitration services, and a mere filing of an AAA consumer arbitration application should allow for a free arbitrator. A good source of information (and forms) on AAA consumer arbitrations can be obtained from the AAA office in Fresno (559-650-8206).

JAMS consumer arbitrations

JAMS literature is confusing when it comes to defining “consumer arbitrations.” Its “Demand for Arbitration Form,” page 5, section on consumer arbitration, states: “Please indicate if this is a

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CONSUMER ARBITRATION as defined by *California Rules of Court Ethics Standards for Neutrals Arbitrators*, Standard 2(d) and (e).” [The standard is quoted in the first section of this article.]

The Demand for Arbitration Form then requires the applicant to check one of two boxes that indicate if the arbitration is a consumer arbitration. The form then repeats verbatim the definitions of “consumer arbitration” and “consumer party,” set forth in Standard 2(d) and (e). As can be seen by the definitions set forth in Standard 2, a consumer arbitration specifically includes health care, medical malpractice, employment, goods and services disputes.

JAMS has another publication entitled “JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses- Minimum Standards of Procedural Fairness,” effective July 15, 2009. This policy provides minimum standards for consumer arbitration procedures, with item number 7 dealing with a *no fee* neutral arbitrator, as follows:

With respect to the cost of the arbitration, when a consumer initiates arbitration against the company, the only fee required to be paid by the

[non indigent] consumer is \$250, which is approximately equivalent to current Court filing fees. All other costs must be borne by the company, including any remaining JAMS Case Management Fee and all professional fees for the arbitrator’s services. When the company is the claiming party initiating an arbitration against the consumer, the company will be required to pay all costs associated with the arbitration. [Bracket added.]

This JAMS publication, in a footnote, defines a “consumer,” as follows:

A consumer is defined as an individual who seeks or acquires any goods or services primarily for personal family or household purposes, including the credit transactions associated with such purchases, or personal banking transactions. [Writer’s comment: This definition of “consumer” appears to use *Civ. Code § 1761, subd. (d)*, rather than the Standard 2(e) definition set forth in the JAMS Demand for Arbitration form. Thus, the two JAMS publications are in conflict as to the definition of “consumer.”]

The footnote goes on to exclude certain commercial transactions and specifically excludes “matters involving

underinsured motorists.” [italics added.] There is no exclusion for *uninsured* motorist claims.

Conclusion

Consumer arbitrations are the most common arbitrations handled by consumer attorneys, and they typically require large sums of money to prosecute. The above information is presented as available tools to obtain waivers of arbitration administrative charges and neutral arbitrator fees for many consumer arbitrations.

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