November 18, 2020

ADR Case Update 2020 - 21

Federal Circuit Courts

- **PRE-LITIGATION LETTER NOT INCONSISTENT WITH ARBITRATION**

  Borror Property Management v Oro Karric North, LLC
  2020 WL 6336316
  United States Court of Appeals, Sixth Circuit
  October 29, 2020

  Oro's contracts with Borror to manage its residential apartments included arbitration provisions. After a dispute arose and Borror ceased managing the apartments, Oro wrote a letter indicating that it planned to proceed to litigation as the contracts "do not limit litigation exclusively to arbitration." Borror filed a federal court complaint, alleging its own breach of contract claim, and Oro moved to compel arbitration. The court denied the motion, finding that Oro waived its contractual right to arbitration through its pre-litigation conduct (the letters). Oro appealed.

  The United States Court of Appeals for the Sixth Circuit reversed and remanded. A party waives its arbitration right when its acts are "completely inconsistent" with that right, and the party's conduct is prejudicial to the opposing party. The Court found that Oro's pre-complaint letter did not amount to conduct inconsistent with its arbitration rights, noting that giving a pre-litigation posturing letter such legal force would raise the stakes for pre-filing communication and give parties little room to work out differences. Even if the letter was deemed inconsistent with arbitration rights, the prejudicial hallmarks were absent. Borror filed a lawsuit a week after Oro sent its letter. Oro's actions cost Borror nothing – neither time nor money, advantage nor disadvantage.

- **CLAIMS BARRED BY PRINCIPLES OF RES JUDICATA**

  Matlin and Waring v. Spin Master Corp
  2020 WL 6580807

United States Court of Appeals, Seventh Circuit
November 10, 2020

Tai Matlin and James Waring were co-founders of Gray Matter Holdings, LLC. In 1999, they entered into a Withdrawal Agreement with Gray Matter that entitled them to royalties on the sales of Key Products. Gray Matter sold some of its assets to Swimways in 2003, and Matlin and Waring took Gray Matter to arbitration on four occasions since that time. The third arbitration determined that Gray Matter did not transfer its royalty obligations under the Withdrawal Agreement to Swimways – only its IP rights. The fourth arbitration determined that there was no evidence to support Matlin and Waring's claim that Swimways tendered fraudulent filings to the US Patent and Trademark Office regarding IP rights in the Key Products. Even assuming the allegations were true, the arbitrator found that Matlin and Waring were not entitled to relief because all IP rights in the Key Products at issue had been transferred to Swimways and Matlin and Waring had no rights left to assert. After Spin Master acquired Swimways, Matlin and Waring sued both, alleging that they were entitled to royalties for the Key Products and Swimways tendered the alleged fraudulent filings to the USPTO. The court dismissed the complaint, and this Court affirmed. The court noted that Waring and Matlin's claims were barred based on res judicata and the contracts' plain language and granted Swimways and Spin Master's motion for sanctions of $271,926.92. Matlin and Waring and Stoltmann Law Office (SLO) appealed.

The United States Court of Appeals for the Seventh Circuit affirmed. The Court found that the court's sanctions order affected the rights of Swimways and Spin Master to costs and fees and thus was not an advisory opinion; that because issue preclusion and the language of the contracts rendered Matlin and Waring's suit frivolous, the court acted within its discretion in awarding Rule 11 sanctions of attorney fees and costs; the amount of attorney fees and costs awarded was reasonable based on the number of hours expended by the attorneys and staff to prepare the motion to dismiss and for sanctions; and that while unsuccessful, the appeal of the sanctions order was not frivolous.

California

- **SANCTIONS PROPER AGAINST PARTIES FILING REQUEST TO LIFT STAY**

McCluskey v. Henry
2020 WL 6389663
Court of Appeal, First District, Division 3, California
November 2, 2020

McCluskey sought damages for the termination of her Airbnb account, alleging intentional infliction of emotional distress at the hands of Henry, Willner, and Ebrahini (all Airbnb employees). The court granted a motion to stay the action and compel arbitration pursuant to a contract between McCluskey and Airbnb. McCluskey filed a claim for arbitration with AAA and paid her filing fee. Though Airbnb sent the fee by wire transfer, AAA did not acknowledge receipt and closed the case due to the defendants' failure to pay their fee (possibly because the payment was sent along with payment for another case). Defendants cleared up the misunderstanding, and AAA asked all parties to confirm that they wanted to reopen the case. McCluskey did not respond and filed a request to lift the stay, asserting that the defendants' failure to pay their filing fee constituted a default, waiver, or breach of the arbitration agreement. The court denied the request, finding it factually and legally frivolous, and granted the defendants' motion for sanctions against McCluskey's counsel, Michael Mogan. The court also denied McCluskey's request for sanctions against the defendants for their motion for sanctions. Mogan appealed, and the defendants moved for sanctions against Mogan and McCluskey for filing the appeal.

The Court of Appeal, First District, Division 3, California affirmed and denied the motion for sanctions. Mogan filed a motion to lift the stay even though AAA had informed counsel that it would arbitrate upon confirmation from the parties, which McCluskey and Mogan did not provide. The court retained jurisdiction over the original suit, despite the stay of action and jurisdiction to ensure the parties adhered to the previous order compelling arbitration. The court also had the authority to impose sanctions for the filing of a frivolous amended motion. The Court denied the

defendants' motion for sanctions against McCluskey and Mogan for filing a frivolous appeal because it could not conclude that Mogan's appeal was so "totally and completely without all arguable merit as to justify an award of sanctions under those demanding requirements."

Colorado

- **POOR DUE DILIGENCE WAIVED FRAUD DEFENSE TO ARBITRATION**

  Peak Billing v. Mountain Sleep Diagnostics (MSD)
  12020COA155
  Colorado Court of Appeals
  November 5, 2020

  Tara Price, doing business as Peak Billing, contracted with MSD to provide billing services. The contract included an arbitration clause. After MSD terminated the contract, Price filed a motion to compel arbitration, asserting that MSD's untimely notice was a breach. Following a two-day hearing, the arbitrator awarded Price $124,224 for MSD's breach of the contract plus attorney's fees. Price filed a motion to confirm, and MSD filed a motion to vacate, alleging that Price had committed fraud while performing billing services. The court granted the motion to confirm and MSD appealed.

  The Colorado Court of Appeals affirmed. Given that only a handful of CO appellate cases had considered motions to vacate arbitration awards due to fraud, the Court looked to federal circuits and found the federal test consistent with existing CO case law: when considering a motion to vacate an arbitration award, the movant must: establish the fraud; show that the fraud was not discoverable by exercising due diligence before or during the arbitration; and demonstrate that the fraud had a material effect on a dispositive issue in the arbitration. It was clear from the record that MSD did not exercise due diligence with respect to Price's alleged fraud. The briefings and affidavits that MSD submitted did not show that Price's alleged scheme was not reasonably discoverable before the arbitration ended, nor did they demonstrate that MSD acted with due diligence to uncover fraud on Price's part while the arbitration proceedings were ongoing.

Case research and summaries by Deirdre McCarthy Gallagher and Richard Birke.

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