NOTICE: NOT FOR OFFICIAL PUBLICATION.
UNDER ARIZONA RULE OF THE SUPREME COURT 111(c), THIS DECISION IS NOT PRECEDENTIAL
AND MAY BE CITED ONLY AS AUTHORIZED BY RULE.

IN THE
ARIZONA COURT OF APPEALS
DIVISION ONE

GMMK LLC, et al., *Plaintiffs/Appellees*,

v.

TREELINE DESIGN GROUP INC, et al., *Defendants/Appellants*.

No. 1 CA-CV 18-0386
FILED: 11-19-2019

Appeal from the Superior Court in Maricopa County
No. CV2014-015332
The Honorable Kerstin G. LeMaire, Judge

VACATED AND REMANDED

COUNSEL

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MEMORANDUM DECISION

Judge Kenton D. Jones delivered the decision of the Court, in which Presiding Judge Michael J. Brown joined. Chief Judge Peter B. Swann specially concurred.

J O N E S, Judge:

¶1 Treeline Design Group, Inc., James Gorraiz, and Stanya Gorraiz (collectively, Treeline) appeal from the default judgment entered against them as a consequence for failing to participate in good faith in private arbitration. For the following reasons, we vacate the judgment and remand for further proceedings consistent with this decision.

FACTS AND PROCEDURAL HISTORY

¶2 In December 2014, GMMK, L.L.C., George Galowicz, and Michael Mars (collectively, GMMK) sued Treeline for breach of contract, negligent misrepresentation, and fraudulent misrepresentation arising out of a November 2013 Business Assets Purchase Agreement (the Agreement), by which GMMK would purchase a landscaping business from Treeline for $650,000. When Treeline did not timely answer the complaint, GMMK moved for entry of default. Treeline responded by moving to dismiss the complaint on the grounds that the Agreement obligated GMMK to submit its claims to private arbitration. In June 2015, the trial court determined the arbitration clause within the Agreement was valid and stayed the case while the parties pursued arbitration.

¶3 After Treeline ignored multiple attempts to coordinate arbitration, GMMK moved to compel arbitration. Treeline did not respond to the motion, and the trial court appointed an arbitrator and, in December 2015, ordered Treeline to participate in arbitration.

¶4 Fourteen months later, GMMK requested the trial court enter default judgment against Treeline as a sanction for thwarting arbitration by failing to pay its portion of the arbitrator's fee. In response, Treeline asked the court to "reinstate the case" and allow it to proceed outside of arbitration. Treeline noted discovery was largely complete and explained it had done "nothing to indicate [it] d[id] not wish to defend" against the lawsuit; Treeline simply could not afford to pay its portion of the fee.

¶5 After hearing oral argument and taking the matter under advisement, the trial court found:

> Despite being ordered . . . to engage in arbitration in the fall of 2015, Defendants [Treeline] never paid . . . their share of the deposit. They never asked the arbitrator to assess the initial costs of arbitration to the Plaintiffs nor did they seek relief from the Court. Defendants simply assert that they are unable to afford the arbitration fees.
>
> Although the Court never favors a default, the Court finds that the Defendants failed to comply in good faith with . . . multiple rulings that they participate in the arbitration as mandated by the parties' contract.

Treeline moved unsuccessfully for a new trial, and the court ultimately entered a default judgment against it, along with other orders that effectuated a rescission of the Agreement. The court also awarded GMMK its attorneys' fees and costs. Treeline timely appealed the final judgment, the orders denying its motions for new trial, and the awards of attorneys' fees and costs. We have jurisdiction pursuant to Arizona Revised Statutes (A.R.S.) §§ 12-120.21(A)(1),[1] -2101(A)(1), and (5)(a).

DISCUSSION

¶6 Treeline argues the trial court abused its discretion in entering default judgment against it as a sanction for failing to participate in good faith in arbitration. We review an order entering sanctions for an abuse of discretion. *Lenze v. Synthes, Ltd.*, 160 Ariz. 302, 305 (App. 1989) (citations omitted).

¶7 "It is well established that a trial court has the authority to dismiss or to enter default judgment, depending on which party is at fault, for failure to comply with its orders." *Green v. Lisa Frank, Inc.*, 221 Ariz. 138, 149, ¶ 29 (App. 2009) (quoting *Flaksa v. Little River Marine Constr. Co.*, 389 F.2d 885, 887 nn.2-7 (5th Cir. 1968)) (collecting cases). That discretion is more limited when the court imposes severe sanctions, such as a dismissal or default judgment. *Lewis v. Lewis* (*In re Estate of Lewis*), 229 Ariz. 316, 323, ¶ 18 (App. 2012) (quoting *Roberts v. City of Phx.*, 225 Ariz. 112, 119, ¶ 27 (App. 2010)) (citations omitted); *see also Lenze*, 160 Ariz. at 305 (noting due process considerations limit the court's power to employ severe sanctions)

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[1] Absent material changes from the relevant date, we cite the current version of rules and statutes.

(citing *J-R Constr. Co. v. Paddock Pool Constr. Co.*, 128 Ariz. 343, 344-45 (App. 1981), and *Golleher v. Horton*, 119 Ariz. 604, 606 (App. 1978)).

¶8 Whether severe sanctions are appropriate is a fact-intensive inquiry that involves consideration of many factors, the most relevant of which are:

> (1) prejudice to the other party, both in terms of its ability to litigate its claims and other harms caused by the disobedient party's actions;
>
> (2) whether the violations were committed by the party or by counsel;
>
> (3) whether the conduct was willful or in bad faith and whether the violations were repeated or continuous;
>
> (4) the public interest in the integrity of the judicial system and compliance with court orders;
>
> (5) prejudice to the judicial system, including delays and the burden placed on the trial court;
>
> (6) efficacy of lesser sanctions;
>
> (7) whether the party was warned that violations would be sanctioned; and
>
> (8) public policy favoring the resolution of claims on their merits.

Green, 221 Ariz. at 154-55, ¶¶ 45, 47. The list is not exclusive; "[a] trial court may identify and address any other relevant circumstances." *Id.* at 154, ¶ 45. Additionally, "[i]f a party is to suffer the ultimate sanction of dismissal or default, then fundamental fairness requires, at minimum, that the party 'be given notice and an opportunity to appear before the trial court to explain the violation or present any evidence in mitigation.'" *Lewis*, 229 Ariz. at 325, ¶ 21 (quoting *Insua v. World Wide Air, Inc.*, 582 So. 2d 102, 103-04 (Fla. Dist. Ct. App. 1991)); *see also Wayne Cook Enters., Inc. v. Fain Props. Ltd. P'ship*, 196 Ariz. 146, 149, ¶ 12 (App. 1999).

¶9 The trial court here failed to consider many of these factors. For example, GMMK did not contend it suffered any prejudice in either its motion for default judgment or its reply. And while Treeline's actions may have delayed resolution of the dispute, delay alone does not establish

prejudice. *Marquez v. Ortega*, 231 Ariz. 437, 442, ¶ 20 (App. 2013) (quoting *Allstate Ins. v. O'Toole*, 182 Ariz. 284, 287-88 (1995)). "Each situation must necessarily be evaluated on its own facts." *Id.*

¶10 Nor does the record reflect that the trial court warned Treeline that failing to pay the arbitrator's fee could result in entry of a default judgment against it. Indeed, while refusing to pay the fees may result in waiver of the right to arbitrate, we know of no authority — and GMMK cites none — suggesting it can also result in waiver of the right to be heard altogether. *See, e.g.*, *Cortez v. Avalon Care Ctr. Tucson, L.L.C.* (*In re Estate of Cortez*), 226 Ariz. 207, 211, ¶ 4 (App. 2010) (stating a party may waive its right to arbitrate by "preventing arbitration, proceeding in contradiction of the arbitration agreement, or unreasonably delaying the assertion of the right to arbitrate") (citing *EFC Dev. Corp. v. F.F. Baugh Plumbing & Heating, Inc.*, 24 Ariz. App. 566, 569 (1975)).

¶11 There is likewise no indication that the trial court considered imposing lesser sanctions, such as an interim award of attorneys' fees and costs.

¶12 Finally, although GMMK contends the trial court could infer Treeline's defenses lacked merit based upon deliberate attempts to "delay and stonewall" arbitration, *see Green*, 221 Ariz. at 152-53, ¶ 39 (affirming the imposition of dismissal sanctions where the party's "contumacious conduct permitted the court to infer that his claims and defenses were meritless"), the court denied Treeline's requests for an evidentiary hearing. Thus, unlike *Green*, where the finding that the party had willfully violated court orders was made after a three-day hearing, there is no record evidence here that would support a negative inference as to Treeline's defenses or a finding of constructive waiver.

¶13 The trial court abused its discretion in entering default judgment against Treeline as a sanction for its failure to comply with the order to complete arbitration when it did not consider the relevant factors outlined in *Green* or hold a hearing to allow Treeline to explain its conduct. Accordingly, we vacate the default judgment. Because the award of attorneys' fees and costs to GMMK was based upon its success in obtaining the default judgment, that award is also vacated.

CONCLUSION

¶14 The default judgment and fee award are vacated. The motion for sanctions is remanded for reconsideration. Upon remand, the trial court should determine whether private arbitration has failed. If the court so

finds, it should conduct an evidentiary hearing to determine, amongst other relevant factors: (1) whether Treeline or its counsel failed to participate in good faith in the arbitration process, and (2) whether lesser sanctions would be effective in addressing any misconduct. We express no opinion on the merits of Treeline's substantive defenses.

¶15 Treeline requests its attorneys' fees and costs incurred on appeal pursuant to A.R.S. §§ 12-341.01(A), 12-349(A), and ARCAP 25. We decline the request. We do not find GMMK's arguments were frivolous or asserted in bad faith such that an award of fees under A.R.S. § 12-349(A) or ARCAP 25 would be appropriate. *See Villa De Jardines Ass'n v. Flagstar Bank, FSB*, 227 Ariz. 91, 99, ¶ 26 (App. 2011) (advising that attorneys' fees should not be awarded as a sanction when "the issues raised are supportable by any reasonable legal theory, or if a colorable legal argument is presented about which reasonable attorneys could differ") (quoting *In re Levine*, 174 Ariz. 146, 153 (1993)). Nor does our decision resolve any substantive claim that arises out of contract. *See* A.R.S. § 12-341.01(A) (permitting an award of attorneys' fees in favor of the successful party in a contested action arising out of contract). However, as the prevailing party on appeal, Treeline is awarded its taxable costs incurred on appeal upon compliance with ARCAP 21(b).

S W A N N, Chief Judge, specially concurring:

¶16 I concur with the majority decision. I agree that the entry of default judgment is a drastic sanction that cannot be imposed absent a hearing. I write separately to emphasize that the court's authority to impose such a sanction is meaningful.

¶17 When a party significantly fails to prosecute, comply with the civil rules, or comply with a court order, the court has inherent and rule-based authority to enter case-dispositive sanctions. *Green*, 221 Ariz. at 149–50, ¶ 29; Ariz. R. Civ. P. ("Rule") 16(h)(1), 37(b)(2)(A), 41(b). In the context of discovery violations, we previously have cautioned that the court has "more limited" discretion when the sanction is case-dispositive. *Zimmerman v. Shakman*, 204 Ariz. 231, 235, ¶ 10 (App. 2003) (citation and quotation marks omitted). To be sure, "[w]henever possible, procedural rules should be interpreted to maximize the likelihood of a decision on the merits." *Allstate*, 182 Ariz. at 287. But recent changes to the civil discovery rules demonstrate that the court's discretion to impose authorized sanctions—even severe ones—is real, and that *Zimmerman* does not fully reflect the spirit of the new rule amendments. *See* Rule 37, cmt. ("Rule 37(d) now contains language underscoring the court's discretion to impose any

sanctions it deems appropriate in the circumstances [of a party or attorney's knowing failure to timely disclose damaging or unfavorable information], which in turn reinforces that the issuance of such sanctions is subject to review for abuse of discretion. . . . These amendments [to pleading, disclosure, and discovery rules] seek to achieve robust initial disclosure through a stronger and clearer mandate to impose sanctions under Rule 37 where in the court's discretion it is warranted, both for failures to disclose relevant material and for abuses of discovery."). The court therefore should not consider our decision today to signal that default judgment is unavailable as a sanction on remand.

AMY M. WOOD • Clerk of the Court
FILED: RB