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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

ELLISON FRAMING, INC.,

NO. CIV. S-11-0122 LKK/DAD

Plaintiff,

v.

O R D E R

ZURICH AMERICAN INSURANCE
COMPANY,

Defendant.

_____ /

Plaintiff Ellison Framing Inc. ("Ellison") brings an action for declaratory and injunctive relief as well as compensatory damages against Zurich American Insurance Company ("Zurich"), a corporation that provided plaintiff with Workers Compensation Insurance. Zurich has moved to stay the action and compel arbitration pursuant to an arbitration provision in the insurance deductible agreements between the parties and the Federal Arbitration Act. For the reasons described below defendant's motion is granted.

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2 **I. BACKGROUND**

3 Plaintiff Ellison is a California corporation that, through
4 its insurance broker, purchased and renewed Workers Compensation
5 insurance from defendant Zurich from March 2003 through March 2007.
6 Ellison's operations are apparently located entirely within
7 California. According to plaintiff, on November 15, 2010, Ellison
8 filed a complaint with the California Department of Insurance
9 claiming that it had been overcharged \$195,000.00 in improper fees
10 by Zurich. In December of 2010, Zurich made a demand for
11 arbitration with the American Arbitration Association, alleging
12 that Ellison owes it \$569,640.97 in unpaid deductibles, pursuant
13 to deductible agreements entered into by the parties.

14 The deductible agreements state in section "O" that "[a]ny
15 dispute arising out of the interpretation, performance or alleged
16 breach of this agreement, shall be settled by binding arbitration
17 administered by the American Arbitration Association (AAA) under
18 its Commercial Arbitration Rules" Dow Decl., Doc. No. 6-2
19 at 15 (Jan. 28, 2011). Section "O" additionally requires that
20 written notice requesting arbitration be sent by the initiating
21 party, and states that "[u]nless the parties under this Agreement
22 agree otherwise, arbitration shall take place in Schaumburg,
23 Illinois." Schaumburg is Zurich's principal place of business. Id.
24 at 15-16. During a conference call in preparation for the
25 arbitration hearing, the AAA determined that the arbitration would
26 be conducted in Schaumburg, despite objections to the venue raised
by Ellison. Dow Decl., Doc. No. 6-5 at 15 (Jan. 28, 2011). The

1 AAA's written confirmation of the decision cites only the venue
2 provision in the parties' agreement in support of its decision. Id.

3 Ellison responded by filing suit in the California Superior
4 Court on January 6, 2011, seeking declaratory and injunctive relief
5 on the grounds that the venue provision of the arbitration
6 agreement is unconscionable. Compl., Ex. 2, Doc. No. 1 at 14, 18
7 (Jan. 13, 2011). Ellison's complaint also requests compensatory
8 damages under a claim of "FRAUD/DECEIT/BAD FAITH-DAMAGES" due to
9 \$195,000 that Ellison claims were charged according to a fictitious
10 "cost containment" scheme by Zurich. Id. at 19. On January 13,
11 2011, defendant removed the action to this court on the basis of
12 diversity jurisdiction. Id. at 1. On January 28, 2011, Zurich
13 submitted a motion to stay the action and compel arbitration. Doc.
14 No. 5 (Jan. 28, 2011). Zurich has not filed an answer to the
15 complaint.

16 **II. STANDARD FOR A MOTION TO COMPEL ARBITRATION AND STAY**
17 **PROCEEDINGS**

18 A party to an arbitration agreement may move to compel
19 arbitration when the other party "unequivocally refuses to
20 arbitrate, either by failing to comply with an arbitration demand
21 or by otherwise unambiguously manifesting an intention not to
22 arbitrate." Paine Webber, Inc. v. Faraqalli, 61 F.3d 1063, 1066 (3d
23 Cir. 1995); 9 U.S.C. § 4. The motion to compel must be supported
24 by an independent basis for federal subject-matter jurisdiction
25 under Title 28 to be brought in federal court, such as diversity
26 of citizenship. Southland Corp. v. Keating, 465 U.S. 1, 15 (1984).

1 Once these requirements are met, and if the court is satisfied that
2 the agreement covers the dispute in question and a valid agreement
3 to arbitrate exists, the court must issue an order directing the
4 matter to arbitration. 9 U.S.C. § 4; see also Chiron Corp v. Ortho
5 Diagnostic Sys., Inc., 207 F.3d 1126, 1130 (9th Cir. 2000) (The
6 court's role is limited to determining whether a valid agreement
7 to arbitrate exists and whether the agreement encompasses the
8 dispute at issue.).

9 Section 3 of the Federal Arbitration Act ("FAA") provides that
10 if a court determines that an agreement is subject to arbitration,
11 it will stay litigation:

12 If any suit or proceeding be brought in any of the
13 courts of the United States upon any issue referable to
14 arbitration under an agreement in writing for such
15 arbitration, the court . . . upon being satisfied that
16 the issue involved . . . 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

17 9 U.S.C. § 3.

18 III. ANALYSIS

19 A. The AAA's decision as to venue may not be reversed 20 because the AAA met minimum standards of fair dealing.

21 Defendant argues that the court should not overturn the
22 venue decision already rendered by the AAA. Mot., Doc. No. 5 at
23 5 (Jan. 28, 2011). The law permits only limited judicial
24 scrutiny of an arbitration award. Aerojet-General Corp. v.
25 American Arbitration Ass'n, 478 F.2d 248, 252 (9th Cir. 1973).
26 "An arbitration award must be upheld unless it be shown that

1 there was partiality on the part of an arbitrator, or that the
2 arbitrator exceeded his authority, or that the award was
3 rendered in 'manifest disregard of the law.'" Id. (citations
4 omitted). Manifest disregard of the law is something beyond mere
5 error of law. Thompson v. Tega-Rand International, 740 F.2d 762,
6 763 (9th Cir. 1984).

7 In Aerojet-General Corp., the Ninth Circuit extended this
8 standard to venue decisions rendered prior to a final
9 arbitration award. Aerojet-General Corp., 478 F.2d at 252. The
10 court found this necessary to avoid frustrating the purpose of
11 arbitration, which is the speedy disposition of disputes. Id. at
12 251. The venue decision was upheld in Aerojet-General Corp.
13 because the contract expressly provided that the AAA would
14 select the locale for the arbitration. Id. at 252 n.3. In the
15 instant case, the parties' contract expressly provides that
16 arbitration will occur in Schaumburg, Illinois (Dow Decl., Doc.
17 No. 6-2 at 16 (Jan. 28, 2011)), the location selected by AAA
18 during the parties' conference call. Dow Decl., Doc. No. 6-5 at
19 15 (Jan. 28, 2011).

20 The arbitration provision at issue in this case states that
21 "[a]ny dispute arising out of the interpretation, performance or
22 alleged breach of this agreement" is subject to arbitration.
23 Based on this broad language, the venue provision within the
24 agreement is subject to arbitration. Accordingly, the AAA's
25 determination as to venue was within the scope of arbitrable
26 issues pursuant to the agreement. Plaintiff has not argued that

1 the AAA's venue decision exceeded the scope of its authority
2 under the agreement, or that the parties did not agree to allow
3 the arbitrator to make a venue decision. Further, plaintiff does
4 not claim and presents no evidence in support of a contention
5 that the AAA's venue decision violated the standards of fair
6 dealing noted above. The court, therefore, lacks the authority
7 to overturn the AAA's decision.

8 **B. The court declines to invalidate the arbitration**
9 **agreement as unconscionable.**

10 The district court has a duty to determine whether an
11 arbitration agreement is itself invalid. Nagrampa v. Mailcoups.
12 Inc., 469 F.3d 1257, 1264 (9th Cir. 2006). Plaintiff urges the
13 court to invalidate the venue clause of the arbitration
14 agreement as unconscionable because it is "financially
15 unfeasible" and designed to give Zurich an advantage or to
16 default its small business customers. Compl., Ex. 2, Doc. No. 1
17 at 3 (Jan. 13, 2011). In California, the prevailing view is that
18 both procedural and substantive unconscionability must be
19 present in order for the court to invalidate a contract.
20 Armendariz v. Found. Health Psychcare Serv. Inc., 24 Cal. 4th
21 83, 114 (2000).¹ Where a weaker party signs an arbitration

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23 ¹ Although a choice of law provision in the agreement appears
24 to provide that disputes are governed by New York law, Dow
25 Declaration, Doc. No. 6-2 at 17 (Jan. 28, 2011), both parties have
26 cited California law in their papers. Motion, Doc. No. 5 at 11
(Jan. 28, 2011); Opp'n, Doc. No. 9 at 6 (Mar. 11, 2011). It appears
to this court that the parties have by their conduct waived the New
York law provision. See Nagrampa, 469 F.3d at 1296 n.4. For the
first time in its reply memoranda, Zurich disputes Ellison's

1 agreement within a contract of adhesion, the court may find that
2 the agreement to arbitrate is procedurally unconscionable.
3 Discover Bank v. Super. Ct., 36 Cal. 4th 148, 160 (2005).

4 Plaintiff asserts that the forum clause is part of a
5 "standardized agreement drafted by a party in a superior
6 bargaining position." Opp'n, Doc. No. 9 at 4 (Mar. 11, 2011).
7 Defendant, however, provided the court with evidence that the
8 terms of the deductible agreements were actively negotiated by
9 the parties. Mot., Doc. No. 5 at 8 (Jan. 28, 2011). As Ellison
10 has not provided the court with evidence of Zurich's superior
11 bargaining position or of the adhesive nature of the agreement
12 other than these bare assertions, the court finds that the
13 negotiations lacked procedural unconscionability.

14 In sum, plaintiff's proof of substantive unconscionability
15 is lacking. Plaintiff asserts that the venue agreement is
16 unconscionable because plaintiff will be unable to preserve its
17 claim against the venue provision and, as such, the claim would
18 be rendered moot if plaintiff participates in the arbitration.
19 Plaintiff's assertion is circular, and the law does not support
20 its view. The rule of law raised by plaintiff is intended to
21 preclude parties from using "procedural gamesmanship" by
22 participating in arbitration, and later raising objections to

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24 unconscionability argument by raising the choice of law provision.
25 Reply, Doc. No. 11 at 4 (Mar. 21, 2011). The court typically cannot
26 consider arguments first raised in reply. Here, the court need
determine whether the argument was properly raised because, even
under California law, the court finds that defendant's motion
should be granted.

1 arbitration only when unsuccessful in the proceedings. Moncharsh
2 v. Heily & Blase, 3 Cal. 4th 1, 30 (1992). For example, in the
3 case cited by Ellison, the court found that the plaintiff had
4 not waived its claims against the arbitration provision even
5 though the plaintiff participated in proceedings, in large part
6 because plaintiff had raised objections before and during the
7 proceedings. Bayscene Resident Negotiators v. Bayscene Mobile
8 Home Park, 15 Cal. App. 4th 119, 129 (1993). In the present
9 case, the plaintiff has already objected to the venue provision,
10 and may further preserve its right by raising these claims
11 before the arbitrator. There is, therefore, no threat to
12 plaintiff's claim in compelling arbitration.

13 Plaintiff also asserts that arbitration in Illinois is
14 financially unfeasible. However, plaintiff has not provided any
15 evidence of this and, thus, the court cannot not find in its
16 favor on this point.

17 Finally, unless a party presents a challenge to the
18 arbitration clause itself, the validity of the agreement,
19 including a claim that it is unconscionable is considered by the
20 arbitrator and not the court. Nagrampa, 469 F.3d at 1268. Here,
21 the complaint challenges not the arbitration provision, but a
22 venue clause within the provision. Since the arbitrability of
23 the agreement is not challenged, it is appropriate for the
24 arbitrator to determine whether the venue clause is
25 unconscionable. For the foregoing reasons, the court determines
26 the venue provision does not preclude the court from granting

1 defendant's motion.

2 **C. Plaintiff's claim for fraud falls within the scope of**
3 **arbitration.**

4 Defendant asserts that plaintiff's claim for fraud must be
5 arbitrated. Mot., Doc. No. 5 at 10 (Jan. 28, 2011). The court's
6 role under the Federal Arbitration Act is limited to determining
7 "(1) whether a valid agreement to arbitrate exists and, if it
8 does, (2) whether the agreement encompasses the dispute at
9 issue." Chiron Corp. v. Ortho Diagnostic Sys., Inc., 207 F.3d
10 1126, 1130 (9th Cir. 2000). The arbitration agreement, the
11 validity of which is not challenged, encompasses "[a]ny dispute
12 arising out of the interpretation, performance or alleged breach
13 of [the deductible] agreement." Dow Decl., Doc. No. 6 at 15
14 (Jan. 28, 2011). It appears to the court that plaintiff's claim
15 against Zurich's "cost containment" fees falls within the scope
16 of the deductible agreement and is, thus, subject to
17 arbitration. Ellison has not contested defendant's assertion to
18 that effect. The court finds that this claim is arbitrable.

19 **D. The court uses its discretion to permit Zurich to file**
20 **a motion to stay in lieu of an answer to the**
21 **complaint.**

22 Plaintiff claims that Zurich is precluded from seeking the
23 relief it requests because Zurich has not yet filed an answer to
24 the complaint. Under Fed. R. Civ. P. 81(c)(2), "[A] defendant
25 who did not answer before removal must answer or present other
26 defenses or objections under these rules within the longest of

1 these periods: [¶] (A) 21 days after receiving - through
2 service or otherwise - a copy of the initial pleadings stating
3 the claim for relief; [¶] (B) 21 days after being served with
4 the summons for an initial pleading on file at the time of
5 service; or [¶] (C) 7 days after the notice of removal is
6 filed." Here, defendant filed its motion to compel arbitration
7 and stay proceedings within this time frame, but has not yet
8 filed an answer. In its motion, defendant did, however,
9 specifically request that the court stay its obligation to
10 answer.

11 A motion to stay is not expressly included in the list of
12 defenses that extend the amount of time necessary to file an
13 answer to a complaint. Federal Rules. Fed. R. Civ. P. 12(b).
14 However, federal courts have authority to hear "certain
15 pre-answer motions that are not expressly provided for by the
16 rules." Ritza v. Int'l Longshoremen's and Warehousemen's Union,
17 837 F.2d 365, 369 (9th Cir. 1988). The court's authority to hear
18 "motions to stay and motions to dismiss because another action
19 is pending" lies in the "inherent power of a court to regulate
20 actions pending before it." 5 C. Wright & A. Miller Federal
21 Practice and Procedure § 1360 (3d ed. & Supp. 2010). Several
22 district courts have permitted a party to file a motion to stay
23 in lieu of an answer. See Green Tree Financial Corp.- Alabama v.
24 Randolph, 531 U.S. 79, 83 (2000) (raising no concern that the
25 petitioners filed a motion to stay in lieu of an answer at the
26 district court level); Drescher v. Baby It's You, LLC, 2010 WL

1 3610134, *1 (E.D. Wisc. Sept. 13, 2010) (motion to stay filed in
2 lieu of an answer); DeGraziano v. Verizon Communications, Inc.,
3 325 F. Supp. 2d 238, 244 (E.D.N.Y. 2004) (same); Applied
4 Materials Inc. v. Semiconductor Spares, Inc., 1995 WL 261451, *1
5 (N.D. Cal. April 26, 1995) (same); Smith v. Pay-fone Systems,
6 Inc., 627 F. Supp. 121, 122-23 (N.D. Ga. 1985) (denying motion
7 for default judgment when defendant filed a late motion to stay
8 in lieu of an answer).

9 Plaintiff has not filed a motion for default. Because the
10 federal policy favors resolution of disputes on the merits over
11 default judgment, the court employs its discretion to permit
12 defendant to file its motion for a stay in lieu of an answer.
13 Smith v. Pay-fone Systems, Inc., 627 F. Supp. at 123.

14 **E. Zurich has not waived its right to seek relief.**

15 Plaintiff asserts that Zurich is required to enter a
16 special appearance in order to seek its stay of the action,
17 because by removing the case defendant is "submitting to this
18 Court's jurisdiction." Opp'n, Doc. No. 9 at 7 (Mar. 11, 2011).
19 Plaintiff cites no law in support of this assertion. To the
20 contrary, in the Supreme Court decision cited by the plaintiff
21 under this point heading, the district court considered a motion
22 to stay similar to the one before the court here. See Prima
23 Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967). No
24 special appearance seems to have been entered in that case, and
25 the Supreme Court affirmed the district court's grant of
26 defendant's motion. Id. at 400. This court therefore finds the

1 plaintiff's assertion is unsupported and find no waiver on the
2 part of the defendant.


3 **IV. CONCLUSION**

4 For the foregoing reasons, the court GRANTS defendant's
5 motion to stay the instant action and compel arbitration (Doc.
6 No. 5).

7 The Clerk of Court is instructed to ADMINISTRATIVELY CLOSE
8 this case. Plaintiff is instructed to inform the court to re-
9 open the case within fourteen (14) days of the completion of
10 arbitration.

11 IT IS SO ORDERED.

12 DATED: April 4, 2011.

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16 LAWRENCE K. KARLTON
17 SENIOR JUDGE
18 UNITED STATES DISTRICT COURT
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