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Focus

An Obligation to Arbitration?

By Richard Chernick

California attorneys are obligated to submit to non-binding arbitration of fee disputes with clients before a local bar association if the client timely demands it, according to the Mandatory Fee Arbitration Act, California Business & Professions Code Section 6201(a), 6200(c). The attorney may also require the client to agree to arbitrate such disputes on a non-binding basis. Business & Professions Code Section 6200(c). The lawyer and client are free to reject any arbitration award and seek a trial *de novo*.

Is that right to a trial *de novo* altered by a predispute binding arbitration agreement (for example, in a retainer or fee agreement), such that if the client rejects the fee arbitration award the matter may be resolved by binding arbitration? In *Alternative Systems Inc. v. Carey,* 67 Cal. App. 4th 1034 (1998), the court held that "trial *de novo*" means just that — the client is intended to be protected by the mandatory fee arbitration statute by the right to proceed to trial in the event the fee arbitration award is rejected; therefore, a predispute agreement for binding arbitration between attorney and client is not enforceable.

This ruling was limited in *Aguilar v. Lerner*, 32 Cal. 4th 974 (2004). There, the client had not elected Mandatory Fee Arbitration Act arbitration but later attempted to avoid the effect of a predispute arbitration agreement with the attorney by insisting on a trial *de novo* under the act rather than binding arbitration. The *Aguilar* majority held that by not electing the Mandatory Fee Arbitration Act initially, the client waived all rights under the act, including the right to a trial *de novo,* and therefore was bound by the predispute arbitration agreement. Justice Ming Chin, in a concurring opinion, argued that the Mandatory Fee Arbitration Act's trial *de novo* provision was not intended to override a contractual obligation to arbitrate disputes under the California Arbitration Act, and suggested that the holding of *Alternative Systems, supra*, should be disapproved. His argument did not carry the day in 2004, but the California Supreme Court finally adopted his reasoning and conclusion in *Schatz v. Allen Matkins Leck Gamble & Mallory LLP*, 2009 DJDAR 1190 (Jan. 26, 2009), in which the court determined that the act does not limit the ability of attorneys and clients to enter into enforceable predispute arbitration agreements.

One is hard-pressed to think of another type of commercial transaction in which the parties' mutual choice of a predispute arbitration agreement is forbidden as a matter of statutory law.

Richard Schatz retained Allen Matkins in connection with a partnership dispute. He signed a retainer agreement that contained the following language: "If you do not agree to arbitrate disputes with us, simply line out this section. Arbitration is not a precondition to us representing you. By signing this letter without deleting this section, you agree that, in the event of any dispute arising out of or relating to this agreement, our relationship, or the services performed (including but not limited to disputes regarding attorneys' fees or costs ...), such dispute shall be resolved by submission to binding arbitration in San Diego County, California, before a retired judge or justice." The client signed the agreement without lining out the arbitration section. The agreement also stated that it would apply to "any additional matters we handle on your behalf or at your direction."

In a later matter with the same client involving an easement, Allen Matkins claimed it was owed $169,000 and when no response was forthcoming invoked the arbitration provision of the retainer agreement. The client claimed the arbitration clause did not apply because the agreement did not refer to the easement dispute and because the agreement to arbitrate was unenforceable under *Alternative Systems, supra*. He demanded arbitration under the Mandatory Fee Arbitration Act and insisted on his right to a trial *de novo*, if later elected. The law firm served notice under the act; the Mandatory Fee Arbitration Act arbitration, before the San Diego Bar Association, resulted in an award for the law firm. Schatz sought a trial *de novo* and Allen Matkins petitioned to compel arbitration under the retainer agreement. The trial court denied the petition, agreeing with Schatz that *Alternative Systems Inc.* prevented enforcement of the predispute agreement. The Court of Appeal agreed with the trial court, and the Supreme Court granted review.

The California Arbitration Act represents a comprehensive statutory scheme regulating private contractual arbitration. The Legislature has expressed a strong public policy in favor of arbitration. The California Arbitration Act establishes rules for the conduct of such proceedings subject to party-agreed variances in procedure. Awards are binding.

The Mandatory Fee Arbitration Act is a separate and distinct arbitration scheme proposed by the State Bar Board of Governors to address the serious problem of disputes over fees and costs and the disparity in bargaining power in attorney fee matters that favor the attorney in dealing with clients who are infrequent consumers of legal services. The right to arbitration is statutory, requiring no prior agreement. And the right to arbitrate is voluntary for the client but mandatory for the lawyer if commenced by the client. Awards are non-binding unless the parties agree, after the dispute has arisen, that the award shall be binding.

The client in *Schatz* made two arguments that the Mandatory Fee Arbitration Act prevents the enforcement of a predispute binding arbitration agreement between attorney and client where the client elects

non-binding arbitration of the dispute under the act. The first is that Section 6204 provides that the client is entitled to a "trial" after the non-binding arbitration is concluded, if timely elected, thereby barring enforcement of a predispute arbitration clause. But Section 6201(c) suggests the possibility that a proceeding other than a civil action might be agreed between the parties (such as a predispute arbitration agreement), and when read together those two sections suggest that a "trial" is not the only possible dispute resolution mechanism that is available after a client rejects the non-binding award under the act. Thus, once the Mandatory Fee Arbitration Act arbitration process is completed or terminated, leaving one party dissatisfied, "the action *or other proceeding* may thereafter proceed subject [only] to the provisions of Section 6204." Reading these two provisions together, the court found no limitation by the reference to "trial" in Section 6204 to a civil action only.

The second argument made by Schatz was that the Mandatory Fee Arbitration Act, adopted after the California Arbitration Act, impliedly repealed the latter. This argument was rejected because the two statutes deal with different things and because the Mandatory Fee Arbitration Act does not purport to make predispute arbitration agreements between attorney and client unenforceable.

The *Alternate Systems* case put lawyers in the unique position of not being able to choose binding arbitration for the resolution of a fee dispute with a client that remains after the parties have participated in the mandatory non-binding process. One is hard-pressed to think of another type of commercial transaction in which the parties' mutual choice of a predispute arbitration agreement is forbidden as a matter of statutory law. "In enacting Section 2 of the [Federal Arbitration Act], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Perry v. Thomas,* 482 U.S. 483 (1987). See also *Moses H. Cone Memorial Hospital v. Mercury Construction*, 460 U.S. 1 (1983).

The U.S. Supreme Court has consistently applied these principles to the adjudication of statutory as well as common law claims in spite of any special protected status of such rights. E.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614 (1984) (antitrust laws); *Rodriguez de Quijas v. Shearson/American Express Inc.*, 490 U.S. 477 (1989) (securities law); *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987) (RICO); *Gilmer v. Interstate/Johnson Lane Corp.,* 500 U. S. 20 (1991) (age discrimination in employment); and *Preston v. Ferrer,* 2008 DJDAR 2511, finding that a statutory labor commissioner proceeding may not displace predispute arbitration agreement between client and his manager.

Thus, in *Doctor's Associates Inc. v. Casarotto,* 517 U.S. 681 (1996), the Supreme Court found a Montana statute that required contracts containing arbitration clauses to so state "typed in underlined capital letters on the first page of the contract" to be pre-empted by Section 2 of the Federal Arbitration Act. The court noted that "Congress [in enacting the Fedreal Arbitration Act] precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts'" quoting *Scherk v. Alberto-Culver Co.*, 417 U. S. 506 (1974). These principles are applicable to all proceedings governed by federal law. 9 U.S.C. Section 2; *Allied Bruce-Terminix Companies Inc. v. Dobson*, 513 U.S. 265 (1995), which dealt with the extremely broad definition of "transaction involving commerce" under Section 2 of the Federal Arbitration Act.

The only "policy" that might affect the enforceability of binding attorney-client arbitration agreements is that contained in the mandatory fee arbitration statute. Unquestionably, the state has the right to require attorneys, as a matter of the regulation of the legal profession, to submit initially to a non-binding process; but the notion that the Legislature intended to prevent formation of an enforceable pre-dispute arbitration agreement in lieu of a trial de novo, or that it could lawfully do so, is contrary to pronouncements of our courts regarding arbitration as a desirable dispute resolution choice and party autonomy in selecting resolution modes for their disputes.

Richard Chernick is an arbitrator and mediator and is managing director of the JAMS arbitration practice. He is a co-author of The Rutter Group's "California Practice Guide — Alternative Dispute Resolution."