ARBITRATION ADVISORY

01-01

IMPACT OF THE TRUTH IN LENDING ACT AND RETAIN INSTALLMENT SALES ACT UPON ATTORNEY-CLIENT FEE DISPUTES

May 31, 2001

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Questions have arisen concerning whether the federal Trust In Lending Act [15 U.S.C. section 1601 et seq.] (hereinafter "TILA") and the Retail Installment Sales Act [Civil Code section 1801 et seq.] (hereinafter "RISA") apply to attorney-client fee contracts and to what extent arbitrators may need to consider the application of these laws in an arbitration hearing.

SUMMARY OF RECOMMENDATION

It is permissible for an arbitrator to determine whether there has been a violation of TILA or RISA and to accordingly deny an award of interest to an attorney or give effect to a right of rescission of a security interest. Because the Business and Professions Code does not permit arbitrators to award affirmative relief, arbitrators should not award statutory penalties or attorney's fees that would otherwise be recoverable under TILA or RISA in a civil action.

The Committee does not recommend that arbitrators aggressively seek to make determinations involving complex issues under these consumer credit laws. However, where there is an obvious violation, it would be inappropriate to recognize a security interest against a client's property or to grant an award of interest.

GENERAL BACKGROUND

This advisory will attempt to provide guidance to arbitrators with respect to

compliance with TILA and RISA in the context of fee arbitration proceedings. TILA and RISA are complex statutes, as are the regulations promulgated thereunder. This advisory is not intended in any way to be a complete analysis of the statutory requirements. Rather, the purpose is to make arbitrators and practitioners aware of the potential application of the statutes and to provide a very generic analysis of the statutory requirements and remedies for non-compliance. Arbitrators and practitioners are encouraged to conduct further research in this admittedly difficult area of law.

TILA and RISA (RISA is also known as the Unruh Act) impose restrictions and disclosure requirements on certain contracts that provide for the accrual of interest or that allow deferred payments. In general, TILA and RISA do not apply to such contracts in commercial or business settings. However, TILA and RISA will apply to such contracts where the money, property or services which are the subject matter of the transaction are primarily for personal, family or household purposes. Attorney-client fee agreements for estate planning, personal injury, criminal defense, adoptions, family law, and other matters of a personal nature are probably subject to TILA and RISA requirements if those agreements provide for the accrual of interest or allow deferred payments.

It should be noted that the requirements of the federal TILA are independent of those of RISA. TILA does not annul, alter, or supercede California's RISA statute except to the extent that California law is inconsistent with TILA, and then only to the extent of the inconsistency [15 U.S.C. section 1610(a)]. For a discussion of whether state law is inconsistent with TILA, see 12 C.F.R. section 226.28(a)(1).

THE TRUTH IN LENDING ACT

Applicability

Unlike California's RISA, TILA is solely a disclosure statute. It does not limit the amount or rate of finance charges. Rather, TILA imposes formal disclosure requirements and provides remedies if the disclosures are not made. TILA applies to persons or organizations involved in regularly extending consumer credit subject to a finance charge (i.e., the charging of interest) or payable by written agreement in more than four installments, regardless of whether or not interest is charged. TILA defines consumer credit as credit offered or extended to a natural person primarily for personal, family or household services [15 U.S.C. section 1602(h)]. One who offers such credit must comply with the TILA disclosure requirements regardless of whether the credit is extended in connection with a loan, the sale of property or the rendition of services [15 U.S.C. section 1602(f)].

The trigger of TILA's requirements is the consumer's ability to make deferred payments under the terms of the contract. Whenever interest is charged, the client is

being permitted to make deferred payments and pays for the privilege. However, when the client is permitted to make payments in more than four installments, TILA will apply regardless of whether or not interest is charged. Conversely, where the contract expressly prohibits deferred payments and requires that all payments to be timely made without exception, TILA would not appear to apply. In fact, when the contract does not permit deferred payments, the imposition of a late charge will not be considered a finance charge [12 C.F.R. section 226.4(c)].

The committee has not been able to locate any case law in California which specifically holds that TILA is applicable to an attorney's fee agreement. However, at least two federal cases have spoken on the subject. In Dougherty v. Hoollihan Neils & Boland, Ltd. (D. Minn. 1982) 531 F.Supp. 717 it was specifically held that TILA was applicable to an attorney-client fee contract and to a client's efforts to rescind a security interest that the attorney had obtained in the client's homestead. The transaction at issue involved legal services in: (1) the sale of personal property from the client's farm; (2) the purchase of pigs; and (3) the defense of a charge of felony theft of pigs. The court determined that the services were related to either the client's household or personal needs and to a personal interest in defending the felony complaint. Because the client had signed a secured, interest-bearing promissory note for the payment of past due legal fees, and because the required disclosures had not been made, the attorney was found liable for statutory damages, attorneys' fees and costs. In addition, the client was able to successfully rescind the promissory note and security agreement.

More recently, the Dougherty case was distinguished on factual grounds by the Eleventh Circuit. In Bonfiglio v. Nugent (11th Cir. 1993) 986 F.2d 1391, the court held that TILA was inapplicable to an ex-husband's court-ordered installment payments to his ex-wife's attorney as payment on an award of attorneys' fees arising out of their divorce. The key factual distinction in Bonfiglio was that the ex-wife's attorney had not "offered or extended" credit to the ex-husband. In fact, the court found it frivolous to contend that the Truth In Lending Act applies either to a debt created by a court order requiring one party to pay another's fees and costs or to a retained payment plan ordered by the court or worked out by the parties. "Credit" as the term is used in TILA "manifestly does not include court judgments or orders." [Id. at 1393]. Other than distinguishing Dougherty on factual grounds, the Bonfiglio court did not comment on the application of TILA to attorney-client fee agreements in general.

Requirements

Under TILA, the person or organization offering the consumer credit must comply with the disclosure requirements of Regulation "Z" [See U.S.C. section 1638(a); 12 C.F.R. section 226]. The disclosure requirements are very complex and will not be described here in detail. Generally, however, the requirements relate to the itemization and disclosure of the amount financed, the annual percentage rate, and notice to the

consumer of a right of rescission.

Remedies For Non-Compliance

TILA imposes specific statutory remedies available to a person who has entered into a contract that does not comply with the disclosure requirements. As discussed below, Business & Professions Code section 6203 prohibits arbitrators from awarding some of these remedies in the context of an arbitration proceeding.

Under TILA's statutory penalty provisions, a creditor can be liable to the consumer in an amount equal to twice the amount of the finance charge imposed, but not less than $100 nor more than $1,000 [15 U.S.C. Section 1640(2)(a)]. This statutory penalty may be recovered without proof of actual damages [Hinkle v. Rock Springs Natl. Bank (10th Cir. 1976) 538 F.2d 295, 297]. Once a court finds a violation, there is no discretion with regard to imposition of the penalties [Grant v. Imperial Motors (5th Cir. 1976].

TILA also provides that, in any consumer credit transaction in which a security interest on the consumer's principal dwelling is obtained, the consumer has the right to rescind the transaction until midnight of the third business day following consummation of the transaction or following delivery of the disclosure as required by the statute, whichever is later. A failure to disclose this right of rescission leaves the contract open to rescission by the consumer at any time up to three years after the date on which the transaction was consummated [15 U.S.C. 1635(f)]. Consequently, a security interest taken by an attorney pursuant to a retainer agreement may be avoided if the client was entitled to receive TILA disclosures and the requirements of the statute were not satisfied.

TILA also provides that a consumer may recover costs and attorneys fees incurred in prosecuting a TILA claim.[1]

Notwithstanding the broad remedies provided by TILA, the Committee does not believe that arbitrators may award statutory penalties or attorneys' fees pursuant to TILA. Because Business and Professions Code section 6203(c) prohibits arbitrators from awarding affirmative relief to clients, it appears that arbitrators do not have jurisdiction to award such penalties or attorneys' fees in fee arbitration proceedings. This should not have the effect of prohibiting clients from recovering such fees or penalties in a subsequent civil action, however, as the lack of jurisdiction would

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[1] Arbitrators should be mindful of the provisions of other requirements governing the taking of a security interest in a client's property by an attorney such as Rule 3-300 of the Rules of Professional Conduct.

preclude a *res judicata* effect. On the other hand, arbitrators who find violations of TILA or RISA in attorney-client fee agreements may deny an award of interest to the attorney or give effect to a client's right of rescission.

THE RETAIL INSTALLMENT SALES ACT

Applicability

Although the definitions used by RISA are different than those used by TILA, RISA's applicability is essentially the same. RISA defines a "retail installment sale" as furnishing services for a deferred payment price payable in installments [Civil Code section 1802.5]. A "retail seller" is any individual, partnership, corporation, association, or other group, however organized, which is engaged in the business of selling goods or furnishing services [Civil Code section 1802.3]. The definition of "services" includes work, labor, and services for other than commercial or business use [Civil Code section 1802.2]. Although there are exceptions for services provided by certain professionals such as physicians and dentists, there is no exception in the statute for attorneys [Id.]. As a result, RISA may apply to an attorney's contract for services which provides for payments in installments in any context where the services are not for commercial or business use.

Like TILA, RISA provides that a contract that does not permit payments to be made in installments may provide for the imposition of a delinquency charge and reasonable collection costs in the event of late payment without triggering RISA's disclosure requirements. However, the delinquency charges may not exceed ten dollars if late more than ten days or fifteen dollars if late more than fifteen days. Only one such delinquency charge may be collected on a delinquent payment, regardless of the length of time in which it remains in default [Civil Code section 1803.6].

Requirements

In addition to disclosure requirements, RISA prohibits certain contractual provisions [Civil Code section 1804.1] and places restrictions on repossessions and re-sales [Civil Code section 1812.2 et. seq.]. There are also specific requirements in RISA that pertain to periodic billing statements. RISA does not limit, however, the interest rate which may be charged or collected on a retail installment contract as long as the finance charges have been disclosed as required by Civil Code section 1810.3.[2]

A significant portion of RISA's disclosure requirements refer to TILA. Persons

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[2]Note, however, that a rate charged by an attorney may be unconscionable under Rules 4-200 of the Rules of Professional Conduct.

extending consumer credit must comply with the disclosure requirements of Regulation Z, as well as other notice requirements. Under RISA, the disclosure requirements and penalties are set forth in Civil Code section 1799.90 through 1799.99. There are specific notice requirements, requirements for various notices to be given in both Spanish and English, and requirements as to the size, placement and content of notices as well as other detailed provisions.

Remedies For Non-Compliance

The statutory penalties for non-compliance with RISA are found at Civil Code sections 1812.7 and 1812.9. As is the case with TILA, the statutory remedies available to consumers are limited in a fee arbitration proceeding. The full panoply of remedies under RISA include the right of the consumer to recover an amount equal to three times the total of any finance and delinquency charges imposed. The creditor would be barred from recovering any such charges. In addition, RISA also provides for attorneys' fees, costs and penalties to be awarded to the prevailing party. However, as with TILA, the Committee recommends that arbitrators refrain from awarding attorneys' fees, costs and penalties in the context of fee arbitration proceedings in accordance with Business and Professions Code Section 6203(c).

CONCLUSION

If an arbitrator determines that an attorneys' fee agreement violates TILA or RISA, the arbitrator may deny an award of interest to the attorney and/or allow the client to rescind any security interest to which the statute applies. However, awards of penalties or attorneys' fees pursuant to TILA or RISA should not be rendered by arbitrators as such awards would violate Business & Professions Code section 6203(c).

Due to the complexity of the statutes involved, it is strongly recommended that arbitrators review the statutory provisions prior to making an award. The Committee cautions arbitrators that this advisory does not contain an exhaustive analysis of all applicable provisions of TILA or RISA. Arbitrators should be especially careful to review the statutory requirements independently and seek guidance where necessary before rendering a decision in a case where these consumer statutes may be applicable.