AGENDA ITEM

MARCH
Revisions to Minimum Standards for MFA Programs -Request for Public Comment

DATE: February 1, 2010

TO: Members, Discipline Oversight Committee

FROM: Joel Mark, State Bar Presiding Arbitrator
Jill Sperber, Director, State Bar Office of Mandatory Fee Arbitration

SUBJECT: Proposed Revisions to the State Bar's Guidelines and Minimum Standards for the Operation of Mandatory Fee Arbitration Programs – Request for 45-day Public Comment Period.

EXECUTIVE SUMMARY

The State Bar of California publishes "Guidelines and Minimum Standards for the Operation of Mandatory Fee Arbitration Programs" ("Minimum Standards") to provide local bar associations with Board-approved standards for operating a mandatory fee arbitration program that complies with the Business and Professions Code (Article 13, Bus. & Prof. Code, §6200 *et seq*. or "the Statute") and relevant law. The State Bar's Mandatory Fee Arbitration (MFA) Committee proposes and recommends that revisions to two of the Minimum Standards be released for public comment.

The first proposal would modify Minimum Standard paragraph 16 covering required language for MFA awards. The proposed revision would delete the option for pre-award interest and provide for automatic post-award interest. This amendment would update the Minimum Standards as to required award language consistent with the suggested award template developed by the MFA Committee last year used by the local bar programs.

The second proposed revision would add new language to Minimum Standard paragraph 19 that would prohibit local bar programs from placing as a condition to obtaining a three-member panel a requirement that the parties waive their right to non-binding arbitration and agree instead to binding arbitration. Under the Minimum Standards, MFA cases with an amount in dispute above a reasonable minimum are heard by three member panels consisting of two attorneys and a lay person. Currently, four local bar programs have rules or practices that require the parties (or at least the petitioner) to waive non-binding MFA in order to obtain a three member arbitration panel in cases where the monetary threshold has otherwise been met. The MFA Committee believes that, to properly execute the MFA statutory scheme, local MFA programs must not condition the benefit of a three-member panel upon the parties waiving the non-binding option expressly provided by the statute.

This item seeks authorization from your Committee to release the revisions to the Minimum Standards set forth in Attachment A for a 45 day public comment period.

Questions concerning this item may be directed to Jill Sperber (415) 538-2023 or jill.sperber@calbar.ca.gov.

I. BACKGROUND

Under the Mandatory Fee Arbitration Statute (Bus. & Prof. Code §6200 *et seq*.), the State Bar must provide a system for the resolution of attorney-client disputes over fees and costs that is "fair, impartial and speedy." Most MFA arbitrations are provided by local bar programs. (Bus. & Prof. Code § 6200(d).) To effectuate the mandate of the Statute, and to provide consistency for the local bar programs, the State Bar publishes "Guidelines and Minimum Standards for the Operation of Mandatory Fee Arbitration Programs" ("Minimum Standards") that articulate the minimum standards that must be met by local programs that elect to provide MFA services.

The Minimum Standards also provide local bar programs with Board-approved standards for operating a mandatory fee arbitration program that complies with the Statute and other relevant law. Several years ago, the MFA Committee developed Model Rules of Procedure for Fee Arbitrations to assist the local bars in complying with the Statute and Minimum Standards as well as promote uniformity among the 44 local bar programs. While not mandatory, to date, most local bar associations have adopted the State Bar's Model Rules in whole or part. While local bar rules of procedure for fee arbitrations may address local needs, they must at a minimum comply with the Minimum Standards and be approved by the Board of Governors or its designated committee. The most recent revision to the Minimum Standards was effective July 20, 2007.

II. PROPOSED REVISIONS TO THE MINIMUM STANDARDS

To address two concerns regarding MFA proceedings under the jurisdiction of local bar programs, and to ensure the Minimum Standards provide appropriate guidance to all local bar programs, the MFA Committee recommends and requests release for public comment the following two proposed amendments to the Minimum Standards.

A. Facilitating Appropriate Awards of Post-Award Interest

To encourage inter-program uniformity and compliance with the Statute and the Minimum Standards, and to make local program awards more uniform and enforceable, last year the MFA Committee developed a sample MFA award template that was provided to the local bar programs. Paragraph 16 of the Minimum Standards sets forth the minimum requirements for inclusion in MFA awards.

Paragraph 16 currently requires the inclusion of the option for pre-award interest in the template. The thirty-year experience with awards of interest in MFA awards, however, has been that, because most MFA awards involve "reasonable value" determinations, among other reasons, pre-award interest is almost never appropriate under the law.

On the other hand, Paragraph 16 is silent regarding the inclusion of an option for the award of post-award interest. Yet, once the award is rendered and a fair period of

time is provided for payment, post-award interest upon unpaid awards is almost universally appropriate. And, unlike a civil judgment, there is no statutory authority for automatic post-award interest unless it is specifically awarded by the arbitration panel.

While drafting the current sample award template, the MFA Committee noticed that the pre-award option in Minimum Standard paragraph 16's award language was present (suggesting a need to make such an award despite the fact that such an award is rarely appropriate in the vast majority of MFA awards), while at the same time, paragraph 16 omitted the far more relevant award of post-award interest on any principal amount awarded to a party (thus failing to highlight for the arbitrators the need for making such an award so that the party found to be owed money will be entitled to interest on the award if not paid within a reasonable period of time).

This lack of specificity with respect to post-award interest has in the past created frustration for the winning party, whether it has been the lawyer or the client. It also has created a dilemma for State Bar enforcement when the client requests State Bar enforcement pursuant to Business & Professions Code section 6204(d). While the client will inevitably insist that post-award interest be included, and the assumption that interest applies is logical, the automatic accrual of interest is not provided by statute. And, where no post-award interest is awarded by the arbitrators, the party against whom the award is made has an unnecessary incentive to delay payment or, in the case of attorneys, resist enforcement in ways that create additional effort on the part of State Bar personnel involved in the enforcement of awards.

Accordingly, to put awards of interest into the proper perspective for MFA arbitrators, and to address the frustration so often experienced when no post-award interest is included when a monetary award is made, the MFA Committee amended its sample award template to remove the boilerplate inclusion of pre-award interest and to include a line for the award of post-award interest when an award of money is given to either party, commencing after 30 days following service of the award.[1] Also, to clarify that pre-award interest may be awarded in the rare cases where it may be appropriate, arbitrators also receive instructions with the standard award template explaining that such awards can be made and explaining when it may be appropriate to do so.

A modification of Paragraph 16 of the Minimum Standards simply would "codify" this change in the standard award template and help arbitrators make awards of interest that are more regularly in compliance with the law, and that fairly compensate parties who are awarded monetary relief for any unreasonable delays in payment of the sums awarded.

[1] Interest commences on the 30th day after service because parties are entitled to reject a non-binding award and file for a trial in court if filed within 30 days of service of the award. (Bus. & Prof. Code §6204 (b),(c).)

B. Proposed Standard to Prohibit Conditioning a Three Member Panel Upon Waiver of the Non-Binding Arbitration Option

1. The Hallmarks of Mandatory Fee Arbitration

The virtue of the Mandatory Fee Arbitration program as a remedial consumer protection program was emphasized by the court in *Liska v. The Arns Law Firm* (2004) 117 Cal. App.4th 275, 281-82:

> "The policy behind the mandatory fee arbitration statutes…is to alleviate the disparity in bargaining power in attorney fee matters which favors the attorney by providing an effective inexpensive remedy to a client which does not necessitate the hiring of a second attorney.(Hargarten [*Fine Tuning California's Mandatory Attorney Fee Arbitration Statute* (1982)] 16 U.S.F. L.Rev. 411, 415.) The process favors the client in that only the client can elect mandatory fee arbitration of a fee dispute; the attorney must submit the matter to arbitration if the client makes that election." (*Manatt, Phelps, Rothenberg & Tunney v. Lawrence* (1984) 151 Cal. App.3d 1165, 1174-1175; see also *Huang v. Cheng* (1998) 66 Cal.App.4th 1230, 1234.)

There are two unique characteristics of the Mandatory MFA statutory scheme that are essential to effectuating the purposes of the Statute. First, unlike most contractual arbitration, the MFA Statute guarantees the right to non-binding arbitration, with a collateral right to a new trial in court (or as confirmed by recent case law, private arbitration if the parties have a pre-existing arbitration agreement) in the event the parties are dissatisfied with the award. However, if neither party seeks a new trial, the non-binding award becomes binding by operation of law. (Bus. & Prof. Code §6203(b).) Business & Professions Code section 6204(a) permits binding arbitration, but only if such agreement is made between the parties in writing and entered into after the fee dispute has arisen. The safeguard of non-binding arbitration may not be waived by the fee agreement or in any other manner in advance of a dispute actually arising.

Second, for many fee disputes above a reasonable monetary threshold, the parties are entitled to a three-member panel where one panel member is required to be a non-attorney. Where a single-member panel is appropriate, the arbitrator must be an attorney. (Bus.& Prof. Code §6200(e)(2.).) Where a three-member panel is appropriate, the Statute guarantees that one member <u>must</u> be a lay member with no past or present connection with the legal profession. (Bus. & Prof. Code §6200(e)(1).)

Providing for non-binding arbitration at the election of either party, and ensuring one lay member will serve on all three-member panels, evidences a distinct legislative recognition of the need for consumer confidence and comfort in the fee arbitration process. And, for many clients, most of whom are in pro per facing a fee dispute through arbitration with a lawyer and offered by a program sponsored by a

lawyer-funded and lawyer-oriented bar organization, the guarantees of a non-binding decision by an arbitration panel with one non-lawyer in fact provides a level of comfort and perceived fairness that encourages far greater use of MFA programs by consumers than likely would be the case without both guarantees.

The MFA Statute does not provide specific guidance as to when a three member panel may be appropriate. However, the current Minimum Standards establish some guidance by focusing on the amount in dispute. Paragraph 19 provides that, if local bar rules provide for a monetary threshold for the appointment of a three member panel, it must be "reasonable." The reasonableness standard encourages programs to strive to provide three-member panels by setting a threshold within reach of many parties. Neither the statute nor the Minimum Standards contemplate that entitlement to a three-member panel be based on anything else, much less a requirement that the parties waive their right to non-binding MFA arbitration.

2. **Requirement of Waiver of Non-binding Option to Obtain a Three-member Panel**

The Board of Governors is obliged to "review the local bar rules to insure that they provide for a fair, impartial, and speedy hearing and award." (Bus. & Prof. Code §6200(d).) Currently, the rules or policies of four local bar programs (out of 44 total programs) have some requirement that the client or both parties waive their right to non-binding arbitration in order to obtain a three-member panel. The remaining 40 programs have no such requirement. Of the four programs with this requirement, some of their rules were previously approved by the Board and in one program, are soon to be updated. In one of the programs, the requirement is a practice stated on the intake forms but not embodied in their approved rules. After discussing these local requirements that parties waive their right to non- binding arbitration to obtain a three-member panel, the MFA Committee has concluded that these policies do not comport with the MFA statutory scheme for the following reasons.

First, the MFA scheme rests on the fundamental consumer oriented rights of non-binding MFA and, depending on a reasonable amount in dispute threshold, a three-member panel consisting of one lay person. Moreover, the statutory provision for binding arbitration rests on the voluntary agreement between the parties only. The only other way an award may become binding is by operation of law, but only if neither party timely rejects the award by seeking a new trial.

Permitting local program rules to abrogate the election of non-binding arbitration takes away statutory rights from the parties. It also conceivably discourages use of the MFA system by consumers. However, based on the lack of objection by parties who notify the State Bar, it is highly suspected that parties either simply accept binding arbitration without appreciating their statutorily guaranteed options in order to obtain a three member panel or pursue non-binding arbitration before a single arbitrator despite meeting the dollar threshold for a three member panel.

Second, some of the policies in question require only the petitioner (usually the client) to agree to binding while others require both parties' agreement (both sides must agree). This disparately impacts the client in the vast majority of cases. Since the respondent attorney may refuse binding arbitration and insist upon non-binding arbitration, the client's agreement to accept binding arbitration or offer to agree to binding arbitration, presumably made to obtain the benefit of a three member panel, is essentially voidable by the lawyer. When the lawyer rejects binding arbitration, the matter will proceed as a non-binding arbitration before a single arbitrator despite the client's agreement to binding arbitration.[2]

3. **The Local Bars' Rationale for the Binding Requirement**

The local bars which require that the parties waive non-binding arbitration as a condition to obtaining a three-member panel offer several rationales: 1) the need to cater to volunteer arbitrators favoring binding arbitration; 2) the perceived extra time and resources required for the program to assign and coordinate a three-member panel and 3) the presence of the State Bar as the "default" program for parties seeking non-binding arbitration with a three member panel.

The first rationale, that programs must cater to volunteer arbitrator perceived or real bias for binding arbitration, does not establish its soundness in the law. The MFA Committee believes that arbitrator bias or preference for binding arbitration should not control program policy, especially where it results in a requirement that parties waive important rights afforded by the Statute.

The arbitrators are volunteers from the program's local community. They must either serve the program faithfully by abiding by the statutes and program rules, or stop volunteering in this capacity. In addition, while complaints are known to be made by arbitrators that their time is too valuable to hear non-binding arbitrations, as the MFA Committee arbitrator training programs teach, writing a non-binding award actually is more challenging since the award must be adequately persuasive to encourage parties to accept the award and not pursue post-arbitration relief. Also, there is no evidence that local programs actually have lost significant numbers of arbitrator volunteers because they are assigned to non-binding arbitrations. And, in all events, those unyielding arbitrators who insist on handling only binding arbitrations still can be assigned to the cases where the parties agreed to binding arbitration.

The second rationale does not really address the policy. The program expends the same time and resources assigning a three-member panel whether the matter is binding or not. The fact that the arbitration is binding does not impact this expenditure. However, since clients, theoretically at least, will want a lay person on the panel, the client will accede to the program's condition and accept binding to obtain this benefit.

[2] One program advises that it is the program's policy to grant the client a three member panel anyway in the event of the lawyer's rejection of binding arbitration.

A trend in recent years by other programs to address the perceived added resource problem of assembling three-member panels is to raise the monetary threshold for three-member panels to higher levels, such as $15,000 or $25,000, up recently from former lower threshold amounts such as $7,500 and $10,000. The MFA Committee has accepted and recommended the adoption of these higher amounts as being consistent with the Minimum Standards to keep up with inflation and to respond to program concerns about the greater resource commitment required by three-member panel assignments. However, higher thresholds than $25,000 have been rejected as not reasonable and thus not in compliance with the Minimum Standards. In all events, however, the second rationale does not in practice justify the requirement that the parties waive important statutory rights.

The third rationale, that the State Bar is available as a safety valve, is more complicated. First, not all programs explain to parties that they may file with the State Bar to pursue non-binding arbitration. Two programs make no such reference in their materials. In addition, the de facto referral to the State Bar erodes the traditional reasons for invoking State Bar jurisdiction: either no local bar program with jurisdiction exists, or a party claims that a fair hearing cannot be obtained through the local bar program. (Rule 12.1, State Bar Rules of Proc.) The State Bar's limited jurisdiction reflects the MFA legislative scheme favoring local bar programs as the primary arbitration providers for attorney fee disputes. (Bus. & Prof. Code § 6200 (d).)

Neither of these traditional grounds for State Bar jurisdiction is present, however, when a party asserts a desire for non-binding arbitration. Yet, the parties are nonetheless forced to seek relief by filing with the State Bar to pursue non-binding arbitration with a three member panel. The State Bar is unable to estimate the number of parties who impacted by this requirement. Nonetheless, the MFA Committee believes this de facto basis for State Bar jurisdiction erodes the statutory preference for providing for attorney fee disputes to be heard locally by the local bar arbitration.

4. **Proposed Minimum Standard Prohibiting the Requirement of a Waiver of Non-Binding Arbitration to Obtain a Three-member Panel.**

In conclusion, the MFA Committee believes that all local bar programs offering MFA ought to be conducted upholding the same goals to provide a "fair, impartial, and speedy hearing." Forty local bar programs assign three-member panels according to a reasonable amount in dispute threshold regardless of whether the arbitration is binding or non-binding. The MFA Committee proposes a new minimum standard that would require program neutrality on the issue of requiring binding arbitration and base the provision of three-member panels only upon the amount in dispute indicated by a reasonable and fair threshold amount, and not additionally upon the parties being required to waive important rights otherwise provided to them by the Statute.

The MFA Committee thus proposes that paragraph 19 be amended as follows:

19. A monetary threshold above which three-member panels will be used must be reasonable. The program may not condition the assignment of a three-member panel upon a party's waiver of the right to non-binding arbitration.

III. REQUEST FOR 45-DAY PUBLIC COMMENT PERIOD

The MFA Committee recommends that the proposed revisions to the Minimum Standards set forth in Attachment A be released for a public comment period of 45 days. The State Bar will directly notify the interested stakeholders - the local bar MFA programs-of this public comment opportunity.

IV. FISCAL AND PERSONNEL IMPACT

No fiscal impact is anticipated.

V. BOARD BOOK/ADMINISTRATIVE MANUAL IMPACT

None.

VI. EFFECTIVE DATE OF APPROVAL

The proposed revisions to the Minimum Standards would become effective upon final consideration and approval by the Board of Governors, after review and recommendation by the Discipline Oversight Committee after public comment.

VII. PROPOSED RESOLUTIONS

Should the Discipline Oversight Committee approve the request to release the proposed revisions to the Minimum Standards for a 45-day public comment period, the following resolutions would be appropriate:

RESOLVED, that the Discipline Oversight Committee hereby authorizes for a 45 day public comment period the proposed revisions to the State Bar Guidelines and Minimum Standards for the Operation of Mandatory Fee Arbitration Programs, in the form attached hereto as Attachment A; and it is

FURTHER RESOLVED that this authorization for release for public comment is not, and shall not be construed as, a statement or recommendation of approval of the proposed revisions.