

# **ARBITRATION ADVISORY**

**2012-03**

## **HANDLING LEGAL MALPRACTICE CLAIMS AND ETHICAL ISSUES DURING ARBITRATION**

**July 17, 2012**

Points of view or opinions expressed in this document are those of the Committee on Mandatory Fee Arbitration. They have not been adopted or endorsed by the State Bar's Board of Trustees and do not constitute the official position or policy of the State Bar of California.

After the new and amended Rules of Professional Conduct became operative on November 1, 2018, the committee reviewed the opinion and updated the citations to the Rules of Professional Conduct.

### **INTRODUCTION**

Business & Professions Code §6203(a) provides that evidence relating to claims of malpractice and professional misconduct shall be admissible in arbitrations conducted under the Mandatory Fee Arbitration Act (“MFAA”) but only to the extent that those claims bear upon the fees, costs, or both, to which the attorney is entitled. Thus, while arbitrators are required to hear evidence regarding alleged malpractice or ethical violations they cannot award affirmative relief in form of damages or offset based on alleged malpractice or professional misconduct. As the MFAA statutes provide very little guidance regarding how arbitrators should handle malpractice and professional misconduct claims, the purpose of this advisory is to provide guidelines for handling legal malpractice and professional misconduct claims in Mandatory Fee Arbitration (“MFA”) proceedings.

### **DISCUSSION**

During the course of a fee arbitration hearing, clients will often claim that the attorney was negligent in the handling of the client's case and/or that the attorney breached his/her ethical duties. While evidence of malpractice and professional misconduct is admissible in MFA proceedings, arbitrators should always be aware that a fee arbitration is not a legal malpractice case. If the client raises issues of malpractice or professional misconduct, the arbitrator will have to evaluate whether the alleged malpractice or ethical violation reduced the value of the attorney's services, but the arbitrator cannot award damages for the alleged malpractice or professional misconduct. Such claims usually present issues of proof and causation.

**A. Differences Between a Civil Action for Legal Malpractice and Claims in MFA Proceedings That the Attorney Negligently Handled the Client's Case.**

The elements of a cause of action for attorney malpractice are: (1) the existence of a duty of care owed to the client to use such skill, prudence and diligence as members of the profession commonly possess; (2) a breach of that duty; (3) a proximate causal connection between the breach and the resulting injury; and (4) actual loss or damage (*Budd v. Nixen* (1971) 6 Cal.3d 195, 200; *Coscia v. McKenna & Cuneo* (2001) 25 Cal.4th 1194, 1199.) Although attorneys are held to a high duty of care to their clients, they do not warrant or guaranty success or a particular result and they are not liable for every mistake made in their practice. (*Banerian v. O'Malley* (1974) 42 Cal. App.3d 604, 623 [attorney cannot be held legally responsible for honest and reasonable mistake of law or unfortunate selection of remedy or other procedural step].)

In order to establish harm caused by an attorney's alleged breach of duty, the client in a legal malpractice action must plead and prove that "careful management of the underlying action would have resulted in a favorable judgment and the collection thereof." (*Laird v. Blacker* (1992) 2 Cal.4th 606, 614.) In other words, the client must prove that "but for" the attorney's negligence, he or she would have obtained a more favorable judgment or settlement in the underlying action in which the malpractice allegedly occurred. (*Viner v. Sweet* (2003) 30 Cal.4th 1232, 1241.) Thus, in the context of an action for legal malpractice, the question of whether the attorney's alleged malpractice or professional misconduct caused damage to the client cannot be a matter of speculation, surmise or conjecture. (*Thompson v. Halvonik* (1995) 36 Cal.App.4th 657, [client's claim of lost settlement value was simply too speculative to support any viable legal malpractice claim; the mere probability that a certain event would have happened, upon which a claim for damages is predicated, will not support the claim or furnish the foundation of an action for such damages]; *Marshak v. Ballesteros* (1999) 72 Cal.App.4th 1514, 1518, [it is not enough to simply allege it was possible to have obtained a better result, as the mere probability that a certain event would happen will not support the claim or furnish the foundation of an action since damage must exist as a legal certainty].)

In the context of an MFA hearing, whether the attorney owed the client a duty of care will usually not be an issue because the existence of an attorney-client relationship, and hence a duty of care, is a jurisdictional requirement for mandatory fee arbitration. The one exception to the jurisdiction requirement of an attorney-client relationship is where the fees and/or costs were paid by a third-party. In *Wager v. Mirzayance* (1998) 67 Cal.App.4th 1187, the court held that the MFA statutes require an attorney to deliver a Notice of Client's Right to Arbitration Form to a non-client who may have contracted to pay for or guaranteed the payment of attorney's fees prior to filing an action against such a third-party payor to collect unpaid fee and costs. (See also, paragraph 13 of the State Bar Guidelines and Minimum Standards for the Operation of Mandatory Fee Arbitration ("Minimum Standards") [a request for arbitration may be made by a person who is not the client but who may be liable for or entitled to a refund of attorney's fees or costs].) However, Minimum Standard 13 provides that in non-client mandatory fee arbitrations the attorney-client privilege is not waived, and the attorney is bound by his/her duty of

confidentiality not to disclose privileged or confidential client information in the absence of a written waiver by the client.<sup>1</sup>

While a non-client payor has the right to participate in an MFA hearing, a non-client payor does not have an attorney-client relationship with the attorney. (See, e.g., *Strasbourgger, Pearson, Tulcin, Wolff, Inc. v. Wiz Technology, Inc.* (1999) 69 Cal.App.4th 1399, 1404-1405 [mere payment of attorney's fees on behalf of another does not create an attorney-client relationship or give rise to any professional duties of care to the person paying the fee on behalf of another]; *Lasky, Haas, Cohler & Munter v. Superior Court* (1985) 172 Cal.App.3d 264, 285 [payment of attorney's fees does not in itself create attorney-client relationship or duty of care]; California Rule of Professional Conduct Rule 3-310(F)(1) [where an attorney's services are paid by someone other than the client, that financial relationship cannot have any interference with the attorney's professional judgment or the lawyer-client relationship].) Even though a non-client payor does not have an attorney-client relationship with the respondent attorney, the non-client payor may claim that the value of the attorney's services should be reduced on the basis of the attorney's alleged malpractice or professional misconduct. (*Wager v. Mirzayance* (1998) 67 Cal.App.4th 1187; See also Arbitration Advisory 2007-02 – Preservation of Client Confidences in Arbitrations Involving Parties Other Than The Client.)

In the context of MFA proceedings between the client and the attorney, the strict rules of proof required in a civil action for legal malpractice do not apply. For example, while expert testimony ordinarily must be used in a legal malpractice action to establish the standard of care and the attorney's failure to meet that standard, expert testimony is not required to support a claim of malpractice in an MFA proceeding. In this regard, the arbitrator is not required to determine whether the attorney's conduct was above or below the standard of care. Rather, the arbitrator's determination of the value of the services requires an assessment of the quality of the attorney's performance; it does not require a determination of whether or not there was breach of the standard of care, so no expert testimony is required.

However, a client's claim in an MFA proceeding that the attorney's fees and/or costs should be reduced on the basis of alleged malpractice or professional misconduct cannot be based on mere speculation. The client in an MFA proceeding must show that the attorney's negligent handling of his or her case affected the value of the attorney's services. If that is shown, then the arbitrator may reduce the fees and costs charged by the attorney, but any damages for the malpractice are beyond the purview of the arbitration and must be left to another forum.

**B. Factors in Determining Whether Fees Should Be Reduced As a Result of a Client's Claim that the Attorney Was Negligent in the Handling of the Case.**

Because of the variety of potential malpractice claims and the differing circumstances in which they may arise, the evaluation of malpractice and professional liability claims in the context of an MFA proceeding must be performed on a case-by-case basis. Factors that an

---

<sup>1</sup> See, Arbitration Advisory 2007-02, Preservation of Client Confidences in Arbitrations Involving Parties Other Than the Client.

arbitrator may consider in determining whether to reduce the amount of fees and costs based on the attorney's alleged malpractice or professional misconduct include the following: (1) did the alleged malpractice cause the attorney to perform extra work which the attorney charged to client; (2) did the alleged malpractice cause the client to lose any of his or her claims or damages; (3) was there an act or omission by the attorney which affected the outcome in a negative way; (4) did the alleged malpractice result in any unnecessary or unauthorized fees or costs; (5) would the client have obtained a more favorable outcome in their case but for the alleged malpractice; and (6) did the attorney commit an ethical breach.

In the context of litigation, an attorney's negligent act or omission may be fatal to the case, *i.e.* the failure to timely file the complaint within the statute of limitations, or the failure to file opposition to a dispositive motion, resulting in summary judgment or dismissal of the case. While the arbitrator is not permitted to award damages to the client based on the malpractice, if the negligent conduct has caused the loss of the client's entire claim(s), it is likely that the services were without value to the client and the arbitrator can accordingly reduce the amount of fees and costs and/or order a refund.

In cases where the attorney's error does not defeat the client's entire claim, the attorney may have billed the client for the cost of correcting his or her negligent conduct. An example of this might be the attorney's failure to timely respond to discovery, resulting in law and motion proceedings, or a waiver of objections which could have been asserted, and/or an award of sanctions. The attorney may have then diligently pursued corrective actions such as a motion for relief from waiver of objection, and billed the client for all of the corrective action costs. Another example might be if the attorney fails to file a responsive pleading in a timely manner resulting in the entry of the client's default, and then bills the client for time spent in taking action to set aside the default. In such cases, the arbitrator cannot award damages, but may choose to disallow or reduce the amount of fees and costs by the time the attorney spent taking corrective action to fix his or her own error.

Other examples of malpractice claims which clients have asserted in MFA proceedings include: the attorney should have settled their case earlier and/or for a higher amount; the attorney failed to raise a particular claim, defense or argument; the attorney failed to investigate the case, conduct proper discovery or they lost or failed to obtain evidence; the attorney failed to name a party; the attorney delayed the handling of their case; the attorney failed to communicate with the client; a different attorney in a firm handled the client's case. There are numerous other examples of potential malpractice issues which may be raised in MFA proceedings. In evaluating malpractice claims in relation to the value of the services rendered, the arbitrator should always elicit enough testimony or evidence to allow the arbitrator to make a determination whether the attorney's alleged act or omission caused additional work or whether the attorney's error had any impact on the outcome of the issue or case and whether but for the attorney's error the client would have obtained a better result. If the answer to those questions is yes, then the arbitrator may reduce the amount of the fees and costs charged. If the answer is no, then there is no basis for reducing the fees or costs.

**C. Determining Whether the Attorney’s Fees Should Be Reduced or Eliminated as a Result of a Violation of the Rules of Professional Conduct or Other Ethical Breaches by the Attorney.**

Because an attorney’s conduct in violation of established ethical standards may also be considered in reducing the amount of the fee charged, disgorgement of fees paid, and whether the attorney is entitled to any fee, arbitrators should be familiar with the Requirements of the Rules of Professional Conduct, particularly Rule 1.8.1 and Rules 1.7, 1.8.7, 1.9, and 1.8.6 (formerly Rule 3-300 and 3-310, respectively) relating to conflicts of interest and Rule 1.16 (formerly Rule 3-700(D)) relating an attorney’s obligations with respect to fees upon termination of the attorney’s employment. Examples of ethical violations or professional misconduct can include charging an unconscionable fee, failing to disclose a conflict of interest, obtaining an adverse interest such as a note and deed of trust against the client’s property to secure fees, disclosing a client’s confidential information, trust accounting issues, failure to return unearned fees, and unethical billing practices.

In making a determination of how an attorney’s ethical misconduct may affect the amount of the attorney’s fees, the arbitrator has several options. The arbitrator may determine that there was an inadvertent technical breach which did not affect the value of the services rendered. (*Pringle v. La Chapelle* (1999) 73 Cal.App.4th 1000 [there must be a “serious violation” of an attorney’s responsibilities before an ethical rule violation will require forfeiture of right to recover fees]; *Mardirossian & Assoc. v. Ersoff* (2007) 153 Cal.App.4th 257 [while an attorney’s breach of a rule of professional conduct may warrant forfeiture of fees, forfeiture is not automatic].) The arbitrator may choose to disallow any fees or costs for services rendered after the date of the ethical breach. (*Jeffry v. Pounds* (1977) 67 Cal.App3d 6 [law firm limited to compensation for pre-conflict services]; *Cal Pak Delivery, Inc. v. United Parcel Service, Inc.* (1997) 52 Cal.App.4th 1 [pre-conflict fees recoverable in class action contingent fee case].) The arbitrator may choose to order disgorgement of fees paid by the client. (*In re Occidental Financial Group, Inc.* (9th Cir. 1994) 40 F3d 1059 [attorney ordered to disgorge fees due to undisclosed conflict].) Or, the arbitrator may conclude that in light of the ethical breach, the attorney is not entitled to any fee. (*A.I. Credit Corp., Inc. v. Aguilar & Sebastinelli* (2003) 113 Cal.App.4th 1072 [attorney’s disqualifying conflict of interest was not a mere technical violation; attorney not entitled to any fee as a result of the disqualifying conflict].)

In *Sheppard, Mullin, Richter & Hampton, LLP v. J-M Mfg. Co.* (2018) 6 Cal.5th 59, the California Supreme Court considered whether an attorney may seek to recover attorney’s fees on a quantum meruit basis where the attorney enters into the relationship with an undisclosed conflict of interest. Sheppard Mullin agreed to represent a manufacturing company in a federal qui tam action. The law firm ran a conflict check and found that another Sheppard Mullin attorney in a different office had represented one of the plaintiffs, South Tahoe Public Utility District, in unrelated employment matters. Sheppard Mullin concluded that because South Tahoe had signed an advance conflict waiver, the firm could take on the representation of the manufacturing company. The firm entered into a fee agreement with the company, which included an advance conflict waiver, but it did not disclose that it represented South Tahoe.

South Tahoe discovered Sheppard Mullin's representation of adverse parties and moved to disqualify the firm. The district court granted the motion.

The dispute was sent to arbitration in accordance with the arbitration clause in the parties' fee agreement, and the arbitrators ruled in favor of the law firm. The superior court confirmed the award. The Court of Appeal reversed, concluding (1) the law firm committed an ethical violation that rendered the parties' agreement, including the arbitration clause, unenforceable in its entirety; and (2) the law firm was disentitled from receiving any compensation for the work it performed for the manufacturer. The Supreme Court agreed that the law firm's conduct rendered the parties' fee agreement unenforceable, including the arbitration clause, but concluded that California law does not establish a bright-line rule barring all compensation for services performed subject to an improperly waived conflict of interest, no matter the circumstances surrounding the ethical violation, and therefore did not categorically disentitle Sheppard Mullin firm from recovering by way of a separate equitable claim or cause of action the reasonable value of the services it rendered to the manufacturer on a quantum meruit basis. The court remanded the case and held that, in asserting such separate equitable claim or cause of action, Sheppard Mullin would have the burden of proof and that it would have to show, among other factors, that: (1) the violation was neither willful nor egregious; (2) the firm's conduct was not so potentially damaging to the client as to warrant a complete denial of compensation; and, (3) such award does not undermine incentives for compliance with the Rules of Professional Conduct.

**D. Should The Arbitrator Raise Issues of Potential Malpractice or Professional Misconduct If They Have Not Been Raised by the Client?**

The California Mandatory Fee Arbitration Program was established by the Legislature in 1979 by the adoption of Business & Professions Code sections 6200, et seq. In enacting the MFA Program, the Legislature noted that disputes concerning legal fees were the "most serious problem between members of the bar and the public." The Legislature also noted that there was a "disparity in bargaining power in attorney fee matters which favors the attorney in dealings with infrequent consumers of legal services" and that "many clients could not afford hiring additional counsel to litigate fee disputes in civil courts." The California Supreme Court also has referred to the MFA Program as one that provides certain "client protections." (*Aguilar v. Lerner* (2004) 32 Cal.4th 974, 983, 987.) In addition, Court have noted that the public policy behind mandatory fee arbitration 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. (*Manatt, Phelps, Rothenberg & Tunney v. Lawrence* (1984) 151 Cal.App.3d 1165, 1174-1175; *Schatz v. Allen Matkins Leck Gamble & Mallory LLP* (2009) 45 Cal.4th 557, 567.)

In light of the public policy behind MFA, MFA matters do not have pleadings that strictly frame the issues as in civil litigation, and claims pertaining to violation of the Rules of Professional Conduct or legal malpractice may not be raised by clients who are unrepresented at the hearing and unfamiliar which legal issues. As a result, and in light of the Legislature's explicit provision in Business & Professions Code §6203(a) that evidence relating to claims of malpractice and professional misconduct "shall" be admissible in arbitrations conducted under

the MFAA, the Committee believes that it is permissible for the arbitrator to raise issue pertaining to possible malpractice and/or ethical violations sua sponte if it is apparent from the request for arbitration, response, materials presented, and testimony of the parties and any other witnesses that such claims may exist and may impact the amount of fees or costs at issue in the matter. Arbitrators have their own styles of conducting arbitration proceedings and they should use their discretion in how they choose to elicit relevant testimony in such cases.

## **CONCLUSION**

When claims of malpractice or professional misconduct are raised in MFA proceedings pursuant to Business & Professions Code §6203(a), the arbitrator must admit evidence of such claims, but only to the extent that those claims bear upon the fees, costs, or both, to which the attorney is entitled. As more particularly discussed above, the issue in MFA arbitrations involving such claims by the client is whether the attorney's acts or omissions affect the value of the services to the client. If so, the fee may be adjusted, but the arbitrator cannot award damages for the malpractice or professional misconduct.

It is important in cases involving claims of alleged malpractice or professional misconduct that the arbitrator not only give full consideration of the client's claims, but that the arbitrator also set forth in the award the reasons for the decision to either adjust the fees in light of those claims or the decision that the alleged conduct did not affect the value of the services rendered. In doing so, the arbitrator should not be concerned that his or her findings may be used in another proceeding as Business & Professions Code §6204(e) provides that an MFA Award and the determinations of the arbitrators shall not be admissible nor operate as collateral estoppel or res judicata in any action or proceeding. (See also, *Liska v. Arns Law Firm* (2004) 117 Cal.App.4<sup>th</sup> 275, 286-287, [in order to maintain the informality and economy of the arbitration proceedings fee arbitration awards are not admissible in evidence and do not operate as collateral estoppel or res judicata in any other proceeding].)