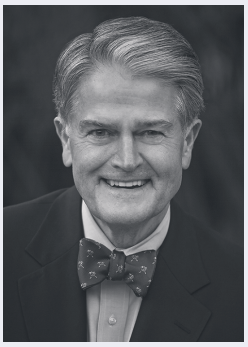
Recovering Attorney Fees in Arbitration

By Charles H. Dick, Jr.



Charles H. Dick, Jr. is a neutral with JAMS, and he serves as a mediator and an individual arbitrator or member of multi-arbitrator panels in complex commercial matters, securities and investment disputes, professional liability cases, products liability issues, and other business-related controversies.

An accurate assessment of damages is critical for case evaluation, and the cost of dispute resolution plays an important role in deciding to pursue claims. Even strong liability cases can fail to make economic sense. That is why a thorough case appraisal should thoughtfully consider the attorney fees to be incurred. And equally important, an objective case valuation should assess the likelihood of recovering attorney fees.

The "American Rule," which specifies that each party must bear its own attorney fees, is a lesson for law school's first year, and though the rule has been slightly modified to encourage certain litigation in the public interest, fee-shifting remains the exception rather than the rule. Against this background, professional responsibility obliges counsel to keep clients informed about litigation economics (Cal. Rules Prof. Conduct, rule 1.4)—something critically important as a case approaches the inevitable mediation. Unfortunately, experience teaches that an exacting analysis of litigation cost and exposure to fee-shifting often is an afterthought, and that the development of case strategies, discovery plans, and tactical maneuvers occurs without thoughtfully weighing the implications of the American Rule and its exceptions. This is a recurring issue in arbitration.

Perhaps litigators approach attorney fee recovery casually, thinking there will be ample time to deal with the question before a final judgment is entered. Arbitration, however, is different. The binding nature of arbitration makes appellate relief unlikely. An arbitrator's award of attorney fees is unlikely to be second-guessed by a court, even if there is no statutory or contractual basis for the award. (See *Moncharsh v. Heily & Blasé* (1992) 3 Cal.4th 1, 33; *id.* at p. 11 ["it is the general rule that, with narrow exceptions, an arbitrator's decision cannot be reviewed for errors of fact or law. In reaffirming this general rule, we recognize there is a risk that the arbitrator will make a mistake."].) When it comes to recovering attorney fees in arbitration, counsel needs to get the issue correct from the beginning.

California has codified the American Rule in Code of Civil Procedure section 1021. Contractual arrangements can modify the rule and provide for fee-shifting, but a careful study of the parties' language is critical. (See *Valley Hardware, LLC v. Souza* (Nov. 20, 2015, D067076) 2015 Cal.App.Unpub. Lexis 8347 [affirming arbitrator fee award in face of inconsistent contract provisions].) Contractual language inevitably varies: Some agreements provide for recovery of fees "when permitted by law"; some

say fees "actually incurred" are recoverable; some limit attorney fees to a percentage of the damages awarded; some say the prevailing party "shall" recover fees, while others use the uncertain "may." Civil Code section 1717 defers to the contracting parties, subject to minor tweaks that limit fees to a "reasonable" amount and require that fee recovery be reciprocal.

In addition to carefully scrutinizing contract language, one also needs to know the procedural rules that will be applied in arbitration. For example, in a Financial Industry Regulatory Authority (FINRA) arbitration regarding the investment brokerage industry, the arbitral panel is directed to determine the "costs and expenses," yet absent some statutory exception to the American Rule, fee-shifting still depends on the parties' underlying agreement (see FINRA rule 12902(c)). Unless the parties' agreement forbids fee-shifting, the rules of the International Institute for Conflict Prevention and Resolution (CPR) authorize the arbitration tribunal to apportion costs for "legal representation and assistance … incurred by a party to such extent as the Tribunal may deem appropriate" (see CPR 2019 Administered Arbitration Rules, rule 19.1(d) & 19.2). Rule 24(g) of the JAMS Comprehensive Arbitration Rules & Procedures is the mirror image: "[T]he Arbitrator may allocate attorneys' fees and expenses … if provided by the Parties' Agreement or allowed by applicable law" (accord, Uniform Arbitration Act, § 21).

If all parties request an award of attorney fees, rule 47(d)(ii) of the American Arbitration Association's Commercial Arbitration Rules and Mediation Procedures authorize an award of attorney fees even if the underlying agreement is silent on the issue. Throwing in a boilerplate prayer for attorney fees and costs without considering the consequences can result in fee-shifting. And during arbitration, even casual discourse about attorney fees can be a basis for fee-shifting, absent an express agreement to the contrary. (*Marik v. Univ. Vill. LLC* (Oct. 3, 2013, B247171) 2013 Cal.App. Unpub. Lexis 7143 [brief asserting entitlement to recover fees provided basis for arbitrator's fee award]; see *Prudential-Bache Securities, Inc. v. Tanner* (1st Cir. 1995) 72 F.3d 234, 242-243 ["costs and expenses" under New York Stock Exchange Rules interpreted to permit award of attorney fees when both sides to dispute requested attorney fee award].)

Counsel should be mindful of an arbitrator's predisposition to produce an award that is "fair to all concerned," and this may include fee-shifting as an exercise in equity. (See *Cohen v. TNP 2008 Participating Notes Program, LLC* (2019) 31 Cal.App.5th 840, 877 [absent parties' agreement limiting arbitrator power, award of attorney fees on basis of equity and conscience affirmed].) Further, misconduct of counsel may be a reason to "sanction" a party by reducing an attorney fee award. (E.g., *Karton v. Art Design & Const., Inc.* (2021) 61 Cal.App.5th 734 [fees reduced for incivility of counsel].) And consider JAMS Comprehensive Arbitration rule 24(g), which authorizes an arbitrator to consider noncompliance with discovery orders when awarding attorney fees.

Attorney fees incurred prosecuting or defending a complaint to compel arbitration may be recoverable, but the procedural posture of the civil court action will determine when fee-shifting may occur. (E.g., *Otay River Const. v. San Diego Expressway* (2008) 158 Cal.App.4th 796.) Though there is authority to the contrary (*Benjamin, Weill & Mazer v. Kors* (2011) 195 Cal.App.4th 40 [allowing recovery of fees even though liability on claim awaited arbitration]), the better-reasoned view is expressed in *Roberts v. Packard, Packard & Johnson* (2013) 217 Cal. App.4th 822. In that case, clients filed suit

against their former lawyers, alleging breaches of fiduciary duty and conversion in connection with settlement of *qui tam* litigation. The law firm's motion to compel arbitration was granted, and the trial court awarded the firm its fees as the prevailing party. On appeal, the court was persuaded the phrase "an action" means an entire judicial proceeding; procedural steps in the course of a lawsuit, such as a motion to compel arbitration, are steps in the prosecution or defense of an action, but they are not the entirety of an action on a contract. The *Roberts* case stands for the proposition only one side can "prevail" in a lawsuit, and fee-shifting had to await the arbitrator's final determination of the clients' professional liability claims. (*Id.* at p. 843.)

Civil Code section 1717 defines the "prevailing party" as the person who recovers the greater amount on a contract. Yet, *Hsu v. Abbara* (1995) 9 Cal.4th 863, makes it clear this involves more than a mathematical calculation. The "court is to compare the relief awarded on the contract claim or claims with the parties' demands on those same claims and their litigation objectives as disclosed by the pleadings, trial briefs, opening statements, and similar sources." (*Id.* at p. 876.) Thus, it is possible for a party to prevail by achieving litigation objectives, even though an opponent may have obtained a favorable verdict on liability theories. Generally, however, when a verdict on contract claims is good news for one party and bad news for another, a court is obligated to treat the happy litigant as the prevailing party.

The identity of a prevailing party becomes more complicated when results of an arbitration are mixed. In this regard, *Marina Pacific Homeowners Association v. Southern California Financial Corp.* (2018) 20 Cal.App.5th 191, is instructive. This case between a homeowners' association and a finance institution exemplifies litigation that produces some wins and some losses for both sides. The case involved a claim by the homeowners that they did not owe monthly fees the financial institution contended amounted to $97 million over the life of a lease. The trial court found against the homeowners and declared there was an obligation to make monthly payments. But the court also found the monthly payment rate was only 40% of the financial institution's demand. On appeal, the court declined to consider settlement communications as being a reliable expression of a party's litigation objectives and concluded the "substance" of the result was a $58 million loss for the defendant. Invoking the decision in the *Hsu* case, the court concluded there was no simple, unqualified result pointing to either side as a prevailing party, and the trial court had acted within its discretion in denying recovery of attorney fees.

One lesson regarding "prevailing parties" is the need for caution in over-pleading one's case. Some counsel cannot resist converting a straight-forward breach of contract action into a fraud case with overtones of unfair business practices and assorted tort claims. Pleading multiple claims that eventually are discarded for want of proof can be dangerous, especially unsubstantiated allegations of fraud. In *De La Questa v. Benham* (2011) 193 Cal.App.4th 1287, 1295, an appellate court acknowledged the practice of overstating one's claims, which makes it more difficult to determine the victor. In a case producing mixed results, unsupported claims may lead to an opponent's recovery of fees.

Counsel in arbitration need to address fee-shifting with a laser focus, beginning with the preliminary hearing, which is the first opportunity to meet the arbitrator and learn his or her preferences. Arbitrators can be expected to employ the lodestar method recognized as

acceptable by a long line of California cases (e.g., *PLCM Group v. Drexler* (2000) 22 Cal.4th 1084, 1094). Several issues can be discussed at the hearing: What procedures will the arbitrator use to deal with attorney fee and cost issues? Will these matters be bifurcated until an interim or tentative award on the merits is delivered? Does the arbitrator have requirements for form, style, and specificity of time records? Will "block billing" be accepted? If more than one law firm will be appearing for a party, the conference also is an opportunity to explain why and set the stage to defuse a later argument about duplicated efforts.

In a case with both contract and tort claims, counsel should consider keeping a separate record of time spent on matters that may not be entitled to recovery of attorney fees. Counsel should be prepared to demonstrate that time records were prepared contemporaneously with the work reported, since there often is a lack of daily time recordation, let alone contemporaneous reporting. The fee application also should explain how the litigation team was deployed and why individual tasks were assigned to team members.

Proving the reasonableness of time and rates ordinarily can be accomplished by declarations of counsel regarding the usual, customary, and regular timekeeping and billing practices of the law firm. Resumes of the personnel involved and a summary of the work may be useful. (See, e.g., *Syers Properties III, Inc. v. Rankin* (2014) 226 Cal.App.4th 691, 702.) And this information can be supplemented by the opinions of other lawyers objectively knowledgeable about actual practices within the community. Survey data often is available for firms in metropolitan areas, and those reports also carry credibility. But counsel should be alert to differences between posted or rack rates and hourly rates actually realized, because there often is a material difference. As with hotels and rental cars, there may be a significant disparity between the advertised rate and what people actually pay.

Nemecek & Cole v. Horn (2012) 208 Cal. App.4th 641 makes it clear that a calculation of "reasonable fees" does not hinge on what fees actually were paid. In that case, defense counsel had been compensated on the basis of negotiated insurance panel rates. The arbitrator refused to be controlled by such rate structures and declined to use the Laffey Matrix employed by the United States Department of Justice in determining rates the federal government believes are reasonable. Instead, the award of attorney fees was based on an independent assessment of what would be reasonable, and the appellate court affirmed confirmation of that award. (See *Chacon v. Litke* (2010) 181 Cal.App.4th 1234, 1260 [awarding reasonable rate $50 greater than counsel's regular rate].)

There are three important things to remember about recovering attorney fees in arbitration. First, carefully study the parties' agreement to understand the rights it extends and the limitations it imposes. Second, avoid pleading unnecessary claims that make it seem the end result tips in favor of one's opponent. Third, vacating an erroneous fee award is unlikely, so make your best case regarding fee-shifting before the entry of a final award.

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