Should Your Firm's Engagement Letter Contain an Arbitration Clause?

By Mitchell L. Marinello

Even well-managed law firms occasionally run into a client that refuses to pay its legal bill. In those instances, the firm sometimes faces a dilemma. Does it sue its client to collect unpaid fees despite the fact that such efforts may result in unfavorable publicity, intrusive discovery requests during the litigation, and possibly the client filing a baseless counterclaim for legal malpractice? Or should the firm just walk away and plan to choose its clients more carefully the next time? The preferred course of action may differ from firm to firm and matter to matter, but having an arbitration clause in your engagement letter may provide you with substantial benefits.

What Can Arbitration Offer That Litigation Cannot?

Reasonable people may disagree about whether arbitration is better than the court system for resolving business disputes. The answer may depend on the kind of case involved, its legal complexity, what is at stake, the need for discovery (particularly from non-party witnesses), and a host of other factors, including whom you draw as your decision maker. I would argue, however, that the benefits of arbitration are greatest for a plaintiff with a sound and straightforward case who wants to preserve privacy and who is concerned about facing a meritless counterclaim that will require a lot of time and resources, which, if not dismissed, may subject it to the uncertainty of a jury decision. That is a basic description of the typical claim by a law firm seeking to collect its unpaid fees. Arbitration is almost tailor-made for such cases.

A Hard Lesson Learned

The benefits of arbitrating fee collection cases became readily apparent to our law firm during a truly awful experience with its alternative. We represented a client in a factually complex case where he and his various real estate partnerships were behind the proverbial eight-ball. A few months before the trial date, our client stopped paying our fees and even stopped paying the expenses for items such as subpoenas and deposition transcripts, but the court would not permit us to withdraw. Stuck in the case, we decided to make the best of a bad situation by doing a first-rate job. Thus, we completed discovery, taking the many fact and expert witness depositions our clients wanted taken, filed strong dispositive motions that eliminated certain claims, vigorously prepared the case for trial, funded out-of-pocket expenses ourselves, and spared no effort in presenting the case during a trial that lasted more than two weeks. When the trial and post-judgment motions were over, we had won beyond all reasonable expectations. Our individual client was absolved of personal liability, all claims against our partnership clients were defeated, and we won a multi-million dollar counterclaim. None of that good work helped us get paid, so, after fruitless efforts to reach some type of arrangement with our client, we brought suit for our fees. We expected liability to be denied—and it was—but despite the results we had achieved, our clients counterclaimed with a substantial legal malpractice claim.

We will spare you the details, but it took seven years before we got paid for our work. Seven years, not just of waiting, but of responding to discovery requests, fighting motions, attending hearings and status conferences, moving for summary judgment and, yes, even briefing an appeal, all the while dealing with continuous delays and malpractice allegations that, although eventually dismissed on the merits, added insult to the mix. Sometime in the middle of that experience, we decided to put a clause in our standard engagement letter that required any disputes, including any legal malpractice claims, to be arbitrated under the Commercial Arbitration Rules of the American Arbitration Association (AAA). We have not looked back since.

A Second, Altogether Different Experience

A few years later, we wound up with a new client who, as many do, asked us to provide litigation and related services on an expedited time schedule. The client was very demanding and required quick turnarounds; work stretched late into the night and on weekends and involved many long meetings. As a result of this demanding schedule, a lot of work was done in a short time frame and the legal bill quickly increased. Then, after getting a positive result, the client simply did not pay its bills.

When it became clear that the matter could not be resolved, we filed an arbitration demand. The client promptly hired new counsel, who made it clear that our experience with him would be less than pleasant. His first words to us included strong accusations of wrongdoing, threats of malpractice claims, and personal assurances that he was no pushover. At the first preliminary hearing, the purpose of which was to set a case management schedule, he claimed that he had no time to become familiar with the facts and requested a long postponement. His request was denied, and he was given a reasonable time of two or three additional weeks to file his clients' response to our arbitration claim. He had threatened to file a very large legal malpractice claim but then came face to face with the fact that doing so would require his client to pay the AAA a commensurately high filing fee. Suddenly, that tactic seemed to lose its appeal. At the next preliminary conference, over our opponent's vehement objections, the arbitrator set a period of about eight weeks for some limited discovery with a final evidentiary hearing about two weeks later. Our opponent's lamentations were audible. Faced with having to try the case on the merits instead of simply making irresponsible allegations that in a court of law would be treated with great deference, our opponent recognized that the jig was up. The case settled a few weeks later.

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Tell Me Again, Why Is Arbitration Better?

Arbitration is private, whereas litigation is public. That can matter when you are being unjustly accused of performing your job badly, even if you know there is no legitimate basis for the accusations and you eventually prove that you were right.

Additionally, discovery is usually much more limited in arbitration than it is in litigation. That helps reduce expenses and the amount of time your firm has to devote to the case. (How much discovery do you need to prove that you did not get paid for the legal services you provided or to show that you did not commit malpractice?) Limited discovery also helps prevent your former client from prying into your private business matters that have only a tangential connection to the case, such as policies that relate to billable hours, credit for revenue generated, compensation, or how your cases are staffed.

Arbitration, by its nature, encourages the parties to cooperate in discovery and discourages motions that do not have a sound basis. One reason for this is that, most of the time, neither party wants to take the chance of being perceived as uncooperative or filing motions that have little or no merit. This is because either of those actions may harm its credibility with the arbitrator, who will be deciding the case on the merits. The same constraint does not always apply in court proceedings. In court, a party may become emboldened because the proceedings typically take longer, the motion and trial judge may not be the same, and certain judges may be known to be reluctant to impose consequences on those who violate the rules or even prior court orders.

Arbitration should and generally does proceed to a hearing on the merits in one year or less; most of the time, that is a lot sooner than the typical lawsuit proceeds to trial. When you have a good case, you want it to be heard quickly. If your client owes you fees and you want to collect them, arbitration usually will enable you to do that a lot faster than litigation.

Litigators often say that there is nothing like an imminent trial date to focus the parties on settling a case. In arbitration, "trials" are scheduled relatively quickly and rarely postponed. In contrast, courts often do not schedule a trial for years and, as a result, the parties sometimes use that time to beat each other over the head with motions and discovery that often do not accomplish much but are expensive.

There is a strong probability that your arbitration will be decided by a person who is an experienced attorney who is familiar with business matters, knows about the practicalities of practicing law, and is familiar with the law of legal malpractice. (In fact, if you take the time to draft your arbitration clause carefully, you can almost guarantee the arbitrator's qualifications in all of these areas.) Unlike a judge faced with a heavy calendar, that arbitrator is likely to have the time to focus considerable attention on your case. Unlike a jury, he or she is unlikely to start the process with a negative image of attorneys or to be subject to emotional sway.

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Finally, an arbitration award generally cannot be reconsidered and the grounds for appeal from an arbitration award are extremely limited. In litigation, just about every issue is fair ground for reconsideration and appeal. And, even if you ultimately win on every single issue, you still have to take the time and expense to brief all of them.

All of these factors would seem to be very good reasons to prefer arbitration to litigation in cases where your firm wants to collect its unpaid legal fees. But, you might wonder, what is the downside to arbitration?

Reasons Not to Choose Arbitration

Despite these advantages, arbitration is not always the best choice for resolving a dispute. Some malpractice insurers do not approve of it; instead, they want all of the legal rights that the law provides, including the right to full judicial review of any significant decision or judgment that is made. Obviously, law firms must check with their professional carriers before adding arbitration clauses to their engagement letters.

The same advantages that arbitration enjoys in simple, straightforward cases can become a disadvantage when a case is factually complex and requires a lot of discovery, particularly when that discovery is needed from non-parties to the arbitration. Today, many arbitrators are guided by a proportionality rule—that is, the amount of discovery they permit in a case is roughly proportional to the amount of money or the gravity of what is at stake. Not all arbitrators follow this principle, so you cannot count on getting the amount of discovery that is appropriate or needed in every situation. And, in arbitration more so than in the courts, discovery is often difficult to get from non-parties, particularly if they are located out-of-state. Thus, arbitration may have significant disadvantages in factually complex cases.

Arbitration also may have disadvantages in legally complex cases and in cases where a great amount of money or other items of value or importance are at stake. Although most arbitrators are capable of providing a decision with a proper interpretation and application of the law, arbitrators do make mistakes. Generally speaking, the courts will not correct an arbitrator's decision on the ground that it contains a mistake of law. In contrast, there is a much better chance that a trial judge's mistake will be corrected on appeal. Law firms providing legal services for large matters, particularly large transactions, may not feel comfortable having their disputes with clients resolved by an arbitrator whose decision, as a practical matter, cannot be reviewed by a court of law. And, of course, having a quick hearing on the merits is great when you have a strong case. But, in those rare circumstances when you face a legitimate and substantial legal malpractice claim or counterclaim, it may make sense to prefer a slower

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decision-making process that gives you the opportunity to raise every argument and defense—even those that have a relatively small chance of success but, if successful, might have a significant impact.

Conclusion

Where your law firm comes out on the question of whether to place an arbitration clause in its standard engagement letter may well depend on its insurance carrier's policy toward arbitration, the size and kinds of matters your firm typically handles, and/or your firm's general comfort with arbitration as a means of dispute resolution. But for collecting outstanding receivables in small- to medium-sized cases and taking the air out of baseless legal malpractice claims, arbitration is hard to beat. ■