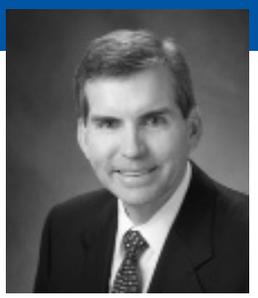
Is a Provision in an Engagement Letter Providing for Arbitration of Malpractice Claims Enforceable?

Avoiding Liability



By Jeffrey P. Lewis

Jeffrey P. Lewis is a member in the Philadelphia office of the law firm of Eckert Seamans Cherin & Mellott LLC. He serves on the PBA Professional Liability Committee.

Jurisdictions are split on whether a clause in an attorney-client engagement letter that provides for arbitration of malpractice claims is enforceable and, if so, under what circumstances. For example in *Hodges v. Reasonover,* 103 So. 3d 1069 (La. 2012), the Louisiana Supreme Court held that such clauses are enforceable only where there has been informed consent. Under *Hodges*, the attorney must inform the client of a whole litany of rights that are waived and the ramifications of agreeing to the arbitration clause. These include but are not limited to the following: that the client is waiving his or her rights to a jury trial, appeal and to broad discovery; that the client is told what claims are subject to arbitration; and that the client may seek independent counsel before signing the agreement. The client also must be informed that his or her right to make a disciplinary complaint is not impinged. In a recent Maine decision, however, a circuit court rejected the reasoning in *Hodges* and affirmed the enforcement of an arbitration provision by the district court where none of these disclosures had been made to the client.

In *Bezio v. Draeger,* 737 F.3d 819 [C.A. 1 (Me.)], the client, a licensed agent and investment adviser, sought representation when "the Maine Office of Securities issued [client] a Notice of Intent to revoke his license and seek other penalties" for alleged violations of various security laws and rules. The law firm the client retained sent him a draft engagement letter that contained an arbitration provision. The clause appeared on Pages 6 and 7 of the agreement and was not highlighted in the document. That provision first addressed resolution of fee disputes but then continued with the following: "*and any other dispute that arises out of or relates to this agreement or the services provided by the law firm shall also, at the election of either party, be subject to binding arbitration.* Either party may request such arbitration by sending a written demand for arbitration to the other." [Emphasis added.]

Client did review the letter, changing one of the provisions, initialing the change and initialing every page. But no one had called the arbitration provision to his attention and explained its consequences. Nor had there been a discussion between the client and the law firm that this provision meant that either party could demand arbitration of malpractice claims. Most important from the client's standpoint, he was never advised that he could seek independent counsel to advise him with respect to the engagement letter.

The client was not unsophisticated, however; and the court found that his previous experience with arbitration was material. Not only had an arbitration action been commenced against him and his former employer by former clients, he, too, had previously commenced an arbitration matter against his former employer after it had terminated him as a result of his conduct that prompted the previous arbitration.

The client did not dispute the enforceability of the arbitration provision to resolve fee disputes. But he offered several arguments against its enforceability to resolve malpractice claims, all of which were rejected by the court. Citing *Hodges*, the major argument the client asserted was "that the Maine Rules of Professional Conduct do not permit arbitration of malpractice disputes unless the attorneys have specifically pointed out and discussed fully the risks and possible consequences of such a clause and the client has given informed consent." The court referred to these as "informed consent preconditions."

With respect to the "informed consent preconditions" argument, the court held that the enforceability of an arbitration provision is determined by application of "ordinary state-law principles that govern the formation of contracts, including validity, revocability, and enforceability of contracts." The court was mindful of the restriction under Section 2 of the Federal Arbitration Act, 9 U.S.C.A. § 1 *et seq.*, which precludes state laws from imposing limitations "which are special to arbitral clauses." The district court had relied upon this restriction, but the circuit court found that the restriction was not implicated here because Maine law does allow attorneys to enforce arbitration clauses.

The court noted Rule 1.4(b) of the Maine Rules of Professional Conduct, which reads the same as Pennsylvania's version of the rule: a "lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." But the court noted that the extent to which a "lawyer shall explain" "will vary by client." Because of this client's level of sophistication with respect to arbitration provisions, the court excused the lawyer's failure to offer any information beyond what was contained within the "four corners" of the agreement. Moreover, the court refused to "conclude that the presence of such an arbitration clause in an engagement agreement, without more, requires that the client be advised to consult other counsel."

The client also argued that the arbitration provisions must "spell out that they apply to malpractice claims by referring explicitly to 'malpractice,' " contending that arbitration of malpractice claims is "slanted toward law firms" and arguing "that the arbitration clause is inherently unconscionable and against public policy under Maine law because of the lack of the informed consent preconditions." Finally, he argued that this provision was an impermissible prospective limit of attorney liability as prohibited by Rule 1.8(h)(1) of Maine's Rules of Profession Conduct (which is also the rule in Pennsylvania). The court rejected all of these arguments, even characterizing the argument that the provision must explicitly reference "malpractice" as "self-evidently frivolous."

To support its conclusion that arbitration clauses in an engagement letter are enforceable, the court cited a formal advisory opinion by the state's Professional Ethics Commission, created by the Maine Law Court, and a formal ethics opinion from the American Bar Association. The ABA opinion specifically concluded that "mandatory arbitration provisions are proper unless the retainer agreement insulates the lawyer from liability or limits the liability to which she otherwise would be exposed under common or statutory law." ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 02-425 (2002).

So there is ample support for the proposition that an arbitration provision in an engagement letter that is broader in scope than just to resolve fee disputes can be enforceable, although there is also contrary authority. Therefore, whether to include such a provision would present a matter for negotiation between the lawyer and client and a matter of firm policy as to whether it presents a preferred means to resolve malpractice and other professional-liability disputes.

Given this court's statement that the client's sophistication with regard to arbitration was material, a less sophisticated client may have seen a different outcome. Attorneys must consider the risk of not providing "informed consent preconditions" to every new client.