Memorandum 90-55

Subject: Study J-900 - Shifting of Attorney's Fees Between Litigants (Scope of Study)

The Commission has been authorized to study whether there should be "changes in the law relating to the payment and the shifting of attorney's fees between litigants." (1988 Cal. Stat. res. ch. 20.) This authorization is the result of a request from the California Judges Association. This memorandum introduces this study by providing background on California law, an overview of the policies and alternative schemes, and a proposed course of action. Before preparing any more concrete materials, the staff needs the Commission's guidance on the broader issues.

Background

Terminology

Under the "American Rule," litigants are expected to bear their own attorney's fees, although the winning party may be entitled to other costs of trial from the loser. Thus, there is no attorney fee shifting under the American Rule in its pure form.

Under the "English Rule," the prevailing party is entitled to payment of all or part of attorney's fees from the losing party as an element of costs. Thus, the winner may not have to pay any attorney's fees while the loser may have to pay the attorney's fees of both sides. It is said that the English Rule applies in most other countries, though there are so many exceptions and qualifications in practice that the significance of this generalization may be questioned.

"One-way" fee shifting is where the prevailing plaintiff (usually) is paid by the losing defendant, but the prevailing defendant is not reimbursed. One-way fee shifting is the most common type of fee shifting statute in the United States.

"Two-way" fee shifting is a system in which the loser pays the winner's attorney's fees, whether the winner is the plaintiff or the

defendant. Two-way fee shifting is also known as the "indemnity" system or the English Rule.

History

The origin of the American Rule is obscure and has been the subject of much academic debate and judicial speculation. The English Rule was part of the common law and as such was originally accepted in the American colonies. The colonies and early states typically regulated attorney's fees by statute, both the fees that an attorney could charge his client and the fees recoverable from the adversary. This system was mainly due to the adoption of English practices, but also to a widespread hostility toward lawyers and the belief that citizens should be able to handle litigation without lawyers. See, e.g., L. Friedman, A History of American Law 81-84, 94 (1973); Leubsdorf, *Toward a History of the American Rule on Attorney Fee Recovery,* 47 Law & Contemp. Probs. 9, 9-12 (1984).

Eventually, it appears that the fee statutes came to be ignored in practice, with lawyers charging their clients more than they could collect from adverse parties, and courts legitimizing the practice. The American Rule emerged as the right of lawyers and clients to agree to fees (including contingent fees) and the right of lawyers to collect fees exceeding statutory limits. Thus, in 1848 the Field Code in New York struck down provisions regulating costs and fees of attorneys and provided that "the measure of such compensation shall be left to the agreement, express or implied, of the parties." (This language should be familiar to anyone who has read California Code of Civil Procedure Section 1021.) See generally *id.* 11-22.

With the growth of large business enterprises and government, and the increasing cost and complexity of litigation, the American Rule has been subject to an increasing number of exceptions on both the state and federal levels and particularly during the last 25 years. One study of state fee shifting legislation found about 310 enactments throughout the country in the first 50 years of this century, 157 enactments in the 1950's, 340 enactments in the 1960's, and 910 enactments in the 1970's. Note, *State Attorney Fee Shifting Statutes: Are We Quietly Repealing the American Rule?,* 47 Law & Contemp. Probs.

321 (1984). Projections for the 1980's near the level for the previous decade.

There must be a limit to the number of potential statutes, and perhaps the 1990's will discover it. Meanwhile, in California, enactments and refinements continue apace. Based on preliminary data, the staff estimates that over 100 fee shifting statutes were enacted in California in the last eight years.

A Sampling of California Law

The basic rule in California, drawn directly from the Field Code as noted above, is set out in Code of Civil Procedure Section 1021:

> 1021. Except as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the parties; but parties to actions or proceedings are entitled to their costs, as hereinafter provided.

This language states the American Rule in broad and somewhat awkward terms. The introductory exception clause was added in 1933, when the general rule was subject to few exceptions. It now opens the door to more than 300 statutory exceptions, some major and some minor. The general rule is also subject to some equitable doctrines created by the courts.

A study of state legislation in force in 1982 determined that California had the greatest number of fee shifting statutes (146) affecting the greatest number of subject areas (26). Note, *State Attorney Fee Shifting Statutes: Are We Quietly Repealing the American Rule?*, 47 Law & Contemp. Probs. 321, 336 (1984). (North Carolina had the least -- two fee shifting statutes affecting two subject areas. Ohio was the median of the 51 jurisdictions with 32 statutes in 13 subject areas.) The staff has little doubt that California has maintained its position, and probably has increased its "lead" over the other states.

As an historical footnote, it is interesting to note that early California law also included a two-way fee shifting statute in actions

for recovery of money or damages or possession of real or personal property that entitled the prevailing party to an "additional allowance" of 5% of the first $1000 recovered (if the plaintiff prevailed) or claimed (if the defendant prevailed) plus 2% of the amount over $1000, subject to a maximum of $500. 1851 Cal. Stat. ch. 5, § 502. This provision was repealed in 1855. 1855 Cal. Stat. ch. 196, § 2.

California fee shifting statutes vary greatly in subject matter, scope, relative impact, and terminology. Major statutes include the statutory private attorney general rule in Code of Civil Procedure Section 1021.5 which was enacted in 1977:

> 1021.5. Upon motion, a court may award attorneys' fees to a successful party against one or more opposing parties in any action which has resulted in the enforcement of an important right affecting the public interest if: (a) a significant benefit, whether pecuniary or nonpecuniary, has been conferred on the general public or a large class of persons, (b) the necessity and financial burden of private enforcement are such as to make the award appropriate, and (c) such fees should not in the interest of justice be paid out of the recovery, if any. With respect to actions involving public entities, this section applies to allowances against, but not in favor of, public entities, and no claim shall be required to be filed therefor.

Another statute with broad application provides for two-way shifting of reasonable attorney's fees in contract actions if the contract provides for attorney's fees for one of the parties to the contract or to the prevailing party. Civ. Code § 1717.

There are a multitude of consumer protection statutes such as those applicable in retail installment sales, credit discrimination, dance studio lessons, health studios, buyers of water treatment devices, invention development services contracts, and immigration consultants. See Civ. Code §§ 1812.4, 1812.34, 1812.62, 1812.94; Bus. & Prof. Code §§ 17577.6, 22386, 22446.5. The victims of "unlicensed" persons may be awarded attorney's fees. Code Civ. Proc. § 1029.8.

Other statutes shift fees in a variety of situations to the advantage of blind or disabled persons, tenants, workers, farm workers, and eminent domain condemnees. See, e.g., Civ. Code §§ 55, 789.3(d); Lab. Code §§ 1197.5(g), 1697.1(c); Code Civ. Proc. §§ 1235.140,

1250.410. Prevailing plaintiffs in civil rights actions may be awarded fees. Civ. Code § 52.1(h).

The civil discovery statutes provide fee shifting as a punishment for misuse of the discovery process, even for the benefit of nonparties. See, e.g., Code Civ. Proc. § 2023.

Small businesses may be awarded fees in proceedings involving regulatory agencies taking action without substantial justification. Code Civ. Proc. § 1028.5. Regulatory agencies and industry groups are given the benefit of one-way fee shifting in many statutes, such as those applicable to the Iceberg Lettuce Commission, the Kiwifruit Commission, and cable television system operators. See Food & Agric. Code §§ 66641, 68113; Pen. Code § 593d.

A relatively rare, pro-defendant one-way fee shift applies where a person charged with child abuse files an action for libel or slander against the accuser and a demurrer is sustained under Civil Code Section 48.7. Another pro-defendant shift occurs where a plaintiff brings a groundless action for an injunction against a group alleged to advocate violence (criminal syndicalism). Code Civ. Proc. § 527.7.

Attorney's fees may even be awarded the prevailing party in an action to prohibit unauthorized use of the name of the Golden Gate Bridge District. Sts. & Hy. § 27563.

Scope of Study

At this point in the study, it is unwise to become too involved with the myriad details of California statutory and decisional law governing attorney fee shifting. Having sampled the statutes, the Commission should consider the general direction of this study and the scope of anticipated revision.

The resolution authorizing the study is broad. Within this authority, several levels of revision could be undertaken. From narrower to broader scope, there are four general levels:

(1) Trouble-Shoot: Develop specific remedies for certain trouble areas, such as the determination of "reasonable" fees and other areas identified by the Commission and interested persons.

(2) Comprehensive Technical Revision: Review and coordinate all fee shifting statutes, along with some trouble shooting.

(3) Ad Hoc Policy Review: Consider policies of major subject areas, such as, for example, private attorney general rule, torts, contracts, landlord-tenant disputes, labor, indigent litigants, or litigation control. This level of revision would also include the comprehensive technical revision of all fee shifting statutes.

(4) Brave New World: Replace existing scheme with the English Rule (or some other, visionary scheme), subject to exceptions to accomplish specific policy goals.

The staff suggests proceeding on the second or third level. The comprehensive technical review is a good place to start and provides a platform for considering specific problem areas and reviewing the policies in major subject areas. A comprehensive review will also develop the expertise needed to determine whether and to what extent general procedures can effectively be applied to the major types of fee shifting statutes. We need to do more than simply consider a limited number of remedial corrections (the first level). While some useful revisions might be accomplished, the sheer bulk of the statutory law in this area would seem to require a more coordinated approach. We suspect that the Judges Association was motivated to request this study in large part because of the overwhelming and inconsistent body of statutes, not to mention case law.

If the Commission is interested, the staff can prepare a brief consideration of the arguments for and against the English Rule, as part of the fourth level. At this stage, the staff believes that the English Rule, which would provide for general two-way fee shifting in favor of prevailing parties, is not the answer. Simply put, the English Rule, by itself, would do no better than the American rule in solving the problems fee shifting has been expected to remedy. We doubt that it would be efficient to revise California law to adopt two-way fee shifting as the general rule in place of the American Rule of no fee shifting. This is because most of the 300+ fee shifting statutes provide for one-way shifts, not two-way shifts. (Preliminary analysis indicates that about 70-80% are one-way statutes.) Adoption of the English Rule as the starting point would also raise the issue of

contingent fees and bring in a host of other problems. It should also be recognized that a one-way fee shift is just as much an exception to the English Rule as the American Rule. Unless California's 280+ one-way fee shifting statutes are to be abandoned, adopting the English Rule would not affect the vast bulk of the statutes and the same amount of work would be involved in reviewing these statutes. We do not want to "reinvent the flat tire."

The contrast between the American and English Rules is far greater in theory than in application, since many practices have grown up to ameliorate the operation of both the American and English Rules. For example, it is generally assumed that juries will award larger damages to compensate for a plaintiff's attorney's fees, notwithstanding the American Rule. One study of the operation of the English Rule in the province of Ontario found that in many situations the parties bore all or most of their own costs of counsel, either because they did not expect to be able to enforce against the loser or because the procedure for taxing costs would not award them the full amount of fees incurred. See Kritzer, *Fee Arrangements and Fee Shifting: Lessons from the Experience in Ontario,* 47 Law & Contemp. Probs. 125 (1984).

The proponents of the English Rule seem, at times, to believe that two-way fee shifting is universally accepted and praised outside of the United States. Closer analysis reveals that, as far as Western Europe is concerned, there are a variety of schemes in force -- and none of them is equivalent to a pure two-way shift. European fee shifting rules have also seen change in recent years. In fact, some proposals for reform in West Germany resemble the American Rule. See Pfennigstorf, *The European Experience with Attorney Fee Shifting,* 47 Law & Contemp. Probs. 37, 74-75 (1984).

Classification of Fee Shifting Statutes

If the Commission decides to proceed on the second or third level of study outlined above, the staff would start with a comprehensive review of the existing statutes with the intent of making them consistent and easier to apply. The first step in this process is to examine each statute and determine its characteristic elements:

(1) Who determines the fee -- whether the court, governmental agency or official, agreement, or otherwise.

(2) Whether the fee shift is mandatory or discretionary, and any standard that may apply to this determination.

(3) Who is entitled to a fee -- e.g., prevailing plaintiff or defendant (one-way shift), or prevailing party (two-way shift).

(4) Who is liable for the fee -- e.g., losing plaintiff or defendant (one-way shift), or losing party (two-way shift).

(5) What is the measure of the allowable fee -- e.g., "reasonable" attorney's fees, fixed amount, maximum amount, percentage of damages.

(6) What is the purpose of the statute, i.e., what policy is it trying to achieve.

The first five elements are normally easy to determine, although some statutes that we have examined, are incomplete or even contradictory. The determination of the policy behind each particular statute will be more difficult and subjective.

The staff proposes to classify the statutory purpose based on the categories set out in an article by Professor Thomas Rowe. See Rowe, *The Legal Theory of Attorney Fee Shifting: A Critical Overview,* 1982 Duke L.J. 651, 653-66; see also Note, *State Attorney Fee Shifting Statutes: Are We Quietly Repealing the American Rule?,* 47 Law & Contemp. Probs. 321, 327-28. Professor Rowe classifies fee shifting statutes in the following six categories:

(1) Simple fairness -- indemnity: The two-way fee shift is justified as a rule of fairness, thought by some to be embedded in popular consciousness and really not in need of explanation. The two-way fee shift is considered a necessary consequence, rather than as a punishment of the loser.

(2) Full compensation -- make whole for wrong suffered: Thus it is argued that a "plaintiff wrongfully run down on a public highway" should recover his lawyer's bill as well as his doctor's bill. A party forced to run up legal fees because of unjustified tactics in litigation should be made whole by payment of the fees by the loser. This rationale tends to support one-way shifts in favor of prevailing plaintiffs.

(3) Punishment and deterrence: The concern here is to punish aggravated misconduct and deter it by the threat of

punishment. The monetary penalty may also compensates the aggrieved party for expenses caused by the misconduct. This policy is obvious in cases of penalties for abuse of process, vexatious litigation, baseless claims and defenses, and unjustified tactics. Fee shifting may also be used as a punishment for gross negligence, bad faith, and other civil offenses beyond the ordinary.

(4) Private attorney general -- public interest litigation: Litigation that may produce social benefits beyond the benefit to the successful party is deterred by the American Rule. In order to encourage this type of litigation, or at least to eliminate the deterrent, fees may be shifted in favor of prevailing plaintiffs. See Serrano v. Priest, 20 Cal. 3d 25, 569 P.2d 1303, 141 Cal. Rptr. 315 (1977); Code Civ. Proc. § 1021.5. (Rowe excludes the "common fund" and "substantial benefit" theories from the realm of fee shifting; these doctrines are cost sharing between plaintiffs and aligned persons, not shifting from adverse parties.)

(5) Equalization -- balancing relative strengths of parties: Concerns with equal access to justice have resulted in many one-way fee shifting statutes to enable the little guy to fight big business or big government. Without a fee shift, the side with the superior resources could routinely prevail in disputes without having to risk determinations on the merits. This problem arises under both the American and English Rules. One-way fee shifting is typically imposed once the legislature detects a regular imbalance in an area.

(6) Litigation control -- litigation rate, settlement rate, speed of litigation, etc.: Much faith is placed in achieving desirable results in litigant behavior by fee shifting mechanisms. As discussed below, however, many of these hopes are unrealistic. Schemes that shift fees in the context of offers of compromise or offers of settlement seek to implement this policy. Shifting fees for frivolous claims or bad faith defenses also fall into this category.

These policies overlap in some respects, and a particular fee shifting statute may seek to achieve more than one purpose. As we analyze the fee shifting statutes, some will no doubt be assigned to more than one purpose category.

Additional Considerations

Predicting the Effects

This is a confusing subject and writers and judges have come to opposite conclusions about the effects of different fee shifting

schemes. Advocates of a scheme often overgeneralize its benefits, failing to perceive or admit the complexity of the subject and the difficulty of accurate prediction. Many recent proposals have been designed to promote settlement, but fail to take into account the effects of the fee rules on both sides. For example, it is commonly assumed that shifting attorney's fees will promote settlement. See, e.g., Bishop, *Let's Adopt the English Fees Awards System,* 4 Cal. Law. #2, p. 10 (February 1984). But this ignores the possibility that the plaintiff will now hold out for more, and make settlement just as difficult or more so. It has been demonstrated that where parties disagree over the outcome of litigation and are "risk neutral" (e.g., corporations and wealthy or indigent individuals -- small businesses and middle income individuals are usually "risk averse"), the gap between the parties is wider under the English Rule than the American Rule, thus reducing the likelihood of settlement. See Rowe, *Predicting the Effects of Attorney Fee Shifting,* 47 Law & Contemp. Probs. 139, 144-45, 155 (1984). Thus, counter to a common expectation, adopting the English Rule cannot be expected to promote settlements in general.

> With a two-way rule there are so many cross-cutting effects and factors -- encouragement from possible recovery of one's own fees, discouragement from possible liability for an adversary's fees, the presence or absence of risk aversion -- that no *general* prediction of the relative overall effects of the American and English rules on the likelihood that prospective plaintiffs will pursue claims seems possible.

Id. at 147.

One economic analysis (the Braeutigam-Owen-Panzer model) predicts that any move away from the American Rule in cases involving risk neutral parties will produce an increase in the level of expenditures in a contested case. This will, in turn, widen the gap between the parties since they can now disagree about a larger amount. At the same time, increased expenditures may affect the outcome in other ways that affect the parties' respective expectations of success, and leading to some other probable conclusion. See *id.* at 158.

As for "risk averse" litigants, typically the "one-shotter", middle income individual, fee shifting generally is expected to make settlement more likely since the risk is increased. It is believed,

therefore, that moving away from the American Rule will increase the likelihood of settlement and discourage filing claims by risk averse persons. See *id.* at 158-59.

Many more interesting, and perhaps counterintuitive, conclusions can be drawn when the issues are taken apart and analyzed carefully, with the assumptions stated clearly. As we confront specific issues in the course of this study, the staff hopes to be able to draw on the extensive literature for some guidance and to avoid the pitfalls common in this area. For now, enough is accomplished if it is understood that predicting the effects of a fee shifting proposal is highly complex and probably speculative.

Undesirable Litigation

A frequently stated goal of fee shifting is to deter undesirable litigation. What is undesirable litigation? On surveying court dockets, some may be driven in their desperation to think that *all* litigation is undesirable, or at least everyone else's litigation. But "'clearing the docket' is not the courts' most noble role, and applying coercive settlement techniques to all cases is questionable policy. Compromise is not an unalloyed good; some cases should be fully adjudicated." Turner & Laporte, *Shifting Attorney Fees to Promote Settlements,* 12 Cal. Law. #12, p. 69 (December 1984).

Recognizing the need to distinguish between good and bad litigation, we are faced with the possibly insurmountable problem of setting standards for making this determination. If the standards are too general and simple, we are likely to be overinclusive or underinclusive. If the standards are more precise (assuming we can agree on what is bad litigation), the scheme will probably be inefficient to administer by taking up too much judicial time.

Amount of Fee Shift

Almost as important as *whether* to shift fees is the *amount* of the shift. Ideally this study can make substantial progress in codifying standards for determining the amount of "reasonable" attorney's fees.

Subsidiary issues include the amount of fees that may be awarded to parties, attorneys or nonattorneys, who conduct their own litigation.

Procedure

A major technical issue involves the appropriate procedure for claiming and determining fees. This is a problem both where the fees are mandatory and where they are discretionary. Some statutes specify or imply a procedure, while others are unclear. Perhaps much of the judicial inefficiency in this area would be remedied if we can develop general procedures for determining the right to fees and the amount of fees in the majority of situations.

Attorney Liability

Fee shifting is normally considered to be a question of liability between parties. However, it is at least an interesting thought problem to consider whether in some cases the losing attorney should pay the fees. Some statutes intended to deter litigation conduct adopt this approach under existing law. See, e.g., Code Civ. Proc. § 2023 (misuse of discovery).

A recent note proposes a two-way fee shift against the losing party's attorney in cases brought by low-income litigants. See Note, *Fee Simple: A Proposal to Adopt a Two-Way Fee Shift for Low-Income Litigants,* 101 Harv. L. Rev. 1231 (1988). This scheme would make fee shifting more effective since indigent plaintiffs are normally judgment proof. By freeing the fee calculation from the amount of the recovery (such as under contingent fee arrangements), the risk is made more certain and rational. It is claimed that this type of arrangement would encourage litigation of cases in which each side is rationally optimistic about its chances of prevailing, which are probably the cases that should be tried. *Id.* at 1248.

Other Issues

Other issues will no doubt arise as we proceed, such as the codification of case-law rules, fees on fees, fees in administrative proceedings, relationship with federal fee shifting rules, allocation of liability for fees among responsible parties, procedural issues, and transitional provisions.

After reviewing the history of the American Rule, Professor Leubsdorf concluded, "Whatever system we adopt, lawyers will no doubt find ways to turn it to their own advantage." Leubsdorf, *supra* at 33.

Respectfully submitted,

Stan Ulrich
Staff Counsel