NEW HAMPSHIRE BAR ASSOCIATION ETHICS COMMITTEE
FORMAL OPINION INQUIRY #1995-96/10
Incorporation of mandatory arbitration clause into attorney-client fee agreements, as requested by malpractice carrier.
May 8, 1996

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RULE REFERENCES:

*Rule 1.8(h)
*Rule 1.5(b)
*Rule 1.4(b)
*Rule 1.7(b)

SUBJECT:

*Prohibited Transactions
*Fees
*Client communications
*Conflict of Interest
*Harsh Reality Test

ANNOTATION:

A lawyer shall not represent a client if the representation of that client will be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless the lawyer reasonably believes the representation will not be adversely affected; and the client consents after consultation and with knowledge of the consequences. [Rule 1.7(b)].

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I. QUESTIONS:

A. Does incorporation of a mandatory arbitration clause within an attorney-client fee agreement limit a client's constitutional right to seek judicial remedy regarding malpractice disputes?

B. Does the incorporation of a mandatory arbitration clause benefit a lawyer's interests but adversely affect the interest of the client by prospectively limiting the client's forum without providing the client with independent representation, thereby causing a conflict of interest?

C. Whether the inclusion of a binding arbitration clause within a fee agreement should be considered a contractual matter between attorney and client, or a legal service provided by a fiduciary?

II. FACTS:

The law firm of the inquiring attorney was approached by its insurance carrier, suggesting that the firm' s fee agreements should contain an arbitration clause, presumably to reduce malpractice insurance expenses to the firm and subsequently to reduce the clients' legal costs. The arbitration clause that the insurance carrier proposed to the firm of the inquiring attorney confines the client's claim solely to binding arbitration, and eliminates any other form of adjudication.

III. ANSWERS:

A. INTRODUCTION

A mandatory arbitration clause is beneficial to a lawyer's interests by reducing the cost of malpractice premiums, and it may even benefit the client by possibly making representation more affordable. However, mandatory arbitration clauses could potentially affect the client's interest adversely by denying the client certain rights, such as access to a jury trial.

At its most basic level, the dispute over whether an attorney, at the behest of his or her insurance company, may require all clients to agree to binding arbitration highlights the dilemma we have as both businesspeople and professionals.

The ethical rules are largely based on the value that an attorney should act as a fiduciary, i.e., with the highest degree of loyalty to the client. However, pure selflessness in the real world is impossible. For example, few would argue that when at attorney sets an hourly rate, the lawyer is primarily concerned with the welfare of each client. The question here is whether the inclusion of an arbitration clause is a business decision, which is then presented to clients for their approval as part of a contractual offer, or is a part of the legal services a lawyer provides as a fiduciary.

The Committee believes the inclusion of a binding arbitration clause to be different than the setting of a fee and that it, therefore, must be analyzed under the standards governing conflicts of interest. In order to be valid, the inclusion of the clause must be based on the best interest of the client. Since this test is necessarily determined for each individual client, the committee further believes that a lawyer may not require inclusion of such a clause for all clients.

B. RULES ANALYSIS

1. Conflicts of Interest

Conflicts of interest are subject to Rules 1.7-1.11 A. The specific rules at issue here are Rules 1.8(h) and 1.7(b).

Rule 1.8 is designed to supplement Rule 1.7(b) by specifying instances where the lawyer's self interest may affect his or her representation. It "addresses two types of conflicts: those plainly within Rule 1.7, but which arise so often as to warrant exact rules to simplify application, and those that present dangers of self-dealing but are arguably not violative of Rule 1. 7." Annotated Model Rules of Professional Conduct 131 (2d ed. 1992). We believe the proper analysis of this situation is under Rule 1.7.

On first read, some might think that this situation is covered by Rule 1.8(h) which provides that:

> A lawyer shall not make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless permitted by law and the client is independently represented in making the agreement...

Agreements limiting liability can have a dramatic impact on clients by removing one method of insuring quality legal services. Also, such agreements are usually negotiated in a setting - the initial interview - that requires trust. The Rules drafters, therefore, singled such agreements out for special care and barred their use unless the client is independently represented.

Given the expense of hiring second counsel and the negative impact on the attorney-client relationship of suggesting the need to get another lawyer to protect the client from the first lawyer, this requirement is a strong deterrent to limitations on liability. However, the rule does permit an informed client to utilize such a device when it is to the client's benefit. One example of such a situation might be having a lower fee offered in return for the exculpation. A similar independent counseling arrangement is included in Rule 1.8(a) governing business transactions with clients

The Committee does not believe that an agreement to arbitrate is a "limitation on liability" as described in Rule 1 .8(h). The lawyer still is liable for damages if he or she commits malpractice. It is only the forum that is different. We also note that arbitration may well be advantageous to a client. Therefore, unlike limitation on liability, which as a policy matter may immunize a negligent attorney, the choice of forum is not as inherently problematic.

The above analysis does not end the ethical inquiry. Rather, since the limitation of forum may have some advantage to the lawyer, such as avoiding the risk of a "run away jury" and lowering malpractice rates, the proposed clause must be analyzed by evaluating the ability of the lawyer to advise the client as to the pros and cons of the arrangement. When, as here, the facts indicate a reasonable possibility that the lawyer's interests may interfere with his or her independent judgement, we must analyze the situation as a Potential conflict.

**Kalled's Case**, 135 N.H. 557 (1992), illustrates an example of egregious violation of Rules 1.4 (b) and 1.7 (b), wherein an attorney's own interests superseded the quality of representation of his clients. This matter involved the drafting of a will and an irrevocable trust for a client by the attorney in which the attorney would receive substantial assets as remainderman. The trust was devised by a husband for the benefit of his physically and mentally disabled spouse. Upon the husband's death, the attorney proceeded to solicit a subsequent will and trust from the incompetent spouse. The attorney did not adequately explain to the disabled wife all options available to her even though he was fully aware that the woman was incapable of comprehending the significance of such matters. The attorney then chose to represent the incompetent woman in guardianship proceedings initiated by her concerned family, and moved to intervene in the proceedings as executor of the estate of the woman's deceased husband. Inasmuch as the attorney stood to profit from the provisions of the deceased husband's will, he persisted in contesting the disabled woman's election to waive the provisions of her husband's will. The matter was litigated in Carroll County Probate Court, and the attorney was found to violate the ethical code in several instances, particularly Rule 1.7(b).

This particular matter reveals the extent of harm a client may prospectively experience when not adequately apprised by counsel of all the options available and the consequences therein. Furthermore, the attorney operated from a position of significant advantage and undertook to materially limit his responsibilities to his clients, both the husband and the disabled wife, in preference of his own interests.

There is a two step process in seeking a waiver of the potential conflicts of interest described in Rule 1.7(b). First, the lawyer must reasonably believe the representation will not be adversely affected. Rule 1.7(b)(1). This test is an objective one and should use the "harsh reality" test.

2. Harsh Reality Test

This test is an objective one. Despite the rules explicit apparent reliance on a subjective "belief,"[1] this committee has long espoused the use of a "harsh reality test." This was first analyzed in NH Op. 1988-89/24. This "harsh reality test" was adopted to determine whether a lawyer properly could request the consent of a client or clients to adverse or materially limited representations pursuant to Rule 1.7.

> Under this test, a lawyer attempting to resolve such an issue should ask himself or herself whether, if a disinterested lawyer were to look back at the inception of this representation once something goes wrong, would that lawyer seriously question the wisdom of the first attorneys requesting the client's consent to this representation or question whether there had been full disclosure to the client prior to obtaining the consent. ...If this "harsh reality test" may not be readily satisfied by the inquiring attorney, the inquiring attorney and other members of the inquiring attorney's firm should decline representation of the private
> client.

NH Op. 1988-1989/24.

This test has been often cited and discussed in subsequent opinions of this Committee, see e.g. NH OP. 1989-90/1; NH Op. 1989-90/17; NH Op. 1991-92/4 (extending the application of this test to Rule 1.1 lA(b) (1), as well as Rule 1.7(b)). While the New Hampshire Supreme Court has not as yet officially adopted this harsh reality test, in the Boyle's Case, 136 N.H. 21 (1992), the court did specifically cite to and adopt the ABA Model Rule Comment upon which this rule is based as follows:

> A lawyer may seek consent to the potentially conflicting representation only when "the lawyer reasonably believes the representation will not be adversely affected." Rule 1.7(b) (emphasis added). The Comments to ABA Model Rule 1.7, which does not materially differ from the applicable portion of our Rule 1.7, explain that "when a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances, the lawyer involved cannot property ask for such agreement or provide representation on the basis of the client's consent.

It is this "disinterested lawyer' that clearly requires an objective analysis under the circumstances, and not solely the subjective belief of the attorney.

Subsequently, in Kelley's Case, 137 N.H. 314 (19930 the Court went on to further describe the practical application of Rule 1.7 (b) (1) and a harsh reality analysis:

> Although Rule 1.7(b) (2) provides that clients can waive a potential conflict after consultation and with knowledge of the consequences, there are situations in which, even if the client consents to representation, a lawyer should decline to represent that client.

The question is whether a disinterested lawyer, faced with a disgruntled client who claims not to have known that he or she was giving up the fundamental right to trial by jury, would question that adequate disclosure by the first lawyer had been made.

3. Adequate Disclosure

Even if the initial lawyer is convinced that the request to waive the conflict is reasonable, NH rules require the client to have actual knowledge of the consequences of the action. Rule 1.7 (b) (2). Many believe this rule (which differs form the Model Rules) imposes almost strict liability. A lawyer considering asking a client at the initial interview to waive his or her right to a jury question should ponder what he or she will say. Will the lawyer indicate that this choice will save the client money in reduced fees? Will the lawyer assert that arbitration will be a better forum of adjudication for this client?

The Committee believes that mandatory arbitration clauses may be an option for clients so long as the attorney discloses completely to the client the significance of such a choice. A sophisticated client with a clear understanding of the ramifications of binding arbitration may fully appreciate such an alternative and its potential for reduced costs for the client. However, the onus lies with the attorney to ascertain the level of sophistication and comprehension of each and every client before determining whether an individual client is sufficiently astute to competently choose mandatory arbitration given the heavy burden on the lawyer to justify the consultation, this will likely be the business or repeat client. By not treating this as a situation governed by Rule 1.8(h), the sophisticated client and the lawyer can enter into this arrangement without the disruptive need for a second counsel.

For other clients, the lawyer should consider carefully the above concerns before seeking inclusion of a mandatory arbitration clause. If the lawyer wishes to offer arbitration to less sophisticated clients, he or she could decrease the risk by referring the client out to independent counsel. This is due to the perceived potentials for overreaching and for an inequality of bargaining power between the parties to the contract. Other ethics committees have adopted this requirement, District of Columbia Ethics Opinion 211 (1990); Philadelphia Ethics Opinion 88-2 (1988).

Further, during the initial interview, an attorney may wish to provide the client with a fact sheet delineating the ramifications of binding arbitration. Such a fact sheet might prevent a client from misinterpreting the lawyer's disclosure of information regarding binding arbitration during the initial interview as legal advice.

In order to protect the rights of the average client, as well as the more sophisticated client, freedom of choice must be available in order to better accommodate the needs and wishes of an attorney's diverse clientele.

4. Informed Consent

In order for an attorney to include the option of binding arbitration within his or her fee agreements with clients, it is imperative for the attorney to comprehensively disclose to a prospective client the full legal significance of such a choice. Ultimately, it is the attorney who must determine the ability of the client to analyze and assess the viability of choosing mandatory arbitration. In the event that the client appears unable to make an informed decision, it is the attorney's responsibility to allow the client to retain the option of pursuing litigation.

IV. CONCLUSION

In light of the above, we think that while binding arbitration clauses may be the norm in many professions, lawyers must be held to a higher standard. This standard should not bar a client from seeking to choose a good method for resolving disputes, especially when the choice results in a lower fee. However, when a client seeks legal advice, he or she is usually relying on the lawyer to choose the best means to resolve a dispute. the client justifiably looks to the lawyer as the expert on these matters. Given this factor, when discussing a waiver of certain options in a dispute with the very lawyer to whom the client has turned for help, the lawyer must adhere to the high fiduciary standards to which our rules and common law bind us.

The incorporation of mandatory binding arbitration clauses into attorney-client fee agreements could deny the client access to any other remedial forums, specifically due process through jury trial. The choice of forum is fundamental, and can only be waived by conscious choice of the client, not by lack of choice. The resolution of malpractice disputes via arbitration cannot be externally mandated. The choice of forum must be offered and explained to the client. Only upon receiving full disclosure from the attorney of the legal significance of arbitration may a client consent to binding arbitration.

In conclusion, attorneys may not preclude due process when including mandatory arbitration clauses within their clients' fee agreements. Therefore, the inquiring firm must inform its insurance carrier that such a clause is unethical when it stands alone and must incorporate such a clause into its representation/fee agreements as a choice only.

[1] Defined under Terminology: "denotes that the person involved actually supposed the fact in question to be true. A person's belief may be inferred from circumstances."