

**WATTS V POLACZYK:
ARBITRATION CLAUSES IN ATTORNEY
RETAINER AGREEMENTS UPHELD**

BY

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For the first time in Michigan jurisprudence, the Court of Appeals in *Watts v Polaczyk, et al*¹ ruled that attorneys can include arbitration clauses in their initial fee agreements for the purpose of covering not only fee disputes, but also *prospective legal malpractice claims* that may arise out of the legal representation making up the subject matter of the agreement. Applying the plain provisions of the Michigan Arbitration Act (“MAA”), finding that nothing in the legislation exempted the provisions of the act from attorneys or their clients and determining that the Michigan Rules of Professional Conduct and State Bar informal ethics opinions did not and could not invalidate such clauses, the Michigan Court of Appeals held that that an ADR clause in a fee agreement which included the “legal malpractice claim” was valid and enforceable.² Under *Watts*, attorneys and their clients now **have** the option of choosing an ADR format to resolve prospective disputes *prior to* the time those disputes may arise. The diverse tasks and responsibilities attorneys undertake in today's legal environment mandate a close evaluation of whether arbitration clauses should be utilized by an attorney in view of his or her practice field.

THE FACTS OF WATTS

The *Watts* case had its genesis in a personal injury suffered by the plaintiff while working at his job. Four days later, while plaintiff was recuperating from his injury, which resulted in the loss of his left leg, he met with defendant attorneys. At that time, a possible lawsuit was discussed and a four page contingent fee agreement (the “Agreement”) was presented to him for review. Although the parties differ over what was discussed at that time, plaintiff ultimately signed the Agreement and retained defendant attorneys to investigate and, if the claims had merit, pursue such claims by way of a civil action. On the third page of the Agreement, at paragraph 11, the following clause was included:

Any controversy, dispute, or question arising out of, in connection with, or in relation to this Agreement or its interpretation, performance or nonperformance, or any breach thereof, shall be determined by arbitration conducted in accordance with the then-existing rules of the American Arbitration Association or the Federal Mediation and Conciliation Service and any decision rendered by the Arbitrator shall be final and binding upon the parties; and Judgment upon any arbitration award, including an award of damages, may be entered in any court having jurisdiction

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thereof. The Arbitrator may not amend, modify, or substitute any of the terms or conditions of this Agreement and his jurisdiction is thereby limited. (Emphasis Added).

After evaluating plaintiff's potential claims, plaintiff was advised that the Michigan Supreme Court had granted leave to appeal in three cases which dealt specifically with the viability and scope of the so called intentional tort exception to the exclusive remedy provision of the Worker's Compensation Act – the key doctrine underlying plaintiff's claims. Defendant attorneys prepared a letter, which plaintiff signed, acknowledging the pendency of the Michigan Supreme Court cases and plaintiff's agreement to wait for the decision on these cases before a determination would be made regarding whether a lawsuit would be filed against plaintiff's employer. The letter also sets forth the statute of limitations deadline for any such claim, which was 10 months away, and that plaintiff was "free to pursue this matter with other attorneys."

Within one week from the date the Michigan Supreme Court decided the three cases, defendant-attorneys advised plaintiff that they had elected not to take his case and that he should pursue a second legal opinion. He was further advised (again) that if he elected to file a lawsuit, he must do so by the statute of limitations deadline (now one month away) or be forever barred. Plaintiff signed an acknowledgment that he received the letter and his file. Unable to find counsel to pursue the case, the limitations period ran on his potential claims. Plaintiff then filed a legal malpractice claim against defendant-attorneys, asserting that the lawyers failed to preserve his alleged meritorious claims.

Defendant-attorneys were ultimately granted summary disposition, per MCR 2.116(C)(7)³, when the trial court determined that, as a matter of law, the arbitration clause was enforceable and that the parties should arbitrate the dispute. Plaintiff appealed.

PLAINTIFF'S LEGAL ATTACK ON THE ARBITRATION CLAUSE

Under the current state of the law, defendant-attorneys had the original burden of showing there was a written agreement to arbitrate the dispute raised in his Complaint. If this burden is met, then plaintiff had to prove the existence of either an applicable statutory exception from the Michigan Arbitration Act or an applicable and recognized common law defense to the enforcement of the arbitration agreement. If he failed to meet this burden, then the matter was properly dismissed and ordered to arbitration.⁴ The trial court determined that defendants established a valid arbitration clause that was not subject to any statutory or common law ground for invalidating contracts in general.

Plaintiff's attack on the validity of the arbitration clause essentially comprised the following: he asserted (1) that the failure of the defendant-attorneys to specifically advise him of the existence of the arbitration clause invalidated the clause under contract law; (2) the clause should be limited only to "fee disputes" and not legal malpractice claims; (3) the arbitration clause constituted a "contract of adhesion"⁵; and (4) the clause is unenforceable because it violated the prohibition, contained in MRPC §1.8(h)(1), preventing lawyers from entering into an "agreement prospectively limiting a lawyer's liability to a client for malpractice unless permitted by law and the client is independently represented in making the agreement."

The *Watts* case did not break any new legal ground in disposing of plaintiff's more traditional contract law arguments -- the first three arguments referenced above. Citing well established contract law, the Michigan Court of Appeals rejected plaintiff's "failure to know of the contents" argument and the "limited to fee disputes only" argument by reaffirming the basic contract principle that the law presumes that one who signs a written agreement knows the nature of the instrument executed and fully understands its contents.⁶ In short, the mere failure to read or allegedly understand an arbitration agreement is not a defense to enforcement of that agreement. The trial court also rejected the "contract of adhesion" claim. See Footnote 5, *supra*.

The analysis of the *Watts* Court concerning the interpretation of the MRPC's and its use in civil litigation, as well as the role of State Bar informal ethics opinions on contract interpretation and their legal effect, is new and worthy of further comment.

THE ROLE OF ETHICS RULES AND MRPCs

Lacking a recognized statutory or common law defense, plaintiff made the unique argument that "where the arbitration agreement is *between an attorney and client, limiting the client's remedies for the attorney's malpractice*, a higher standard applies to a review of the validity of the clause."⁷ Plaintiff supported this argument by referencing MRPC §1.8(h)(1) and *informal* opinions of the State Bar Association.⁸

Prior to *Watts*, informal ethics opinions dampened the use of arbitration clauses, suggesting that they may run afoul of rule 1.8(h)(i) of the MRPC, which prohibits lawyers from entering into contractual arrangements that *prospectively* limits their liability. These ethics opinions⁹, discussed in *Watts*, also suggested that prudence and ethics dictated that a lawyer desiring such an arbitration clause was required to advise the client in writing to obtain independent legal counsel concerning the arbitration clause – suggesting that a client must hire an attorney in order to hire an attorney. The plaintiff in *Watts* argued, among other things, that the failure to provide him an opportunity to consult with independent legal counsel, *consistent* with the informal ethics rulings, invalidated the arbitration clause.

This legal argument was predicated on three legal premises: (1) that the informal ethics opinions from the State Bar, interpreting the MRPCs, were binding on all attorneys and the Courts; (2) that such opinions, interpreting MRPC §1.8(h)(1), constituted a legally binding gloss on the MRPCs; and, therefore, (3) as argued by plaintiff, because a violation of an MRPC is like "violating a statute" and constitutes "rebuttable evidence of malpractice," the ADR clause in the fee retainer agreement is invalid and unenforceable because it violated the asserted mandatory requirement of advising a client *in writing* to seek independent legal counsel before entering into an arbitration agreement.

Plaintiff's argument was bottomed on the pre-MRPC case of *Lipton v Boesky*, 110 Mich App 589; 313 NW 2d 163 (1981) which held that, like statutes, a violation of disciplinary rule under the prior Code of Professional Responsibility (replaced by the MRPC in 1988) is "rebuttable evidence of malpractice" and therefore was legally sufficient to bar the enforcement of the arbitration clause (even absent more traditional common law grounds to void a contract, like fraud, duress, etc). Defendant attorneys' alleged failure to

comply with MRPC 1.8(h)(i), including the requirements read into the rule by the State Bar informal ethics opinions, made the agreement to arbitrate invalid according to plaintiff.

The *Watts* Court rejected this argument and affirmed the validity of the arbitration clause. In affirming, the *Watts* Court held that informal ethics opinions interpreting the legal effect of the MRPC's are not binding on the Courts and, further, specifically held that an asserted violation of MRPC 1.8(h) by plaintiff "does not give rise to a cause of action for enforcement of the rule or for damages caused by failure to comply with the rule", citing §1.0(b) of the MRPC.¹⁰ In short, *Watts* rejected plaintiff's argument and enforced the arbitration clause notwithstanding any alleged failure to recommend that the client seek additional legal counsel regarding such a clause -- a ruling that rejects the implicit (and offensive) notion that lawyers are inherently untrustworthy and, therefore, must have their clients hire a lawyer to determine whether they should hire a lawyer.

In effect, the *Watts* Court held that the statutory law, embodied in the Michigan Arbitration Act -- law that is binding on all courts and all attorneys and their clients -- took precedence over and trumped the State Bar Informal Ethics Opinions and the MRPCs. This reading is not only consistent with Michigan law, the MRPCs and the limited legal effect of informal opinions, but it is also consistent with the manner in which other states have addressed the validity of arbitration clauses in light of their versions of MRPC §1.8(h)(1).¹¹ These courts have essentially held that an agreement to arbitrate "did not limit the attorney's liability to the client for legal malpractice, but merely selected a forum for deciding those claims."¹² Prior Michigan cases, in the medical malpractice field, also recognized this basic truth: agreements to arbitrate do not limit liability, but instead merely select the method of resolving a dispute over liability.¹³

CONCLUSION

Attorneys and clients are now faced with the issue of whether an arbitration clause should or should not be included in the retainer agreement. For a client with a well armed legal malpractice claim, arbitration may seem like a poor alternative to a trial. Prospective plaintiffs and their counsel may hope to maximize an award in front of a jury, who they hope will carry the baggage of our popular culture concerning attorneys into the jury deliberation room. On the other hand, weaker claims that might otherwise be subject to summary dismissal will probably obtain an extended life in an arbitration process and result in some award.

Lawyers desiring to seek a more private and less public route to resolve potential claims may opt for arbitration clauses. On the other hand, limited discovery, relaxed rules of evidence, the loss of procedural weapons like summary disposition and the loss of appellate rights from an adverse result may effect the analysis as to whether an ADR clause should be included.

For attorneys considering the inclusion of such clauses, they must comply with all aspects of the Michigan Arbitration Act. However, beyond that, attorneys should also carefully consider whether, in light of their particular practice fields, they should include an arbitration clause in their retainer agreements. The variety of situations in which attorney error can occur, and the harm or injury that can result, may make it difficult to assess the

positive and negative aspects of arbitration. However, under *Watts*, attorneys and their clients now have the option of choosing such a format to resolve their disputes.

Post Script: *At arbitration, plaintiff's claims were ultimately denied under the professional judgment rule. The arbitration decision was later confirmed by the Circuit Court and plaintiff's claims were dismissed.*

ENDNOTES

1. *Watts v Polaczyk, et al*, 242 Mich. App. 600, 619 N.W.2d 714 (2000).
2. *Id. at 719.*
3. MCR 2.116(C)(7) provides, in part, that summary disposition may be granted if:

the claim is barred because of release, payment, prior judgment, immunity granted by law, statute of limitations, statute of frauds, an **agreement to arbitrate**, infancy or other disability of the moving party, or assignment or other disposition of the claim before commencement of the action.

4. Under Michigan law, an agreement to arbitrate must be in writing. See MCL 600.5001(1), (2) and *Mitchell v Dahlberg*, 215 Mich App 718, 725; 547 NW2d 74 (1996) (“Where the parties to an action have agreed in writing to submit any disputes to arbitration, the arbitration provision is binding.”). “Under MCL 600.5001(2) any dispute under a contract which contains an arbitration clause is entitled to be arbitrated unless it has been expressly exempted by the terms of the contract.” *Campbell v Community Service Ins Co*, 73 Mich App 416, 418; 251 NW2d 609 (1977). In *Burns v Olde Discount Corp*, 212 Mich App 576, 580; 212 Mich App 576 (1995), the court explained the procedure for determining whether a dispute should be arbitrated:

To ascertain the arbitrability of an issue, the court must consider whether there is an arbitration provision in the parties' contract, whether the disputed issue is arguably within the arbitration clause, and whether the dispute is expressly exempt from arbitration by the terms of the contract. Any doubts about the arbitrability of an issue should be resolved in favor of arbitration.

“Once prima facie evidence of such an agreement [to arbitrate] has been presented, the statutory presumption of validity accrues, and the burden of going forward with evidence to rebut the presumption then shifts to the party seeking to avoid the agreement.” *Grazia v Sanchez*, 199 Mich App 582, 584-585; 502 NW2d 751 (1993). See *McKinstry v Valley OB-GYN*, 428 Mich 167, 181; 405 NW2d 88 (1987) *Morris v Metriyakool*, 418 Mich 423, 439-440; 344 NW2d 736 (1984).

5. This argument, although raised at the trial court level, was not raised in the appeal. Defendant-attorneys argued that under the common law test for adhesion contracts, the challenged arbitration term was “substantively reasonable and not oppressive or unconscionable,” citing *Rehman, Robson & Co v McMahon*, 187 Mich App 36, 43-44; 466

NW2d 325 (1991). Because “[r]easonableness is the primary consideration in determining whether a contract clause is enforceable”, per *Rehman*, defendants persuaded the trial court that ADR clauses have been upheld in various professional, business and trade contexts that prevented such a finding. Plaintiff’s argument, however, was ultimately raised in the appeal in the context of whether arbitration clauses run afoul of the Michigan Rules of Professional Conduct -- an argument ultimately rejected by the *Watts* Court.

6. *McKinstry v Valley OB-GYN*, 428 Mich 167, 184; 405 NW2d 88 (1987). *McKinstry* involved the enforceability of a medical malpractice arbitration clause and affirmed this basis contract principle. In *Christy v Kelly*, 198 Mich App 215, 217; 497 NW2d 194 (1993), the Michigan Court of Appeals underscored the fundamental nature of this principle:

The stability of written instruments demands that a person who executes one shall know the contents or be chargeable with such knowledge. If he cannot read, he should have a reliable person read it to him. *His failure to do so is negligence which estopps him from voiding the instrument on the ground that he was ignorant of its contents*, in the absence of circumstances fairly excusing his failure to inform himself.

7. Plaintiff-Appellant’s Brief, p 7 (emphasis in Brief).

8. Informal ethics opinions are issued by the Ethics, Professional & Judicial Committee of the State Bar of Michigan. This Committee is charged with “expressing its written opinion concerning the *propriety of professional . . . conduct* when requested to do so by . . . any member of the State Bar who inquires concerning his/her own contemplated conduct.” Bylaws of the State Bar of Michigan, Article VI (emphasis added). In short, informal opinions do not interpret the **legality** of potential conduct. This may be why Michigan Courts have never considered such opinions to be no more than “some guidance.” See, e.g., *Barkley v Detroit*, 204 Mich App 194, 202; 514 NW2d 242 (1994).

9. See State Bar Michigan Ethics Opinion RI-2 (January 28, 1989); RI-196 (March 7, 1994); and RI-257 (April 8, 1996).

10. *Watts, supra*, at 718, fn.1. Before adopting the MRPC in 1988, the Michigan Supreme Court drafted and added §1.0, entitled “Scope and Applicability of Rules and Commentary”, a section which does *not* appear in the current *ABA Model Rules of Professional Conduct*. It provides that the MRPC “*does not . . . give rise to a cause of action for enforcement of a rule or for damages caused by failure to comply with an obligation or prohibition imposed by a rule.*” MRPC §1.0(b) (emphasis added).

The Supreme Court’s Official Comments to MRPC §1.0 underscores the repudiation of the *Lipton* principle:

[A] violation of a Rule does not give rise to a cause of action, nor does it create any presumption that a legal duty has been breached. The rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability. (Emphasis supplied).

11. In *McGuire, Cornwell & Blakely v Grider*, 765 F Supp 1048, 1051 (D Col 1991), the court “conclud[ed] that Oklahoma Rule of Professional Conduct §1.8 does not void the parties agreement to arbitrate.” See *Powers v Dickson, Carlson & Campillo*, 54 Cal App 4th 1102; 63 Cal Rptr 261 (2nd Dist, Div 5 1997); *Monahan v Paine Webber Group, Inc*, 724 F Supp 224 (SDNY 1989); *Haynes v Kuder*, 591 A2d 1286, 1288 (DC App 1991).

12. *Powers v Dickson, Carlson & Campillo*, 54 Cal App at 1114.

13. See, e.g., *Cudnick v William Beaumont Hosp*, 207 Mich App 378, 387; 525 NW2d 891 (1994) (“medical arbitration agreements merely provide for an alternate method of resolving disputes concerning medical treatment; they do not purport to relive a hospital or physician from liability”).