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Calif. Justices Create Arbitration Compromise Conundrum

By **Daniel Rozansky and Crystal Jonelis** (August 6, 2019, 3:31 PM EDT)

The California Supreme Court's recent decision in Heimlich v. Shivji[1] provides litigants in arbitration valuable guidance on when and how to notify arbitrators of existing offers to compromise made pursuant to California Civil Procedure Code Section 998.

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As most know, Section 998 is a cost-shifting statute intended "to encourage the settlement of litigation without trial, by punishing the party who fails to accept a reasonable settlement offer from its opponent."[2] More specifically, Section 998 imposes mandatory and discretionary penalties on a party that declines to accept a settlement offer made under Section 998 and then fails to obtain a more favorable judgment at trial or arbitration.

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For example, if a plaintiff declines a defendant's Section 998 offer to settle the matter for $50,000, but then recovers only $30,000 at trial, the plaintiff is prevented from recovering any costs she incurred after the defendant made the 998 offer.[3] In addition, the plaintiff must pay the defendant for all his post-offer costs, even though the plaintiff ultimately prevailed in the matter.[4] The court or arbitrator also has discretion to order the plaintiff to pay the defendants' reasonable post-offer expert costs.[5]

The decision to issue or accept a 998 offer can alter the economics of a case where the prevailing party is entitled to attorney fees as a matter of law or contract. If there were a prevailing party fee provision, the prevailing plaintiff in the above example would be limited to recovering only those attorney fees predating the offer, whereas the defendant would be entitled to all his attorney fees postdating the offer.[6] Either party can make a 998 offer up to 10 days prior to trial or arbitration.[7] Critically, a 998 offer is not admissible to prove liability.[8]

In Heimlich, the plaintiff and respondent Alan Heimlich, an attorney, sued his former client, the defendant and appellant Shiraz Shivji, for outstanding legal fees. Shivji made a 998 offer, offering to pay Heimlich $30,001 to settle the case, which Heimlich rejected.[9] Later, the court granted Shivji's motion to compel arbitration pursuant to an arbitration clause in the parties' retainer agreement. In the arbitration, Shivji also filed claims against Heimlich, seeking a refund of fees already paid, and made a second 998 offer, offering to pay Heimlich $65,001, which Heimlich did not accept.[10]

The arbitrator issued a final award, granting $0 to both Heimlich and Shivji and directing that "each side will bear their own attorneys' fees and costs." Within six days of the issuance of the award, Shivji informed the arbitrator of the two prior 998 offers to Heimlich.[101] Accordingly, because Heimlich had failed to obtain a more favorable result, Shivji sought costs from Heimlich. The arbitrator, however, took the position that because he had issued his final arbitration award, he no longer had jurisdiction to take any further action in the matter.[12]

Shivji filed a motion to confirm the award with the trial court, attaching a memorandum of costs seeking $76,684.02 from Heimlich. The trial court confirmed the award but refused to add costs, stating that a request for costs under Section 998 in connection with an arbitration must be resolved by the arbitrator.[13]

The court of appeal reversed, holding that Shivji timely submitted his post-award request to the arbitrator.[14] The appellate court noted that a determination regarding a 998 offer must necessarily follow an arbitration award, and that Shivji could not have notified the arbitrator of the 998 offer prior to the award, as such offers are not admissible in trial or arbitration. The appellate court further held that the trial court had authority to vacate the arbitrator's award because the arbitrator had refused to hear evidence material to the controversy.[15]

The California Supreme Court granted review and first determined that Shivji was required to request costs from the arbitrator.[16] The court then examined whether Shivji was required to make the request before or after the arbitrator issued his award. The court found that the appellate court erred by determining that Shivji was prevented from revealing the 998 offer prior to the issuance of an award.[17] In particular, though Section 998 provides that a 998 offer "cannot be given in evidence upon the trial or arbitration,"[18] the court found a 998 offer may nevertheless be admissible to prove unrelated matters. Thus, Shivji could have informed the arbitrator of the 998 offer prior to the issuance of the award.[19]

The court further held, however, that Shivji was not obligated to inform the arbitrator of the offer prior to the issuance of the final award.[20] The court acknowledged that notifying an arbitrator of a 998 offer prior to the arbitrator issuing his or her final award is enough to potentially influence the arbitrator's award. In particular, the admission that a party made a 998 offer, even if the amount of the offer is not disclosed, "could influence a merits determination by signaling that the defendant is willing to pay at least some amount."[21]

Moreover, even if a party alerts an arbitrator of the existence of the 998 offer without disclosing the amount or the identity of the party that actually made the offer, the arbitrator nevertheless may logically assume that the party informing the arbitrator is the party who has incentive to ensure that the arbitrator is aware of the offer; that is, "the party whose offer was rejected."[22] Accordingly, requiring parties to inform an arbitrator of a 998 offer prior to the issuance of the award could cause parties reservations about making a 998 offer, thereby undermining the very purpose of Section 998, which is to promote settlement.[23]

In addition, the court observed that in amending Section 998 to apply to private arbitrations, the legislature intended "to place parties in arbitration on equal footing with parties in civil actions."[24] A rule requiring "parties in arbitration to disclose settlement offers before an award is made would contradict the goal of equal treatment."[25]

Taking all this into account, the court ruled "[c]onsistent with practice in civil litigation, for 15 days after

issuance of a final award, a party to an arbitration may submit a cost request asserting rejection of an earlier 998 offer."[26]

In making this ruling, the court rejected Heimlich's argument that an arbitrator's powers automatically terminate upon the issuance of a final award.[27] Rather, relying on both legislation and the Federal Arbitration Act, the court found that, even upon issuance of a final award, the arbitrator has ongoing jurisdiction to "amend the award and address the undecided issue."[28] Thus, regardless of whether the ruling is designated as interim or final, the "arbitrator has implicit power under section 998 to consider the request [for costs] and amend any award accordingly."[29]

Unfortunately for Shivji, however, despite the arbitrator's error in failing to consider Shivji's timely request for costs, there were no grounds for the court to vacate the arbitrator's denial of costs. The court noted that "an arbitrator's legal or factual error in determining which party prevailed may not be reversed."[30] Thus, although Shivji "was legally entitled" to wait until after the arbitrator issued his award before raising the 998 offer, by doing so "he ran the risk that the arbitrator would erroneously refuse to award costs, leaving him without recourse under the narrow grounds for vacation or correction contained in the statutory scheme."[31] Thus, the California Supreme Court reversed the appellate court's judgment.[32]

The California Supreme Court's ruling leaves parties that made or intend to make a 998 offer in arbitration with difficult choices. More specifically, parties can (1) inform the arbitrator prior to an award being rendered that a 998 offer has been made, and run the risk that the arbitrator's decision will thereafter be influenced, or (2) wait and timely inform the arbitrator that a 998 offer has been made after an award is issued, and run the risk that the arbitrator will improperly find the request untimely, thereby leaving the party with no grounds to vacate the bad ruling. Moreover, an arbitrator may unknowingly force a party to disclose the existence of a 998 offer by requesting that the issue of attorney fees and costs be included in the parties' post-arbitration briefs (in which case the party may also be compelled to disclose the amount of the 998 offer prior to the issuance of a final award).

To avoid placing parties in these difficult situations, arbitrators should take a more active role in their case management efforts. In particular, arbitrators should, as a matter of course, inform all parties at the beginning of a case that, in an effort to encourage settlement and the exchange of 998 offers, the arbitrator will issue an interim award. After the issuance of the interim award, the parties may timely inform the arbitrator of any 998 offers before the arbitrator issues his or her final award. Indeed, dispute resolution providers, such as JAMS and AAA, can explicitly incorporate this procedure into their rules.

In the meantime, parties should take affirmative steps to protect themselves. For example, the court in Heimlich suggested that "[p]arties may also agree to jointly tell an arbitrator, before any award is announced, that a 998 offer was made and rejected, without identifying the terms or who made the offer. Such notice would permit the arbitrator to designate an otherwise final award as interim and then consider the parties' presentations concerning costs and fees."[33]

If the opposing party refuses to jointly inform the court, the party making the 998 offer can also notify the case manager, where applicable, and request that the case manager inform the arbitrator that the existence of a 998 offer necessitates that the award be designated as interim. Another option is for a party to preemptively raise the possibility at the initial conference that 998 offers may be exchanged, and request that the arbitrator issue an interim award following the arbitration hearing and allow the parties to subsequently brief issues relating to attorney fees and costs.

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[1] 7 Cal. 5th 350 (2019)

[2] See Elite Show Services, Inc. v. Staffpro, Inc., 119 Cal. App. 4th 263, 268 (2004).

[3] See Cal. Civ. Proc. Code § 998(c)(1).

[4] Id.

[5] Id.

[6] See Scott Co. of Cal. v. Blount, Inc., 20 Cal. 4th 1103, 1107 (1999).

[7] Cal. Civ. Proc. Code § 998(b).

[8] Id. at § 998(b)(2).

[9] Heimlich¸ 247 Cal. Rptr. 3d at 607.

[10] Id.

[11] Id.

[12] Id.

[13] Id. at 607-08.

[14] Id. at 608.

[15] Id.

[16] Id.

[17] Id. at 610.

[18] Cal. Civ. Proc. Code § 998(b)(2).

[19] Heimlich¸ 247 Cal. Rptr. 3d at 610.

[20] Id.

[21] Id. at 611.

[22] Id.

[23] See id.

[24] Id.

[25] Id.

[26] Id. at 614.

[27] Id. at 612.

[28] Id.

[29] Id. at 614.

[30] Id. at 616.

[31] Id. at 618.

[32] Id. at 619.

[33] Id. at 615 n.8.