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Guidance on Section 998 Offers to Fee Shift in Arbitration

CODE OF CIVIL PROCEDURE SECTION 998 was enacted in order to create an added incentive for settlement.[1] In 1997, the California Legislature amended the statute to expand this incentive to arbitration proceedings.[2] When a party makes a "statutory" pretrial settlement offer or demand that is rejected by the opposing party, and the opposing party does not obtain a better result at trial, Section 998 authorizes the court to award costs to the offering party, even if that party is not otherwise the prevailing party in the litigation.[3]

In such a situation, both parties may recover costs, but not all their costs. The plaintiff is entitled to recover "costs" as the prevailing party pursuant to Code of Civil Procedure Section 1032. However, because the plaintiff did not ultimately recover more than the amount of the Section 998 offer, he is limited to preoffer costs.[4] The defendant is entitled under Section 998 to post-offer costs (i.e., because his Section 998 offer was greater than the plaintiff's judgment, he is treated as the prevailing party for purposes of post-offer "costs").[5]

The efficacy of this statute is generally limited, however, in that the costs allowed under the statute are quite restricted. It is only when attorneys' fees are at stake in the litigation or arbitration that Section 998, and the designation of "prevailing party," becomes interesting and significant. Costs recoverable by a prevailing party under Section 1032 include attorneys' fees, if such fees are authorized by statute or contract.[6]

As discussed in *Biren v. Quality Emergency Medical Group, Inc.*,[7] "a defendant whose settlement offer exceeds the plaintiff's recovery is entitled to post offer attorney fees where the parties' contract has an attorneys' fee provision."[8] In such instances, Section 998 rejected offers and/or demands may become extremely important, as the attorneys' fees in a case may approach or exceed the amount at issue in the case. In a litigation context, there are hard and fast rules for the timing of parties' applications for fees and costs pursuant to Section 998. After a trial on the merits, the prevailing party, whether the one that actually won the trial or the "prevailing party" as determined by a rejection of a statutory offer and/or demand, files a memorandum of costs to the court that includes a request for and breakdown of attorneys' fees, which the court will rule on before issuing a final judgment.

In an arbitration context, the procedure has never been as clear. Section 998, itself, provides: "If the offer is not accepted prior to trial or arbitration or within 30 days after it is made, whichever occurs first, it shall be deemed withdrawn, and cannot be given in evidence upon the trial or arbitration."[9] The reasoning behind this section, like Evidence Code Section 1152, is to eliminate the possibility that the jury will confuse a settlement offer with liability and to eliminate the possibility that the Section 998 offer will influence or even dictate the amount of the jury's award.

This section is easy to interpret in a litigation context; one simply does not present evidence of the Section 998 rejection to the jury. In an arbitration context, it is not as clear. There is typically no procedure after an award is rendered by an arbitrator for a party to submit some sort of memorandum of costs. Should one therefore wait until after the arbitrator renders his or her award and present fees and costs in a memorandum of costs to the court?

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Maaso v. Signer

That question was answered decisively by the California Court of Appeal in *Maaso v. Signer*.[10] In *Maaso*, the prevailing party under Section 998 failed to address the fees/costs issue with the arbitrator and applied to the court for fees and costs via a motion to confirm the arbitration award. The trial court granted the motion to confirm but construed the opposition to the cost portion of the motion as a motion to tax costs and granted that motion.

In affirming the judgment on appeal, the court ruled that it is the function of the arbitrator, and not that of the court, to determine the propriety of awarding fees and costs, and the proper amount thereof:

[N]ot only is the determination as to the amount [of attorney

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> fees and costs] properly within the purview of the arbitrator, but we observe it is the arbitrator, not the trial court, which is best situated to determine the amount of reasonable attorney fees and costs to be awarded for the conduct of the arbitration proceeding.[11]

The court found that the petition to "confirm" the arbitration award was essentially seeking "correction" of the award by asking the court to add costs and interest that had not been awarded by the arbitration panel, and which were in fact inconsistent with the panel's award.[12] The court ruled that a party seeking recovery of costs pursuant to Section 998 must inform the arbitrator of a rejected Section 998 offer before the arbitrator issues a final award and that the party seeking fees and costs could not subsequently request such fees and costs as the prevailing party from the trial court.[13]

Although *Maaso* made it clear that the parties were required to seek their fees and costs pursuant to Section 998 from the arbitrator and not the court, it did not shed any light on when such an application was to be made, other than "before the arbitrator issues a final award."[14] This ruling potentially ran afoul of the statutory mandate that evidence of a rejected Section 998 offer "cannot be given in evidence upon the trial or arbitration."[15]

Essentially, if the arbitrator must make all decisions regarding fees and costs pursuant to Section 998, when may a party present such evidence to him or her, if it may not be done during the arbitration? Many practitioners, particularly those who found Section 998(b)(2) to be vague, especially in an arbitration context, refrained from submitting evidence of a Section 998 rejection during the actual arbitration hearing but submitted the evidence as part of a closing argument brief. Yet, their opponents would still object to the request, claiming that the timing did not comport with Section 998(b)(2).

Heimlich v. Shivji

However, the California Supreme Court, in *Heimlich v. Shivji*,[16] put an end to this controversy, ruling that a party may submit evidence of a rejected Section 998 offer to an arbitrator at any time before an award is rendered, up to and including 15 days after the arbitrator renders a final award.[17]

In *Heimlich*, an attorney sued a client for fees, notwithstanding an arbitration provision in their fee agreement. The parties litigated the case for a year, during which time the client made a Section 998 offer to compromise for "the amount of thirty thousand and one ($30,001.00) dollars, including all taxable costs of suit to date of acceptance," with each party to bear its own attorney fees and costs.[18] The offer was rejected. Shortly thereafter, the court denied the client's motion for summary judgment and the attorney's motion for judgment on the pleadings (except with respect to eleven affirmative defenses).

Within four days of the court's partial denial of the attorney's motion for judgment on the pleadings, one year after the client filed his answer to the complaint, the client filed a demand for arbitration with the American Arbitration Association. Five months later, the arbitrator in the case ruled that the issue of whether the client had waived the arbitration provision was one for the trial court to determine. Thereafter, the trial court granted the client's motion to compel arbitration and to stay the superior court action pending the arbitration.[19]

When the case was ultimately ordered to arbitration, the client filed a 21-page statement of claims in which he alleged that the attorney had obtained approval of only one of the client's 108 patent claims, for which the client and his corporation paid the attorney approximately $177,000.00 in five years. The client accused the attorney of unauthorized flat fee billing, double billing, unilateral fee increases, delayed billing, and inflated billing, in causes of action ranging from breach of contract to breach of fiduciary duty to breach of the duty of good faith and fair dealing to unlawful business practices.

The client requested restitution for unjust enrichment, a refund of amounts paid, punitive damages, and "all costs of suit incurred herein."[20] However, there was nothing in the client's statement of claims or in any other pleading that indicated the client made a specific claim for costs pursuant to Section 998.

In response to the client's claims, the attorney filed an 18-page counterclaim, in which he realleged the five causes of action that were contained in his amended civil complaint. He also added claims for indemnification and comparative fault. Essentially, he sought to recover damages for unpaid invoices, attorney's fees, and costs of the lawsuit and arbitration pursuant to Code of Civil Procedure sections 3300 and 1032.

The arbitration hearing lasted six days, after which the arbitrator rendered an eight-page decision awarding nothing to either side. The arbitrator found that the value of the attorney's services was not less than the amount that he was paid. The arbitrator also found that any money due to the attorney for his services were owed by the client's corporation, which the attorney failed to sue. Arbitration expenses were to be "borne as incurred," and all attorneys' fees and costs for the arbitration and the pre-arbitration litigation were to be borne equally by each side.[21] According to the arbitrator, the award was "intended to be a complete disposition of all claims and counterclaims submitted to this Arbitration."[22]

Six days after the award was rendered, the client's attorney sent an e-mail to the arbitrator stating:

> There is one open matter that has to do with the award of costs pursuant to CCP § 998 and the procedure to follow regarding the same.... Our understanding is that the demand for an award for recovery of these costs should be submitted to the Arbitrator rather than directly to the Court. Your confirmation of this procedure will be appreciated.[23]

The arbitrator responded: "Counsel, once I issued [m]y Final Award I no longer have jurisdiction to take any further action in this matter. As discussed in the Award, whatever may have been the costs, fees, etc. associated with the Santa Clara litigation were to be borne by the parties...."[24]

The client then filed a motion to have the court resume jurisdiction in the case, confirm the arbitration award, and "Grant Interest and Costs Pursuant to CCP §998." The court confirmed the ($0) arbitration award, "notwithstanding consideration of any motions pursuant to California Code of Civil Procedure § 998."[25]

At the hearing on the client's request for costs, the court indicated in a tentative ruling that:

> I came to the conclusion that the leading case cited by plaintiff was on point and the one that the Court should follow, [is the] *Maaso vs Signer* case [citations]. Basically, when the matter went to the arbitrator, it was incumbent upon the defendant to raise the CCP 998 issue with the arbitrator on a timely basis. In the view of the arbitrator, it got raised late after the award.[26]

After taking the matter under submission, the court denied the client's motion, and confirmed the arbitrator's division of fees and costs.[27]

Court of Appeal Decision

On appeal, the attorney argued that the client should have presented evidence of the Section 998 offer and rejection to the arbitrator before the final award was rend-

ered. However, the court of appeal rjected that argument, based upon subsection 998(b)(2). The court, in reversing the trial court's decision, ruled that the arbitrator was empowered to recharacterize his "final" award as "interim, interlocutory, or partial" in order to determine cost apportionment in accordance with Section 998.[28] The court held that the arbitrator, by refusing to hear the evidence of the Section 998 offer and rejection after his "final" award, exceeded his powers, and was therefore in violation of subsection (a)(5) of Code of Civil Procedure Section 1286.2.

The California Supreme Court, in a unanimous decision, reversed the court of appeal decision "with directions to affirm the trial court's confirmation of the arbitration award and denial of costs."[29] The court ruled that a request for costs under Section 998 is timely if filed with the arbitrator "within 15 days of a final award. In response to such a request, an arbitrator has authority to award costs to the offering party."[30] The supreme court further held that if an arbitrator refuses to award costs, judicial review is limited. Thus, the court ruled that the court of appeal erred in relying on a "narrow exception to those limits, for failure to consider evidence," and reversed the appellate decision.[31]

The court started its analysis by reaffirming the court of appeal decision in *Maaso*, stating that the client was unequivocally required to request costs from the arbitrator "in the first instance," and that "failure to do so would have precluded relief."[32] The court held that the client's request to the arbitrator for costs was sufficient to comply with *Maaso*.

The court went on to discuss the practical effect of rejecting a Section 998 offer, i.e., that a party that might not otherwise qualify as the prevailing party may still be entitled to costs because it made a Section 998 pre-arbitration offer that was rejected, and "a better outcome ensued"[33] so that a losing defendant (or plaintiff) whose settlement offer exceeds (or is less than) the judgment "is treated for purposes of postoffer costs as if it were the prevailing party."[34]

The court then stated that subsection 998(b)(2)'s mandate that a declined Section 998 offer "cannot be given into evidence" is similar to the proscription in Evidence Code Section 1152 against using evidence of settlement discussions to prove liability, i.e., although evidence of a Section 998 offer or rejection may not be admitted to prove liability, it may be used at any time to prove "unrelated matters," in this case an entitlement to costs.[35] In other words, it would have been perfectly proper for the client to have submitted evidence of the Section 998 offer or rejection to the arbitrator at any time prior to the final arbitration award.

However, the court immediately went on to state that "[j]ust because [the client] could have raised the rejected 998 offer sooner does not mean that he was required to do so."[36] The court specifically found that the text of Section 998 does not mandate that evidence of the offer be presented to the arbitrator before a final award and that the policy underlying the statute militates in favor of allowing such evidence to be presented after the award.[37]

The court then discussed Rule 3.1700 of the California Rules of Court, which provides that a party seeking costs after a trial must do so within 15 days of notice of entry of judgment or within 180 days of entry of judgment in the absence of a notice, thus allowing a party to wait until after a decision on the merits to reveal a rejected Section 998 offer.[38]

When the legislature amended Section 998 to extend its application to private arbitrations, it did not specify a different timetable. As such, the court held that evidence of a Section 998 offer or rejection is timely if presented within 15 days after an arbitrator's final award.[39]

However, this rule did not help the client in *Heimlich*. The court went on to hold that, notwithstanding its definitive ruling that evidence of a Section 998 offer or rejection may be made at any time up to and including 15 days after an arbitrator's final award, and that the client actually presented such evidence within six days of the award, which was well within the 15-day mandate, the arbitrator's refusal to hear evidence of the Section 998 offer or rejection, whether or not the arbitrator violated the law by doing so, was not subject to vacatur.

The court stated:

> While [the client] was legally entitled to do so [present evidence six days after the final award was rendered], 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. "'[I]t is within the power of the arbitrator to make a mistake either legally or factually. When parties opt for the forum of arbitration, they agree to be bound by the decision of that forum knowing that arbitrators, like judges, are fallible.'"[40]

Heimlich makes it clear that evidence of a Section 998 offer or rejection in an arbitration proceeding may be presented at any time (albeit not to prove liability) from before the award up until 15 days after the arbitrator renders a final arbitration award. However, *Heimlich* also makes it clear that, if the arbitrator, through inadvertence or by design, fails to entertain such evidence, there is nothing that anyone can do about it. The better practice, therefore, is, and has always been, to notify the arbitrator of a Section 998 offer or rejection prior to the rendering of a final arbitration award to be certain that the arbitrator will consider the issue in rendering his or her award. ■

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[1] Heimlich v. Shivji, 7 Cal. 5th 350 (2019).
[2] 1997 Stat., ch. 892, §1; Pilimai v. Farmers Ins. Exchange Co., 39 Cal. 4th 133, 139, 149. (2006).
[3] Martinez v. Brownco Constr. Co., 56 Cal. 4th 1014, 1019 (2013).
[4] *See* Code Civ. Proc. §998(c)(1).
[5] *See* Code Civ. Proc. §998(c)(1); *see* Scott Co. v. Blount, Inc., 20 Cal. 4th 1103, 1110 (1999); SCI Cal. Funeral Servs., Inc. v. Five Bridges Found, 203 Cal. App. 4th 549, 576-578 (2012); Biren v. Equality Emergency Med. Group, Inc., 102 Cal. App. 4th 125 (2002).
[6] *See* Code Civ. Proc. §1033.5(a)(10).
[7] Biren, 102 Cal. App. 4th 125.
[8] *Id.* at 140.
[9] Code Civ. Proc. §998(b)(2).
[10] Maaso v. Signer, 203 Cal. App. 4th 362 (2012).
[11] *Id.* at 379, quoting DiMarco v. Chaney, 31 Cal. App.4th 1809, 1816-1817 (1995).
[12] Maaso, 203 Cal. App. 4th at 378.
[13] *Id.* at 380.
[14] *Id.*
[15] Civ. Proc. Code §998(b)(2).
[16] Heimlich v. Shivji, 7 Cal. 5th 350 (2019).
[17] *Id.* at 354.
[18] Heimlich v. Shivji, 12 Cal. App. 5th 152, 157 (2017).
[19] *Id.*
[20] *Id.* at 158.
[21] *Id.*
[22] *Id.* at 159.
[23] *Id.*
[24] *Id.*
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.* at 174.
[29] Heimlich v. Shivji, 7 Cal. 5th 350, 371 (2019).
[30] *Id.* at 356.
[31] *Id.*
[32] *Id.* at 358, citing Maaso v. Signer, 203 Cal. App. 4th 362, 377-78 (2012); Corona v. Amherst Partners, 107 Cal. App. 4th 701, 706-07 (2003).
[33] Heimlich, 7 Cal. 5th at 359, citing Civ. Proc. Code §998(c)–(e).
[34] Heimlich, 7 Cal. 5th at 359, citing Scott Co. v. Blount, Inc., 20 Cal. 4th 1103, 1114 (1999).
[35] Heimlich, 7 Cal. 5th at 360, citing White v. Western Title Ins. Co., 40 Cal. 3d 870 (1985).
[36] Heimlich, 7 Cal. 5th at 360.
[37] *Id.* at 361.
[38] *Id.*, citing Cal. R. Ct. 3.1700(a)(1); Kahn v. Dewey Group, 240 Cal. App. 4th 227, 234-37 (2015).
[39] Heimlich, 7 Cal. 5th at 356.
[40] *Id.* at 370-71, citing Moncharsh v. Heily & Blase, 3 Cal. 4th 1, 12 (1992), quoting That Way Prod. Co. v. Directors Guild of Am., Inc., 96 Cal. App. 3d 960, 965 (1979).