BILL ANALYSIS

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Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	**Migden**	**SB 1113**

SUBJECT

Authorize Court to Award Attorney's Fees and Costs, Including Expert Witness Fees

SUMMARY

This bill would authorize a court to include costs, including expert witness fees, when awarding attorney's fees under the Code of Civil Procedure (CCP).

PURPOSE OF BILL

According to the author's office, this bill is intended to return the law regarding expert witness fees and other costs to the long-held understanding prior to a recent court decision because these costs are often critical to the outcome of public interest cases.

EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2009, and apply as of that date.

ANALYSIS

CASE LAW

Northwest Energetic Services, LLC v. Franchise Tax Board[1]

- In 2006, a superior court awarded attorney fees of $3.5 million against the Franchise Tax Board (FTB) under CCP section 1021.5 and the common fund doctrine.
- FTB appealed arguing that the award of attorney fees should not have been granted.
- The appellate court found that attorney's fees could be awarded under CCP section 1021.5; however, the amount awarded by the trial court was excessive, and the case was remanded back to the trial court to re-determine the amount to be awarded.
- The FTB petitioned the California Supreme Court for review, and that petition was denied.

Beasley v. Wells Fargo Bank[2]

- In 1991, the California Appellate Court held that expert witness fees and other nonrecoverable expenses incurred by counsel may be awarded under CCP section 1021.5. However, *Olson*, below, rejected this interpretation and thus overruled Beasley.

[1] *Northwest Energetic Services, LLC v. Franchise Tax Board* (A114805, A115841, and A115950 [Consolidated].
[2] *Beasley et. al. v, Wells Fargo Bank* (1991) 235 Cal. App. 3d 1407.

Olson v. Automobile Club of Southern California[3]

- In 2008, the California Supreme court rejected the *Beasley* interpretation and thus overruled *Beasley*.
    - The Court noted that the plain language of CCP section 1021.5 authorizes an award of attorneys' fees to a prevailing party and is silent with respect to expert witness fees.
    - The Court further noted that expert witness fees are typically not considered a subset of attorneys' fees, but rather as a distinct and independent subset of the costs of litigation.
    - In addition, the Court emphasized that the Legislature's omission of expert witness fees from the statute was notable in light of the numerous statutes that expressly include language regarding expert witness fees.

CURRENT LAW

Revenue and Taxation Code (R&TC)

- R&TC section 19717 provides that certain parties that prevail against the FTB in a civil proceeding may be awarded reasonable litigation costs, which is defined by that section to include court costs, expert witness fees, the cost of studies, and attorney fees.
- To receive attorney fees a prevailing party must meet the following three requirements:
    1. All available administrative remedies must have been exhausted prior to initiating the lawsuit.
    2. The litigation costs must be reasonable and allocable solely to the State of California.
    3. The prevailing party must have reasonable litigation costs during the civil proceeding, except for the period in which the prevailing party has unreasonably protracted that proceeding.
- If the State of California establishes that its position was substantially justified, then the prevailing party may not recover any litigation costs.[4]
- To be substantially justified, the state's position must have a reasonable basis in law and fact. It does not need to be a winning argument.[5]

[3] *Olson v. Automobile Club of Southern California* (2008) 42 Cal.4th 1142.
[4] R&TC section 19717(c)(2)(B)(i).
[5] *McDonnell Douglas Corp. v. Franchise Tax Bd.*, 26 Cal. App. 4th 1789, 1798 (Cal. Ct. App. 1994).

Code of Civil Procedure (CCP)

- CCP section 1021.5 provides that a prevailing party whose litigation results in the enforcement of an important public interest may be awarded attorney fees.
- To receive attorney fees, a party must meet three requirements:
    1. Provide a significant benefit to the general public or a large class of persons.
    2. The financial burden of private enforcement makes the attorney fee award appropriate.
    3. To achieve justice, the circumstances require that attorney fees be provided in addition to the recovery.
- A significant benefit may be monetary or non-monetary. It does not need to be a concrete benefit.[6] The significant benefit requirement is met if the benefit only affects the general public.
- A financial burden that makes an award appropriate is one where the cost of victory exceeds the party's personal interest so that the cost of the lawsuit is disproportionate to the disputed issue.
- A court may award less than the full amount of attorney fees when a successful party's financial gain warrants.
- Public entities may not receive attorney fees in litigation against individuals.[7]
- Attorney fees are calculated by determining the lodestar and applying a multiplier. The lodestar is the product of hours the attorney worked times a reasonable hourly rate. The trial court may increase or decrease the lodestar by a multiplier.[8] (For example, if an attorney worked ten hours at a reasonable hourly rate of $350, then the lodestar is $3,500. If a multiplier of 2 is applied, the final attorney fees awarded are $7,000.)
- Unlike R&TC section 19717, CCP section 1021.5 does not require the exhaustion of administrative remedies and allows an award of attorney fees even if the defendant (here FTB) was substantially justified in defending the lawsuit. For example, in *Ventas*[9] the award under CCP section 1021.5 was 1.5 times the lodestar or about $225,000, but in that case there had been no exhaustion of administrative remedies and thus attorney fees would not have been awarded under R&TC section 19717.
- The California Constitution requires a state agency to enforce a statute until an appellate court determines it is unconstitutional or unenforceable.[10]

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[6] *Woodland Hills Residents Ass'n v. City Council of L.A.*, 23 Cal. 3d 917, 939 Footnote 12 (Cal. 1979).
[7] Cal. Code Civ. Proc. section 1021.5.
[8] *Downey Cares v. Downey Community Development Com.*, 196 Cal. App. 3d 983, 994 (1987).
[9] *Ventas Finance I, LLC v. Franchise Tax Board*, (A116277, app. pending First District of the California Court of Appeal.)
[10] Cal. Const. Art. III, section 3.5.

THIS BILL

This bill would authorize a court to award costs, including expert witness fees, in addition to attorneys' fees, under CCP section 1021.5. As a result, the State, when party to a lawsuit, could be required to pay expert witness fees and other costs, in addition to attorneys' fees.

PROGRAM BACKGROUND

- In 1974, the United States Court of Appeals for the District of Columbia awarded the Wilderness Society, Environmental Defense Fund, and Friends of the Earth attorney fees for serving as a private attorney general.[11]
    - The attorney fees were sought for the plaintiff's litigation to prevent construction of an Alaskan pipeline.
    - The Court of Appeals found that the plaintiffs acted as a private attorney general by enforcing public policy and should not have to finance litigation that was for a public benefit. The fee shifting was not intended to be punitive.
- In 1975, the United States Supreme Court reversed the decision in *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y* [12] because the Court of Appeals awarded the attorney fees without a statutory basis and because this award was contrary to "the general 'American rule' that the prevailing party may not recover attorneys' fees as costs or otherwise."
    - The Supreme Court in this case also stated that it was within the authority of Congress to create a private attorney general doctrine.
- In 1977, the California Supreme Court created the private attorney general doctrine in *Serrano v. Priest*.[13]
    - The court found that the financing system for California schools violated the state constitution's equal protection provisions.
    - The court found that the United States Supreme Court's ruling against a federal private attorney general doctrine did not prevent state courts from creating it as a state-based doctrine.
    - The court found that even though California statutes followed the general American rule regarding attorney fees, the California courts had already established two exceptions "based upon the inherent equitable power of the court."

[11] *Wilderness Soc. v. Morton*, 495 F.2d 1026 (D.C. Cir. 1974).
[12] *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 241 (1975).
[13] *Serrano v. Priest*, 20 Cal. 3d 25 (1977).

1. The first exception was the common fund principle: those who benefit from another's litigation that creates a fund should share in the expense that created the fund.
2. The second exception was the substantial benefit rule: non-litigants who benefit from litigation that acts in a representative capacity and creates a substantial benefit for the non-litigants should share in the expense that created the substantial benefit.

- The court's rationale for the doctrine was that many citizens have common interests. The benefit to society of these interests is momentous, but not large enough for one private citizen to litigate alone.
- The court applied the doctrine to constitutional rights and left the determination of whether it should apply to statutory rights for another case.

- In 1978, the California legislature codified the California Supreme Court's decision by enacting CCP section 1021.5.
- In 1980, The Equal Access to Justice Act (EAJA) was enacted by Congress. [14] It has a justification similar to the private attorney general doctrine.
  - The purpose of the EAJA was to reduce the disincentive for certain parties to engage in litigation with the federal government because of the high cost involved in protecting their rights.

OTHER STATES' INFORMATION

The laws of *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* were surveyed because their tax laws are similar to California's income tax laws.

- None of these states have an Equal Access to Justice Act as broad and encompassing as California's private attorney general doctrine as codified in CCP section 1021.5.
- *Florida* has a private attorney general provision in Florida Statute section 400.023.
  - The statute pertains to the rights of those in nursing homes and related health care facilities. Recovery of costs and reasonable attorney fees not to exceed $25,000 are available to parties who prevail in seeking injunctive relief or an administrative remedy.
  - A prevailing taxpayer may be awarded attorney fees and litigation costs when the tax agency's position is not substantially justified.
  - Under the Florida Equal Access to Justice Act, a qualifying party may recover attorney fees and litigation costs resulting from adjudicatory proceedings or administrative proceedings. In an action initiated by the state, an award for attorney fees and costs may not exceed $50,000.

[14] Oct. 21, 1980, PL 96-481, Title II, section 202, 94 Stat. 2325.

Illinois, *Massachusetts*, and *Minnesota* law have no equivalent mention of attorney fee and litigation cost recovery in the tax code. *Illinois* and *Massachusetts* law does not contain an EAJA type act. *Minnesota* law contains a provision similar to the federal EAJA. It permits a prevailing party in a civil proceeding with the state to recover fees and other expenses if the party shows the state's position was not substantially justified. The act includes attorney fee awards in tax cases. *Michigan* law permits a taxpayer to recover actual damages, which include attorney fees, up to $10,000 when the tax agency intentionally or recklessly ignores a rule, guideline, procedure, or the law. *Michigan* does not have an EAJA-type act.

- *Illinois*, *Massachusetts*, and *Minnesota* law have no equivalent mention of attorney fee and litigation cost recovery in the tax code.
- *Illinois* and *Massachusetts* law does not contain an EAJA type act.
- *Minnesota* law contains a provision similar to the federal EAJA.
    - It permits a prevailing party in a civil proceeding with the state to recover fees and other expenses if the party shows the state's position was not substantially justified.
    - The act includes attorney fee awards in tax cases.
- *Michigan* law permits a taxpayer to recover actual damages, which include attorney fees, up to $10,000 when the tax agency intentionally or recklessly ignores a rule, guideline, procedure, or the law. *Michigan* does not have an EAJA-type act.
- *New York* tax statute provides the exclusive remedy for a prevailing party to be awarded litigation costs and attorney fees in connection with the determination, collection, or refund of any tax. *New York* Tax Law section 3030 provides that certain parties that prevail against the Department of Taxation and Finance in a civil proceeding may be awarded reasonable litigation costs.
    - Reasonable litigation costs include court costs, expert witness fees, the cost of studies, and attorney fees. The hourly rate for attorney fees is capped. The court may adjust the rate upon a determination that there is an increase in the cost of living.
        - The statutory rate is $75 per hour.
        - A court may award attorney fees above the capped rate when a special factor presents itself.
        - The statutory example of a special factor is the limited availability of qualified attorneys for such proceedings.
        - To be considered a prevailing party, the party must substantially prevail on the disputed amount, or substantially prevail on the significant issues in the case. However, if the tax agency establishes that its position was substantially justified, then the prevailing party may not recover any litigation costs.
- *New York* has an EAJA, but it is not applicable to tax cases because the tax law provides an exclusive remedy.

FISCAL IMPACT

- This bill may result in some departmental administrative costs resulting from increased litigation expense awards brought under CCP section 1021.5. The increased amount that may be incurred is speculative because there have been few awards made under CCP section 1021.5.

ECONOMIC IMPACT

State Fiscal Impact Discussion:

- This bill could increase state expenditures by specifying that CCP section 1021.5 authorizes a court to award attorney's fees and costs, including expert witness fees. As a result, FTB could be required to pay expert witness fees and other costs in addition to attorney's fees in the future in connection with suits brought under CCP section 1021.5.
    - The amount of this additional expenditure cannot be quantified because it depends on the outcome of pending litigation, the frequency of future relevant litigation, and on the size of future awards, all of which are unknown.

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- In August 2006, for the first time, a prevailing party in tax refund litigation against the FTB was awarded attorney's fees under CCP section 1021.5. Additional fee awards under CCP section 1021.5 have been awarded in two cases since that time. In these cases, there were no expert witness fees. The amount of future additional costs resulting from by this bill will depend on the following events occurring:

    1. A taxpayer prevails in a refund suit against FTB;
    2. The taxpayer seeks and is awarded fees and costs under CCP section 1021.5;
    3. The court determines the taxpayer's action resulted in the enforcement of an important right affecting the public interest;
    4. Expert witness fees are part of the litigating costs borne by the taxpayer.

Because this proposal applies to decisions rendered after 1/1/2009, and there is typically three to four years between the date litigation is filed and the date an award for litigation costs is made, it is possible that the state will be required to make additional expenditures in the 2008/09 fiscal year.

Appointments

None.

Support/Opposition

Support: Consumer Attorneys of California; California League for Environmental Enforcement Now; Los Angeles County Bar Association; Sierra Club; Center for Environmental Health; Youth Law Center

Opposition: California Chamber of Commerce; Civil Justice Association of California; Association of California Insurance Companies

VOTES

Assembly Floor – Ayes: 42, Noes: 33
Senate Floor – Ayes: 23 , Noes: 14
Concurrence – Ayes: 22, Noes: 14

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