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New York Panel Rules that Indemnification Clauses of Contracts Must Meet the "Exacting" Test to Entitle a Prevailing Party to Attorney's Fees

Client Alert

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In a decision that will have a reverberating effect on how indemnification language will be negotiated and drafted in New York contracts and undoubtedly influence a party's choice as to whether to pursue costly litigation, the Appellate Division of the First Department of New York recently unanimously held in *Gotham Partners, L.P. v High Riv. Ltd. Partnership* (2010 NY Slip Op 06149) that, unless an indemnification clause of a contract is "unmistakably clear" and meets the "exacting" test set forth nearly 20 years ago in *Hooper Associates v AGS Computers* (74 NY2d 487), the winning side of a dispute between two parties to a contract will not be entitled to attorney's fees, regardless of the contracting parties' original intent.

Typically under American law, parties to litigation are responsible for paying their own legal fees. Contracting parties, however, regularly negotiate and draft indemnification clauses to include language that is intended to entitle one contracting party to reimbursement of its attorney's fees and damages from the other – regardless of whether the fees were incurred from defense of a third-party claim or its prevailing in a dispute between the contracting parties. Such universal indemnification clauses have become boilerplate language, regularly inserted into virtually every form of American contract from real estate transactions to the sale of goods.

The Appellate Division of the First Department of New York held in *Gotham Partners, L.P.*, however, that the use of such boilerplate language is not sufficient to entitle a prevailing party to attorney's fees unless it is "unmistakably clear" that the indemnification covers the fees of the winning side of a dispute between two parties to the original contract. Reminding that New York State is inherently and "distinctly inhospitable" to the use of indemnification clauses to recoup attorney's fees, the Panel held that "for an indemnification clause to serve as an attorney's fees provision with respect to disputes between the parties to the contract, the provision must ***unequivocally*** be meant [and interpreted] to cover claims between the contracting parties ***rather than*** third-party claims." Otherwise, even if an indemnification clause can be interpreted to entitle a party to attorney's fees that indemnification clause will be void as it applies to the fees of a prevailing party to a suit between two original contracting parties.

The panel's decision will have a lasting effect on literally thousands of existing contracts in New York and will influence parties' negotiation of such clauses in the future. No longer are parties able to negotiate and craft indemnification clauses "with an eye to extracting the essence of a right to attorney's fees for the winning side." At least for now, "a contract provision employing the language of a third-party claim for indemnification may not be [crafted] to encompass an award of attorney's fees to the prevailing party based on the other party's breach of the contract," regardless of the parties' original intent.