

The Dirt Report

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September 27, 2011

Drafting An Attorneys' Fee Provision That Pays

Samuel Goldwyn famously commented that "an oral contract isn't worth the paper it's written on." It turns out that, in some cases, the same can be said for attorneys' fee provisions in written contracts. Understanding why that is the case can help in drafting a more valuable fee provision.

Take the case of Seller, who spent months negotiating a written contract with Buyer. The agreement included an attorneys' fee clause stating that, "in any dispute between the parties arising out of this agreement, the prevailing party shall be awarded its attorneys' fees and costs incurred in connection with the dispute." Seller insisted on that clause to discourage meritless lawsuits and protect her if she had to defend against one.

Buyer later sued Seller for breach of contract, fraud and other torts relating to the transaction. In defending against what she believed to be baseless claims, Seller took comfort in knowing that she would be entitled to recover her attorneys' fees and costs if she prevailed.

Two years later, and just days before trial was to begin, Buyer voluntarily dismissed all claims. Seller had a complete resolution of the claims against her without any liability to Buyer.

So, Seller was entitled under the contract to recover her attorneys' fees, right?

Well, maybe. And, if so, only in part. *Why?*

General Rule: When the Prevailing Party's Fees Are Recoverable as Costs

In California, a "prevailing party" is entitled under Code of Civil Procedure Section 1032 to recover its costs incurred in a civil action. Under Code of Civil Procedure Section 1033.5(a)(1), attorneys' fees may be awarded as costs only where authorized by a contract, statute or law. California cases routinely hold that a contract like Seller's encompasses a right to fees incurred in defending against both contract and tort claims arising from the transaction.

Seller was the "prevailing party" as that term is used in the Code of Civil Procedure and under general rules of contract interpretation. Section 1032 expressly provides that a "prevailing party" includes "a defendant in whose favor a dismissal is entered." And "prevailing party," in its "ordinary or popular sense," refers to the party who achieved its objectives in the litigation. *Santisas v. Goodin* (1998) 17 Cal.4th 599, 609. Seller achieved her litigation objective by preventing Buyer from obtaining any relief against her. Therefore, if the issue were determined only by the rules of contract law and the Code of Civil Procedure, Seller would be entitled to recover the fees incurred in defending against Buyer's claims.

But, under the state Supreme Court's ruling in *Santisas*, Seller's claim for fees incurred on Buyer's *contract* claims are barred by Civil Code Section 1717, and her right to recover fees incurred on the *tort* claims is uncertain and subject to the trial court's discretion to be exercised based on indefinite criteria.

Fee Award Barred Civil Code Section 1717

Civil Code Section 1717 was originally enacted to require mutuality of right to recover fees where the contract provides the remedy to only one party, but it has been expanded to apply "in any action on a contract" where the contract authorizes an award of fees. Section(b)(2) provides: "Where an action has been voluntarily dismissed or dismissed pursuant to a settlement of the case, there shall be no prevailing party for purposes of this section." So that section precludes any award of fees to Seller incurred in Buyer's action on the contract. According to *Santisas*, "[t]his bar, however, applies only to causes of action that are based on the contract and are therefore within the scope of section 1717." Fees incurred for tort claims (such as the fraud claim against Seller) are recoverable by the prevailing party if authorized by the contract.

On the other hand, fees incurred on tort claims may not be *automatically* awarded to a party who has obtained a voluntary dismissal. "In particular," *Santisas* noted, "it seems inaccurate to characterize the defendant as the 'prevailing party' if the plaintiff dismissed the action only after obtaining, by means of settlement or otherwise, all or most of the requested relief, or if the plaintiff dismissed for reasons, such as the defendant's insolvency, that have nothing to do with the probability of success on the merits."

That comment in *Santisas* suggests that a party seeking fees for tort claims must make a showing that the dismissal was "on the merits," or was motivated by the plaintiff's assessment of its probability of success on the merits. Obviously, proving *why* the plaintiff dismissed a claim will, in most cases, be difficult. If the plaintiff recovered nearly all the relief it sought through settlements with other parties, then the inquiry may be relatively simple. (The only case on point is *Silver v. Boatwright* (2002) 97 Cal.App.4th 443, in which plaintiffs recovered \$68,500 of their \$70,000 damages claim before dismissing the remaining defendant, as it was not practical to try the case for the remaining \$1,500.)

But, where a plaintiff recovers only a fraction of the claimed damages from other sources, the court is apparently required under *Santisas* to examine the strengths and weaknesses of the parties' positions - essentially forcing the parties to try the merits of the case despite the dismissal. Trial courts are given little guidance on how to proceed in such cases, what criteria to apply and what evidence or measure of proof is required. One thing that is clear - a defendant seeking to recover its fees in such a case will likely incur substantial additional fees to prove it is a "prevailing party" entitled to recover its fees.

Drafting Tips

Like most contract provisions, attorneys' fee clauses are generally intended to afford the parties some certainty about what to expect during the contract relationship – specifically if the relationship winds up in litigation. Although Section 1717(b)(2) and the Supreme Court's comment in *Santisas* can make the right to recover attorneys' fees highly uncertain, some greater degree of certainty can be achieved through careful drafting of the fee provision.

With respect to fees incurred on contract claims, Section 1717 cannot be waived. Thus, *Santisas* held that, when a plaintiff voluntarily dismisses contract claims, "Section 1717 bars the defendant from recovering attorneys' fees incurred in defending those causes of action, even though the contract on its own terms authorizes recovery of those fees."

Where fees are sought for defense of dismissed tort actions, however, the courts will look first to the contract to determine which party should be deemed the prevailing party, "including any contractual definition of the term 'prevailing party' and any contractual provision governing payment of attorneys' fees in the event of dismissal." The contract drafter would be wise to clearly express the parties' intentions.

For example, the fee provision may state:

In any dispute between the parties arising out of this agreement or the transaction, the prevailing party shall be awarded its attorneys' fees and costs incurred in connection with the dispute, including fees and costs incurred in any appeal. All such costs and attorneys' fees shall be deemed to have accrued on commencement of any legal action or proceeding and this section shall be Sanenforceable whether or not such legal action or proceeding is prosecuted to judgment. For purposes of this section, and to the fullest extent permitted by law, "prevailing party" includes a party against whom a legal action is filed and later voluntarily dismissed in whole or in part, regardless of the reason or motivation for such dismissal.

Of course, the fee provision should be tailored where possible to the specific transaction and the types of claims likely to arise. For example, where fees are likely to be incurred in an action filed by someone other than the other contracting party but arising from the contract relationship, the fee provision should be drafted to encompass any fees incurred by a party in defending its rights under the contract. Likewise, where there is a potential for incurring fees in administrative hearings or proceedings other than civil litigation, which should be reflected in the fee provision to help ensure that the parties' intention to award fees to a prevailing party will be enforced.

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