

Prevailing party attorneys' fees clause: Some challenges

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A prevailing party attorneys' fees clause in a contract can create havoc when trying to resolve disputes in a reasonable manner—particularly when looking to professional liability insurance to cover damages.



An example of a prevailing party clause is as follows: "In the event of litigation relating to the subject matter of this agreement, the prevailing party shall be entitled to receive from the other party its reasonable attorneys' fees and costs."

This contract provision requires the party that does not prevail in a lawsuit to pay the prevailing party's legal fees and other costs that have been itemized in the contract clause, such as expert witness fees.

For the reasons discussed below, this paper suggests: (1) don't agree to include prevailing party clauses in contracts, and (2) if your client absolutely requires one, then at a minimum, (a) limit it to fee disputes; (b) carefully define what it means to be the "prevailing party" in order to remove the uncertainty of how a court or arbitrator might subjectively determine the prevailing party; and (c) cap the recovery of attorneys' fees at the amount of the actual compensatory damages recovered.

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Contractual liability exclusion bars coverage for shifted attorneys' fees

Professional liability insurance policies only cover damages that a design professional is legally obligated to pay as a result of its negligent acts, errors or omissions in the performance of professional services.

All professional liability policies, as far as we know, include what is known as the "contractual liability" exclusion. That exclusion states there is no coverage for liability that the insured design professional assumes under a contract that it would not have had at common law for its negligent acts, errors or omissions.

Under what is known as the American Rule, each party to litigation will bear its own litigation costs in the absence of a statutory or contractual requirement. By agreeing to pay the attorneys' fees of a client that prevails in a claim against the insured, the insured has created a contractual liability that is excluded from coverage because it is an obligation it would not otherwise have at common law, but which was created solely by virtue of the contractual promise.

Whether any claim is covered is a decision made by the carrier's claims department after a claim has been made against the insured. The coverage decision is based on the application of the law, the policy and the specific facts of the case.

It is also important to consider that because professional liability policies are "claims-made," the policy in effect when the claim is made could very well be different and written by a different insurance company by the time a claim for prevailing party fees and costs is made against the design professional.

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the claim is made. Therefore, it will be the current insurance carrier's policy and interpretation of coverage that matters, rather than the company that wrote the policy at the time the contract between the design professional and client was entered into.

The old idea that frivolous law suits would be discouraged by prevailing party clauses has not panned out

There was a time when the design and construction community (as well as some of their legal and risk management advisors) recommended prevailing party clauses as 1) a way to make plaintiffs think twice before filing frivolous lawsuits, and 2) as a means to facilitate litigation by designers and contractors against their clients who were arbitrarily refusing to pay fees when due.

The thinking was that the cost of pursuing legal action to recover unpaid fees would be so excessive that designers and contractors would not be able to justify the legal battle and would have to forego collecting their fees. The prevailing party clause was supposed to remedy that by forcing the recalcitrant client to pay the plaintiff's legal fees in addition to the fees earned under the contract.

Unfortunately, there was a problem with this logic. Anyone who has spent time in the construction industry knows that virtually every time a designer or contractor sues its client for unpaid fees, there is going to be a countersuit claiming negligent performance of services and various errors, omissions and deficiencies that caused the client to incur extra project costs and damages.

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A polling of numerous design professional insurance carriers reveals that many of the claims they have paid on behalf of their insured design professionals resulted from counterclaims brought by clients after the designer sued to recover its fee. This has become so prevalent that many carriers consider designers who sue clients for a fee to be a high risk and include a question on the insurance application asking whether the designer files suits against its clients to collect fees.

The irony is that not only does the prevailing party clause not help the designer or contractor to collect its fees through litigation; it has actually resulted in adverse settlements because, as discussed below, it may be safer to settle for less than to potentially pay the other party’s attorneys’ fees at the end of lengthy and expensive litigation.

The prevailing party clause may be encouraging litigation

Based on anecdotal evidence, it appears that rather than discouraging litigation, the prevailing party clause may actually be encouraging project owners to make claims they would have otherwise foregone based on a cost-benefit of analysis of how much they would have to pay in attorneys’ fees compared to how much they would potentially recover from the defendant. If, however, the owner can recover its attorneys’ fees, it does not matter that it may ultimately get a relatively small compensatory damage recovery from the defendant. The prevailing party clause can make it worth the gamble for the plaintiff to pursue a claim that it might not otherwise have pursued.

Prevailing party clause may adversely impact settlement

Due to the threat of having to pay an adverse party’s expensive legal costs, some contractors and design firms are settling disputes for less than their true value. They are finding it is too dangerous

to take the risk that their client might prevail on some small part of their overall claim and yet be deemed the “prevailing party” and receive attorneys’ fees far exceeding the compensatory damages awarded.

This has a chilling effect on seeing litigation or arbitration through to a final determination, even if it is predicted that the defendant would be able to successfully defend against the biggest part of the claims. The problem is that if the defendant successfully defends against 80% of the claim, so that the plaintiff only prevails on 20% of its claim, that plaintiff could still be deemed the “prevailing party” and be entitled to its attorneys’ fees pursuant to the prevailing party clause. How courts interpret the prevailing party clause varies widely from state to state.

From my own recent experience in defending claims against design professionals by contractors (one in court and one in arbitration), the prevailing party attorneys’ fees provision caused the design firm to make a risk management decision to settle the cases for more than they would likely have paid if the matters went to final judgment. This is because even a small judgment might have resulted in having to pay exorbitant attorneys’ fees to the contractor as the “prevailing party.”

In those cases, the prevailing party clause could be said to have encouraged the filing of claims against the design professional and then have caused the design professional to pay settlement amounts it felt were unjustified.

It is examples like this that are causing some insurance carriers to advise their design professional insureds to strike out the prevailing party attorneys’ fees clause in contracts when negotiating the contract terms and conditions.



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What costs are to be awarded to the prevailing party?

To avoid uncertainty concerning what costs are intended to be reimbursed to the prevailing party, it is advisable that a detailed description or listing of the cost be included in the clause. For example, rather than stating that the prevailing party will be entitled to recover “reasonable attorneys’ fees and court costs,” it would be better to describe in greater detail the costs and expenses intended to be covered. For example, confusion could be avoided by stating that the prevailing party will be entitled to recover “any and all costs and expenses incurred with respect to such litigation or other proceeding, including without limitation, reasonable attorneys’ fees, court costs, other disbursements and costs and expert fees and costs.”¹

If the clause does not specifically state that it includes expert fees as part of the recoverable cost, it is quite possible the court will not allow them. In the case of *Specialty Retailers Inc. v. Main Street NA Parkade, LLC* (Massachusetts 2012), a court found that expert fees were not recoverable under a prevailing party clause that only entitled recovery of “reasonable attorneys’ fees and court cost” because, in the court’s opinion, expert fees do not equate to court costs. This demonstrates the importance of being clear with regard to your intent when drafting prevailing party clauses.

Who is the prevailing party?

According to Black’s Law Dictionary, the prevailing party is “a party in whose favor a judgment is rendered, regardless of the amount of damages awarded.”²

The United States Supreme Court has stated, “Plaintiffs may be considered ‘prevailing parties’ for attorneys’ fees purposes if they succeed on any significant issue in litigation which achieves some of the benefit the parties sought in bringing suit.”³ Federal Rules of Civil Procedure, Rule 54 (d)(1) provides that even in the absence of a prevailing party clause, the “prevailing party in federal litigation is entitled to recover costs other than attorneys’ fees.” As a result of this rule, at the conclusion of a case, federal judges must make a determination of who is the “prevailing party” in order to award “court costs.” For purposes of rule 54 (d), a party is deemed a prevailing party if the court awards it “substantial relief.” See *Smart v. Local 702 International Brotherhood of Electrical Workers*.⁴

A party that obtains “substantial relief” is deemed the prevailing party in federal litigation “even if it does not win on every claim.” (*Slane v. Mariah Boats, Inc.*)⁵ An excellent example of this is seen in the case of *Summerfield v. City of Chicago*⁶, where a jury awarded a plaintiff \$30,000 on two counts of a complaint, found against him on a third count and the judge earlier dismissed two other counts by summary judgment.

This decision is instructive as to how courts can be expected to determine who is a prevailing party in general. Courts look to whether “substantial relief” was awarded and not necessarily what percentage of recovery the plaintiff was awarded as compared to its overall claim. Thus, even if a defendant is successful in defeating most of a plaintiff’s claim, as in *Summerfield*, a small recovery by that plaintiff might be sufficient for the court to find they obtained “substantial relief” and are entitled to recover all or some significant portion of their attorneys’ fees.



Example of plaintiff recovering attorneys' fees despite losing claim for compensatory damages

In the case of *Signature Flight Support Corporation v. Landow Aviation Limited Partnership*⁷, the impact of a prevailing party clause was severe. The plaintiff sued to obtain declaratory relief preventing the defendant from continuing certain actions. It also sued for compensatory damages of over \$4 million.

The court granted declaratory judgment and an injunction in favor of the plaintiff prohibiting the defendant from continuing certain business practices that the plaintiff alleged was causing it harm. The court found in favor of the defendant, however, on the breach of contract and accounting claims because the court concluded the plaintiff failed to prove the monetary amount of its damages. The net result of the court decision was that the defendant had to stop certain business practices but it did not have to pay any of the compensatory damages claimed.

At the conclusion of the trial, the plaintiff filed an application for over \$1 million in attorneys' fees along with a bill of almost \$200,000 for costs it expended in the litigation. After considering the reasonableness of the fees, the court awarded the plaintiff attorneys' fees in the amount of \$1,130,843.60 and costs in the amount of \$176,577.34.

This case is a striking example of how attorneys' fees can far exceed any compensatory damages awarded, and in fact might be the only financial damages awarded.

Define the prevailing party as the overall "net" winner of the total law suit

In one recent decision (*Sharif v. Mehusa, Inc.*)⁸, an appellate court in California held that both the plaintiff and defendant could be prevailing parties in the same legal action and both entitled to recover attorneys' fees from their opposing party. In the trial, a plaintiff was awarded damages on one claim but lost another claim. Each party sought to recover its fees as the prevailing party under two different fee-shifting statutes applicable to the separate causes of action.

The plaintiff argued, however, that she was the prevailing party within the meaning of the applicable California code that defined prevailing party as "the party with the net monetary recovery." She further argued that there can be only one prevailing party in a civil action and because she had won on one of her three claims, she was the one that prevailed.

The trial court and appellate court rejected the plaintiff's argument and concluded that because the defendant prevailed in defending two of the claims, the defendant was also a prevailing party under the fee-shifting statute applicable to those two claims. The court explained, "When there are two fee-shifting statutes in different causes of action, there can be a prevailing party for one cause of action and a different prevailing party for the other cause of action."

The need to carefully define specifically who is the prevailing party

As seen from the cases discussed in this briefing, the question of who is the prevailing party can be quite subjective, and judges and arbitrators can have broad discretion in making the determination. Rather than risking the unpleasant surprise of having one's opposing party found to be the prevailing party despite having lost most of their case, it is wise to define prevailing party in a manner that removes some of the subjectivity as well as the decision-maker's discretion.

Indemnity clauses may create uninsurable prevailing party attorneys' fees

Pursuant to a contractual indemnification clause, a trial court awarded damages of \$810,000 in attorneys' fees against an engineer in favor of a project owner, Wal-Mart Stores, Inc., on a jury verdict that found Qore, Inc. only liable for \$48,600 in actual property damages

The indemnification clause in question provided the following:

"The Testing and Inspection Firm [Qore] further agrees to indemnify and hold Wal-Mart free and harmless from any claim, demand, loss, damage, or injury (including Attorneys' fees) caused by any negligent act or omission by the Testing and Inspection Firm, its agents, servants, or employees."

An initial question to be determined by the court was whether this indemnification only applied to claims brought against Wal-Mart by third parties or whether attorneys' fees were permitted in a first-party dispute (i.e., Wal-Mart directly against the engineer) as well. The court held that the language of the indemnity clause allowed recovery in first-party actions.

Wal-Mart's first party claim against the engineer, a general contractor and others was for damages due to failure of a parking lot in which the engineer had provided geotechnical and design services to allow the store and lot to be built on a layer of clay just below the surface. A jury found the total damages to the building were \$486,000, with engineer being 10% at fault and the general contractor being 90% at fault for the damages. Thus, the engineer was liable for only \$48,600 but had to pay many multiples of that in attorneys' fees as a result of the contract clause that the court held constituted a prevailing party attorneys' fees clause.

With regard to the parking lot, the jury found no liability on the part of the engineer, but instead found Wal-Mart 50% liable and a general contractor 50% liable and awarded Wal-Mart \$1.6 million in damages for the parking lot. In a post-trial motion, Wal-Mart sought to recover its attorneys' fees incurred in the litigation on all the claims (both the ones it succeeded on and the ones it lost).

The court awarded the entirety of the attorneys' fees against the engineer pursuant to the indemnity provision of the contract. This decision was reversed on appeal, with the court holding that Wal-Mart's recovery of attorneys' fees should be limited to those claims upon which it prevailed against the engineer. The court did not suggest, however, that this limitation would prevent an award of attorneys' fees that would exceed the compensatory damages on those claims. See *Wal-Mart Stores, Inc. v. Qore, Inc.*⁹

Lesson learned from Wal-Mart

As noted by the court in this case, responsibility for paying attorneys' fees incurred by another party can arise by express contract language despite the fact that they would not otherwise be recoverable under state common law or statutory law. When negotiating indemnification clauses in design professional contracts (and other types of contracts as well), it is important to carefully craft the clause so that the obligation to indemnify is limited to the extent of damages caused by the design professional's negligence and to make the clause applicable only to damages arising out of third-party claims against the indemnitee. It is often assumed that the indemnity clause is only intended to respond to legal liability that the indemnitee incurs as a result of third-party claims, but that may be a bad assumption, as the decision in this case demonstrates. If that is the intent, it needs to be clearly stated.

Design professionals should also be aware that the contractual liability exclusion in the professional liability policy precludes coverage for liability assumed under indemnification clauses that would not have been imposed by law (meaning either state common law or statutory law). If the only legal basis for recovery of attorneys' fees from the design professional is the contractual indemnification language, there is no insurance coverage for those fees since they are not "damages" that would be awarded by the court in the absence of the contract language.



Definitions of prevailing party clauses found in contracts

Each of these is somewhat different, but the key thing they have in common is that they create an objective way to determine the prevailing party and they eliminate the uncertainty of having a judge or arbitrator make that decision on a subjective basis.

1. Prevailing party shall be defined (1) as a claimant that is awarded net 51% of its affirmative claim, after any offsets for claims or counterclaims by the other party, and (2) as a defendant / respondent against whom an award of less than 50% of a claimant's claim is granted. In claims for money damages, the total amount of recoverable attorneys' fees and costs shall not exceed the net monetary award of the prevailing party.
2. Prevailing party is the party who recovers at least 75% of its total claims in the action or who is required to pay no more than 25% of the other party's total claims in the action when considered in the totality of claims and counterclaims, if any. In claims for money damages, the total amount of recoverable attorney's fees and costs shall not exceed the net monetary award of the prevailing party.
3. Prevailing party, as used herein, shall mean a party who recovers on an affirmative claim an award which equals or exceeds 67% of the claim (principal only), or a party who is required to pay no more than 33% of the other party's claim after offsets for any counterclaims or affirmative defenses. To the extent the award yields a result that falls between 33.01% and 66.99% of an affirmative claim, there shall be no prevailing party. If both parties assert affirmative claims, each party's claims shall independently be, in the aggregate, evaluated by this standard. In claims for money damages, the total amount of recoverable attorneys' fees and costs shall not exceed the net monetary award of the prevailing party.
4. In any arbitration or litigation by either party to enforce the terms of this contract, the prevailing party is entitled to reimbursement of its reasonable attorneys' fees and costs in bringing or defending the action. As used herein, prevailing party means the party that is afforded the greater relief (whether affirmatively or by means of a successful defense) with respect to claims having the greatest value or importance as determined by the court or arbitrator(s) allowing for all of the claims, counterclaims, and defenses asserted under the contract. In claims for money damages, the total amount of recoverable attorneys' fees and costs shall not exceed the net monetary award of the prevailing party.
5. Prevailing party within the meaning of this section shall include, without limitation, a party who substantially (i.e., 51% or greater) obtains or defeats, as the case may be, the relief sought in the action when considered in the totality of claims and counterclaims, if any. In claims for money damages, the total amount of recoverable attorneys' fees and costs shall not exceed the net monetary award of the prevailing party.

Conclusion: Just say “no” to the prevailing party clause

In a prior time, the prevailing party clause seemed like a good idea. Surely, it was thought, the client would pay the amount it owed rather than risk being compelled to pay the design professional’s legal fees and costs in addition to the unpaid fee amount. Today we know that the prevailing party clause creates more problems than it was ever intended to solve.

Unfortunately, prevailing party clauses are becoming more common in agreements written by clients. It seems that every client thinks that it will win every dispute and sees little downside to inserting the clause. For the design professional that could be faced with uninsurable liability for the client’s legal fees and costs, the downside is substantial. When presented with a prevailing party clause, the design professional’s first response should be to request its deletion in favor of the American rule, which makes each party responsible for its own costs. Only if that request fails should the other steps described above be taken to negotiate a clear definition of the prevailing party, limit application of the clause to fee disputes, and cap the amount of the attorneys’ fees and costs that must be paid.

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- ¹ Please note that from the author’s perspective, the fewer defined costs that are included in a prevailing party clause, the less uninsurable risk may result.
- ² Black’s Law Dictionary, 8th ed. 2004. P. 1154.
- ³ *Hensly v. Eckerhart*, 461 U.S. 424, 433 (1983).
- ⁴ *Smart v. Local 702 International Brotherhood of Electrical Workers*, 573 F.3d 523 (7th Cir. 2009).
- ⁵ *Slane v. Mariah Boats, Inc.*, 164 F.3d 1065 (7th Cir.), cert. denied, 527 U.S. 1005 (1999).
- ⁶ 2012 WL 5381255
- ⁷ *Wal-Mart Stores, Inc. v. Qore, Inc.*, 647 F.3d 237 (5th Cir., 2011)
- ⁸ *Sharif v. Mehusa, Inc.*, Cal. App. LEXIS 897 (2015), Cal. App. 2d Dist. (Oct 14, 2015).
- ⁹ *Wal-Mart Stores, Inc. v. Qore, Inc.*, 647 F.3d 237 (5th Cir., 2011).

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