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Risk Management Tools for the Design Professional



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Prevailing Party Perils: Attorney's Fees' Clauses in Professional Service Contracts

by David A. Ericksen, Esq.

In the world of claims-related contract clauses for design professional agreements, the indemnity and defense clauses get all the attention. However, lurking in the shadow of the indemnity clause is a menacing cousin with potentially even greater and more frequent impact and risk: the prevailing party attorneys' fee clause. Both clauses share the common risk that they are often not covered by professional liability insurance because each represents a contractually-assumed liability which would not exist in the absence of the contract.

The indemnity clause draws the far greater attention because that obligation and exposure often arises during the claim by way of the defense obligation, as opposed to the attorneys' fees clause which ultimately comes into play definitively only after a final judgment. Moreover, many design professionals (and especially their CFOs) are attracted to the prevailing fees clause as a means of effectively collecting unpaid fees. Without such a clause, they worry that the expense of pursuing collection of unpaid fees will eat up much of the ultimate recovery. Accordingly, it has some initial positive appeal.

However, that appeal is limited in perspective and overlooks the far greater potential negative impact of the prevailing party attorneys' fees clause in the context of a professional liability claim which is the all too common response to even justified actions to recover unpaid fees. As opposed to the indemnity and defense obligation, the prevailing party attorneys' fees clause will apply far more frequently. The indemnity and defense clause applies only where the client itself is facing a third-party claim. By contrast, the prevailing party attorneys' fees clause will generally apply to every client dispute, regardless if third parties are involved. Since the majority of claims against design professionals come from the project client, that

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makes it far more likely and relevant. Moreover, where professional liability issues are involved in the dispute, the presence of the clause may actually dilute the design professional's fiscal advantage. Specifically, absent the perceived panacea of the prevailing party attorneys' fees clause, design professionals frequently hold a superior financial advantage during claims by virtue of their insurance which will fund defense costs as compared to the client claimant which is often left to fund the costs of litigation from their own resources. The unfortunate reality is that pacified by the promise or potential to recover their attorneys' fees at the end of the dispute, many client claimants and their attorneys incur far more than they would absent that prospective reimbursement—even to the point of incurring multiples in expense beyond the prospective recovery. Even if the claim is largely defeated or reduced, even a minimal net recovery may establish the client as the prevailing party entitled to recover the attorneys' fees incurred in the action.

Whether expressly stated as such, or not, it is important to recognize that a prevailing party attorneys' fees clause is almost always a two edged sword equally available to both parties. As a matter of consumer protection, nearly every state has statutes which refuse to recognize one-sided attorneys' fees clauses and automatically convert the clause into a bilateral clause entitling and exposing each side to the benefits and burdens of the clause. (See for example Oregon Revised Statute 20.096 and Florida Statute Section 57.105(7).) Accordingly, a clause which purports to entitle the design professional to recovery of its attorneys' fees in pursuit of its fees will most often to create and equivalent right of recovery in the client for contract related claim.

Whether proposed by the client or by the design professional, prevailing party attorneys' fees clauses are a common component of many commercial contracts, including design professional service agreements. An unqualified prevailing party attorneys' fees clause is almost never a good idea for a design professional. Where such a clause is proposed, the following five options present a descending structure of preferred approaches. In proposing or negotiating any of these five options, frequently the best rationale in support of these approaches is that any dispute should focus on resolution of the dispute and not arming the lawyers for battle. The five preferred approaches are:

1. The first and preferred option is simply never to include and always seek to delete any prevailing party attorney's fees clause.
2. The second option is a close strategic equivalent and perhaps even better from the perspective of collection of fees. Specifically, it is to make the clause subject to a fixed dollar cap. Ideally, the cap should be consistent with likely expenses in fee recovery action and limited enough that it can be managed without imperiling the economic future of the firm. Most often, such a

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Severson & Werson has provided legal services throughout California and the country for more than fifty years. The firm provides counseling and litigation support to all members of the construction process, including design professionals, construction managers, environmental professionals, owners, contractors, and insurance carriers.

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modification may be accomplished by the simple words, “up to a maximum of \$XXX” or “not to exceed \$XXX”.

3. The third option is not universally viable in all states. Some states, such as Florida, expressly allow and approve the use of “fee collection only clauses,” to allow recovery of attorneys’ fees only as to the collection aspect of the case, but not requiring the expansion to fees in a dispute over a different contractual obligation. Other states such as California (Civil Code Section 1717) necessarily read the reciprocity of an attorneys’ fees clause much more broadly so as to include all contract based claims even where the sole contractual reference is to collection of fees. Where such a limitation is available, it may best be accomplished by the use of words such as “solely with respect to a dispute over payment of Consultant’s compensation” and including it in the compensation section of the agreement as opposed to the dispute resolution section.

4. The reality is that many clients will not concede to any of the foregoing. They do not want the risk and want leverage to fund and force solutions. In this situation, the final remedy may be to redefine “prevailing” such that a mere net recovery is not enough to be the prevailing party. Too often, even a small fractional recovery on the stated claim would be enough to establish the client as the “prevailing” party. Again, the focus should be on solutions. To that end, one common sense definition would be to provide, “In order to be determined the prevailing party, a party must be more successful in the final judgment than in the best written offer of settlement made at any time prior thereto.” Such a clause not only establishes a more balanced and equitable determination of the status as the prevailing party, but also actually promotes resolution by compelling parties to make reasonable and aggressive compromises in pursuit of resolution.

5. Finally, if none of the foregoing are viable, yet the business justifications still favor accepting the project and client, at least insist on inclusion of the word “reasonable” as a point of balance or better yet “reasonable in relation to the recovery” as an additional point of comparative rationality with the final outcome.

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