

AN ATTORNEY'S FEE PROVISION IN A CONTRACT CAN AFFECT THE OUTCOME OF A CONSTRUCTION DISPUTE

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California follows the “American Rule” under which each party to a lawsuit ordinarily must pay his or her own attorney’s fees. Code of Civil Procedure section 1021 provides parties to a contract with a rather broad right to “contract out” of the American Rule (for example, by including in the contract an attorney’s fee provision providing for recovery of attorney’s fees by the prevailing party in the event legal action is filed). The right to “contract out” of the American Rule is, however, subject to certain restrictions and conditions. It also has implications affecting the outcome of a construction dispute.

Does your contract contain an attorney’s fee provision? If so, does this provision provide for the recovery of attorney’s fees incurred before a lawsuit is actually filed? Does it provide for fees only if you arbitrate a dispute? Answers to these questions with regard to an attorney’s fee clause in a construction contract can make the difference between settling the case early and avoiding the expense of litigation, or avoiding a large (and oftentimes unexpected) award of attorney’s fees should the case go to trial.

Civil Code section 1717 states that if a contract contains an attorney’s fee provision in which the “prevailing party” can recover their attorney’s fees if legal action is instituted “to enforce” the contract, then the party determined to be the “prevailing party” (as that term is defined in other code sections) is entitled to recover “reasonable” attorney’s fees in addition to other costs (incidentally, the party awarded attorney’s fees need not be a party to the contract). At first glance, the words “in an action . . . to enforce” seem to say that a lawsuit must be filed before attorney’s fees are recoverable. Courts have ruled that these words do *not* limit the recovery of attorney fees to amounts incurred only during litigation. *Grossman v. Park Fort Washington Association* (2012) 212 Cal.App.4th 1128, 1133. In one case, the court said that no language in Civil Code section 1717 “precludes compensation for fees incurred prior to filing the complaint, where fees were reasonably and necessarily incurred at that time by the prevailing party.” *Stokus v. Marsh* (1990) 217 Cal.App.3d 647, 655-656.

So what does this mean? Since parties can “contract out” of the American Rule by inserting attorney’s fees provisions in contracts, it is important to consider the implications of this provision if a dispute arises. If there is no attorney’s fees provision in the contract, the wealthier party is likely to have an advantage in a construction dispute. If this provision specifically excludes recovery of fees incurred before a lawsuit is filed, it can discourage pre-litigation settlement efforts such as mediation. If an attorney’s fees provision provides for “reasonable” fees, it may preclude recovery of all fees incurred. If this provision applies only to arbitration but the contractor cannot enforce the contract’s arbitration provision against the owner, the contractor may not be able to recover attorney’s fees incurred in a court action.

A poorly-worded attorney's fees provision may require the parties to litigate the issue of recoverability of attorney's fees in addition to litigating the underlying claim. It is particularly aggravating when the underlying claim is relatively small in relationship to the amount of attorney's fees incurred to resolve the claim. A strongly-worded attorney's fee provision allows the parties to focus on resolution of the claim with the understanding of the consequences if they lose.

It is important to consider the long-term, potential effects of the attorney's fee provision in your contracts should a dispute arise. An experienced construction attorney can provide invaluable assistance in this regard.

Myer Law attorneys Raymond A. Myer and Ariana A. Vugrek have over 45 years of combined experience representing contractors, suppliers, owners, architects and engineers in construction-related matters ranging from the preparation and negotiation of contracts to litigation in state and federal courts. Myer Law provides this information as a service and it does not establish an attorney-client relationship with the reader. This article is not a substitute for legal advice. Since laws change frequently, you should contact an attorney to before using this information. Raymond A. Myer and/or Ariana A. Vugrek can be reached by phone at 805.962.0083, or by email at rmyer@myerlawpc.com or avugrek@myerlawpc.com, or visit our website (www.myerlawpc.com). January 2016.