PROFESSIONAL LIABILITY AGENTS NETWORK
NEWSLETTER
PLAN

Prevailing Party Clauses: Why They Are Dangerous And Should Not Be Ignored

It is not uncommon to find a clause in a client's agreement form that relates to responsibility for attorneys' fees and litigation expenses. It's common to see this towards the end of a contract, perhaps in a section entitled "Miscellaneous Provisions". Possibly it's contained within the dispute resolution provisions. Wherever it is located, by the time one comes to what is commonly referred to as a "Prevailing Party" clause, one's brain can be tired. A Prevailing Party clause is a clause that many design firms don't spend a great deal of time or energy negotiating. Many firms don't see it as a critical clause, nothing worth fighting about. Isn't a clause like this why firms buy insurance? Hopefully, you understand that in many instances, Prevailing Party clauses drafted by your clients are often totally uninsurable. Since litigation costs can be enormous, this is not a clause you want to ignore or pass over quickly. Cases arise regularly where one party agrees to an onerous Prevailing Party clause, only to find themselves paying a relatively small amount in damages, but a vast sum in legal fees. Very often, merely the threat of the massive expense of a legal squabble is enough to convince the architect or engineer to make a business decision to settle, even if they have little liability.

The origin of the Prevailing Party clause goes back to merry old England. England is usually thought of as the Mother Country of the United States. As such, many of the laws in the early colonies were borrowed from Mother England. One legal concept that the United States left behind when it became a sovereign nation involved the rule over which party was responsible for legal fees incurred during civil litigation. The longstanding "English Rule" held that the party who loses in the litigation pays the winning party their legal costs incurred in the lawsuit. The rationale behind the English Rule seems fair enough: if you sue me and I win, it's only fair that you pay me for the legal fees I've incurred, because I won. If I sue you, and you win, fairness dictates that I pay your legal costs. Since most claims against design firms are resolved without any damages being paid out by the design firm, it might seem the English Rule would be preferable for the American design profession.

Alas, the U.S. follows the American Rule. The American Rule holds that each party to a lawsuit should bear their own legal fees. The reasoning behind the American Rule is the belief that the English Rule inhibits individuals from pursuing legitimate claims. If some poor soul has been injured, they might not pursue their legitimate claim because if they lose, they could potentially owe the other party a great deal of money in legal fees. Many people believe, rightly or wrongly, that the English Rule takes away 'the keys to the courthouse' for people without the financial resources to risk having to pay the other side's legal costs. Some believe the American Rule encourages litigation. In any event, in litigation in the U.S, in the absence of a contractual clause or a statute obligating one party to pay another's legal costs, usually both parties to a contract are responsible for their own legal costs.

Claims against design firms almost always seem to fall under the Professional Liability Policy. A longstanding policy exclusion amongst professional liability carrier policies is that they exclude coverage for the other party's

legal costs. The insurance carriers did not want to incentivize claimants to pursue a claim against an architect, engineer, or other design firm, as they might also recover their attorney fees. In recent years, many professional liability carriers have relaxed the total exclusion of coverage for the other party's legal fees to add coverage for the reasonable defense fees incurred by the other party to the extent those fees were incurred because of the insured's professional negligence. While these changes provide some coverage for litigation costs where there was none before, the coverage is still quite limited. There are other nuances as well to whether you would have coverage on this issue, so it is essential to discuss this with your professional liability broker.

One example of a poor owner-generated Prevailing Party clause is:

"If Architect defaults in its obligations to Owner under this Agreement, Owner shall be entitled to recover from Architect, in addition to any other damages incurred by Owner, Owner's reasonable costs (including reasonable attorneys' and experts' fees and expenses) incurred by Owner to enforce this Agreement." This is poor language for several reasons. It is not mutual; it only favors the owner. It isn't tied to or limited to your negligence. It also incentivizes the Owner because you are agreeing to reimburse it for its costs in pursuing you. Let's look at another couple of examples:

"If the Owner is the prevailing party in any action, litigation, or proceeding arising out of or related to this Agreement, the Engineer shall pay the Owner's attorneys' fees, expert witness fees, and costs."

Or

"In the event of any litigation arising under this Agreement, the unsuccessful party shall pay the reasonable attorneys' fees of the prevailing party."

The term "prevailing party" is undefined and ambiguous in its meaning. Courts can interpret it to mean anything they deem appropriate. It is even possible for a party to recover less than 10 percent of its claim and be awarded 100 percent of its attorneys' fees as the Prevailing Party." Since the Prevailing Party clause may create uninsurable losses, the preferred course of action is to strike this clause from your contracts. However, if the owner insists, the term "prevailing party" needs to be carefully defined. Never agree to a Prevailing Party clause unless you add a definition such as the ones below. Note that there are numerous ways to draft a definition, and different percentages can be used at the option of the parties. The important thing is that there be some definition of what this critical term means. One example is:

"Prevailing Party" is the party that recovers at least 67% of its total claims in the action or that is required to pay no more than 32% of the other party's total claims in the action when considered in the totality of claims and counterclaims, if any. In claims for monetary damages, the total amount of recoverable attorney's fees and costs shall not exceed the net monetary award of the Prevailing Party.

Another example:

"In the event of a dispute arising out of this Agreement, the prevailing party will be entitled to recover from the non-prevailing party all reasonable costs, including but not limited to reasonable attorneys' fees, incurred by the prevailing party arising from such dispute. "Prevailing Party" shall be defined (1) as a claimant that is awarded net 51 percent of its affirmative claim, after any offsets for claims or counterclaims by the other party, and (2) as a defendant/respondent against whom a net award of 50 percent or less of a claimant's claim is granted. 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.

Recommended Approaches

1. Strike the Clause: The safest option is to remove Prevailing Party clauses entirely.
2. Define "Prevailing Party": If removal isn't possible, include a clear definition tied to claim percentages and limit recoverable fees to the net award.
3. Mutual and Insurable Language: Consider clauses that apply only to third-party claims and are contingent on proven negligence and court-awarded costs.
4. Discuss with your professional liability broker.