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An “Attorneys’ Fees” Clause: Use It or Lose It?

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances. We would like to thank PLAN member Jeffrey W. Cavignac, CPCU, RPLU, President of Cavignac and Associates in San Diego, California, for his significant contribution to authoring this article.

An “attorneys’ fees” or “prevailing party” clause is a contract provision that requires the loser of a lawsuit or claim to pay the winning party’s legal fees. In the absence of such a provision, each party typically bears its own legal costs.

Historically, the insurance industry and the legal profession have recommended that attorneys’ fees clauses be included in design professional contracts. Such clauses will make a client think twice before bringing a meritless complaint against a design firm. Facing the fact they might have to pay the defendant’s legal costs in the event they do not prevail, many prospective plaintiffs reconsider filing a questionable claim.

Attorneys’ fees clauses are especially helpful when design firms are forced to sue a client for nonpayment of fees. The prospect of spending thousands of dollars to collect your receivables without the possibility of recovering your legal costs may cause you to just throw up your hands, forget recovering the fees and chalk the loss up to experience. With an attorneys’ fee clause, you are more apt to keep your resolve and fight for the fees you deserve.

A typical attorneys’ fees clause might read as follows:

In the event of any litigation arising from or related to this Agreement, or the services provided under this Agreement, the prevailing party shall be entitled to recover from the non-prevailing party all reasonable costs incurred including staff time, court costs, attorneys fees, and all other related expenses incurred in such litigation. In the event of a no-adjudicative settlement of litigation between the parties or a resolution of a dispute by arbitration, the term “prevailing party” shall be determined by that process.

Is an Attorneys’ Fees Clause a Good Idea?

Recently there has been much discussion as to whether or not an attorneys’ fees clause is, in fact, in a design professional’s best interest. This controversy arises from the fact that if your contract has such a clause and a court finds you negligent as alleged, you have to pay the other party’s legal expenses in addition to the damages you caused. This voluntary contractual assumption of liability for the other party’s legal defense costs may not be covered by your professional liability policy.

As you probably know, professional liability insurance covers your legal liability arising out of your negligent acts, errors or omissions. It does *not* cover your contractual assumptions of liability unless you would be legally liable in absence of the contract clause. Because of this, some insurance companies currently recommend against including an attorneys fees clause in your contracts. In fact, in some cases, they may deny coverage of such fees.

We approached a number of underwriters from different insurance companies that write professional liability coverage to get their opinions on this matter. Of the seven who responded, three were in favor of the position.

One underwriter stated, *“The clause is there to discourage frivolous claims, and we encourage its usage. Although one can never generalize about the outcomes of specific situations until one knows the facts and sees the actual contract language, we can say that, for the most part, we will cover prevailing parties’ legal costs unless a unique circumstance prohibits it.”*

Another underwriter opined, *“This has always been the typical ‘double-edged sword,’ and we have encouraged its use in most instances. We are not aware of any instances in which it has been used against our insureds; however, there have been situations in which it has been used to our insured’s advantage.”*

Four underwriters were not in favor of the provision, mainly due to the fact that the contractual assumption of another’s legal fees would not be covered under their insurance policies. (The three that agreed with the provision felt that in most cases it would be covered.)

One of the four stated, *“While prevailing party clauses can be a deterrent, if the insured is in fact the loser, costs incurred by the plaintiff who the defendant is contractually obligated to reimburse would be excluded contractual liabilities and uninsured as such.”*

Another underwriter said that the insured would be *“assuming liability by contract that they would not otherwise have, and therefore no coverage would apply.”*

We also approached three different attorneys who specialize in defense of design professionals. While one attorney was opposed to the use of the provision, one was in favor of it, and the other was on the fence, but leaning toward the negative view.

The attorney in favor of the clause stated, *“I recommend [attorney clause] provisions to all of my clients, since without them you cannot afford to pursue fee claims, which you’ll want to do far more often than you’ll be sued. I believe it tends to discourage frivolous claims against design professionals.”*

The attorney opposed to the provision stated, *“The attorneys’ fees clause is a trap for design professionals; i.e., it encourages owners to sue, and it is uninsurable under the typical E&O [errors and omissions] policy. The ‘American Rule’ is that parties bear their own attorneys’ fees in litigation. Attorneys’ fees clauses in professional services contracts are not at all typical, and they tend to promote litigation when the proper thing for the parties to do is to work out their difficulties, whatever they may be, through informal discussion or mediation, i.e., methods where attorneys are not involved.”*

The third attorney stated, *“I draft a fair number of contracts for design professionals, and I always discuss the pros and cons of an attorneys’ fees clause. The clause will deter a plaintiff from filing a claim out of fear of an award of attorneys’ fees. Most claims, however, settle, and the settlement typically includes a waiver of fees and costs. It is rare to have a recovery for fees and costs. My experience has been that when we are negotiating settlements and attempt to raise the fee clause for leverage, there is typically very little impact from such a maneuver. Lately the trend is not to include a prevailing party clause. I think that would be my current position, if asked to prepare a contract.”*

Consider a Limited Clause

So what is a design professional to do?

One alternative is to use an attorneys’ fees clause in your billing and collection provisions only. It would therefore be limited to suits for fees, where such a clause makes it financially feasible to attempt to collect unpaid amounts. Such a clause might read as the following example from XL Insurance:

*In the event legal action is necessary to enforce the payment terms of this Agreement, the Consultant shall be entitled to collect from the Client any judgment or settlement sums due plus reasonable attorneys fees, court costs and other expenses incurred by the Consultant for such collection action and, in addition, the reasonable value of the Consultant’s time and expenses spent for such collection action, computed according to the Consultant’s prevailing fee schedule and expense policies.**

On a larger scale, the question is whether or not to include such a provision for all liability. Those in favor of using attorneys' fees clauses will tell you that, first and foremost, it causes prospective plaintiffs to carefully evaluate their cases to make certain there is merit. Secondly, they will point out that since most claim settlements typically include a waiver of fees and costs, it is rare that the provision will actually come into play. Having the provision in your contract, however, can strengthen your bargaining position when negotiating a claim settlement.

Those opposed to including attorneys fees clauses do so mainly because the design professional's obligation to reimburse a plaintiff's defense costs could be uninsurable.

Finally, consider this excerpt from a recent *Communiqué* newsletter published by XL Insurance:

"To make sure our guidance to policyholders agrees with our current experience and that of our claims staff and panel counsel, we are no longer advising policyholders to add attorneys' fees clauses on a blanket basis, and are removing any such recommendation from *The XL Insurance Contract Guide for Design Professionals* and other loss prevention and education materials. There are always exceptions of course, and in certain, limited circumstances an attorneys' fees provision may be appropriate. If you have any questions about whether you should have such a clause, speak with your attorney about the pros and cons in light of your particular practice, client and project."*

If you do not have a strong conviction for the use of an attorneys' fees clause, then we generally recommend against it. Alternatively, you might consider using such a clause in your billing and payment section only. Regardless, the inclusion or exclusion of such a clause should be discussed with your attorney. We welcome the chance to answer any insurance questions that you might have.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management

policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.

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