

Attorney Fees Clause Gives Reciprocal Rights

By June Lin

Introduction

Imagine a promissory note that includes a standard attorney fee provision requiring the borrower to pay all costs of collection, including reasonable attorney's fees. The borrower defaults and the lender sues to enforce the note. The borrower countersues, claiming the note is usurious. The borrower prevails on his usury claim. But is the borrower entitled to an award of attorney fees, when there is no attorney fee provision in the note in favor of the borrower? Yes, if the note is governed by California law.¹

Reciprocity Rule in California Civil Code Section 1717

California Civil Code Section 1717 provides, "In any action on a contract, where the contract specifically provides that attorney's fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to other costs." The primary purpose of Section 1717 is to ensure mutuality of remedy for attorney fee claims under contractual attorney fee provisions. Courts have recognized that Section 1717 has this effect in two situations.

First, Section 1717 grants a reciprocal right to attorney fees when a contract provides the right to one party but not the other. In this situation, Section 1717 allows recovery of attorney fees by whichever contracting party prevails, whether or not such party is the party specified in the contract.

¹ For a discussion of California usury laws, please see my article "California Usury Laws" in the Primerus BCI e-Newsletter for November 2009.

Second, Section 1717 also applies when a contract provides that attorney fees incurred to enforce the contract shall be awarded to the prevailing party, but the party sued on the contract successfully defends the litigation on the basis that no contract was ever formed, the contract was invalid, or such party was not a party to the contract. Because these arguments are inconsistent with a contractual claim for attorney fees, a party prevailing on these bases usually cannot claim attorney fees as a contractual right. If Section 1717 did not apply to this situation, the right to attorney fees would be effectively unilateral, regardless of the reciprocal wording of the attorney fee provision allowing attorney fees to the prevailing party, because only the party seeking to affirm and enforce the contract could invoke the contract's attorney fee provision. To ensure mutuality of remedy in this situation, courts have held that when a party prevails in an action on a contract by establishing that the contract is invalid, inapplicable, unenforceable, or nonexistent, Section 1717 permits that party's recovery of attorney fees whenever the opposing parties would have been entitled to attorney fees under the contract had they prevailed. Section 1717 therefore applies to contracts containing reciprocal as well as unilateral attorney fee provisions.

By building a reciprocal right to attorney fees into contracts, Section 1717 reflects the legislative intent that equitable considerations must prevail over both the bargaining power of the parties and the technical rules of contract interpretation. Section 1717(a) further states, "Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract..." This reciprocal right to attorney fees may therefore not be waived by contract, consistent with the equitable purpose of Section 1717.

By its terms, Section 1717 applies specifically to contract actions. But the range of recognized contract claims is broad, and includes causes of action for rescission, declaratory relief, shareholder derivative claims premised on contract, and statutory claims such as Truth in

Lending. In addition, California courts have permitted victorious parties to claim attorneys' fees pursuant to Section 1717 for efforts devoted to non-contract claims, such as fraud or breach of fiduciary duty, where the facts and issues common to the contract and non-contract claims are sufficiently intertwined.

Section 1717 also clarifies that the "party prevailing on the contract" is the party who recovers a greater relief in the action in a final judgment. Furthermore, if an action has been voluntarily dismissed or dismissed pursuant to a settlement of the case, then there would be no prevailing party entitled to attorney's fees. Courts have held that equitable considerations prevent the award of Section 1717 contractual attorney fees to the defendant after the plaintiff's voluntary dismissal of a complaint before trial. Recovery of attorney fees by defendants in such cases might encourage plaintiffs to maintain pointless litigation in moot cases or against insolvent defendants to avoid liability for those fees.²

Conclusion

Parties contracting in California need to be aware of California Civil Code Section 1717, which provides that any contractual attorney fees provision must be applied mutually and equally to all parties to the contract, even if written otherwise. Choosing a governing law of a different State without California's reciprocity rule may not get you out of Section 1717, if the contract was negotiated and signed in California and the parties had sufficient contacts with California.

This article is intended to provide a general summary and should not be construed as a legal opinion nor a complete legal analysis of the subject matter. June Lin is an attorney at Niesar & Vestal LLP in San Francisco, a law firm specializing in business law and corporate finance.

²Although Section 1717 bars recovery of attorney fees incurred in defending contract claims in voluntary pretrial dismissal cases, it would not bar recovery of attorney fees incurred in defending tort or other noncontract claims in such cases.