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CONSTRUCTION

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SO FAR AWAY FROM HOME IT'S NO LONGER AN AMERICAN TUNE: FEE SHIFTING IN CONSTRUCTION DISPUTES

Unlike the law in England, Canada, and other countries, the so called American Rule is that each party in a litigation bears its own attorneys' fees. That rule is fast becoming the exception. Whether by statute or contract, it is now common for prevailing parties in the United States to be able to recover attorneys' fees. This is perhaps best demonstrated by the fact that at least one carrier is now offering what it calls "Contract Litigation Insurance."[1]

The rationale behind fee shifting is simple. Winners should win. After all, the legal fees were incurred only because the other side refused to acknowledge what a court or arbitrator has now found — that they should have paid up long ago or that their claim did not have merit.

HISTORY OF THE AMERICAN RULE

As recounted by Supreme Court Justice Byron White in *Alyeska Pipeline Service Co., v. Wilderness Society, et al.*,[2] at common law costs were not allowed. However, as early as 1278, courts in England had statutory authority to award costs, including attorneys' fees to successful plaintiffs. Since 1607, the English courts have been able to award fees to defendants as well. That concept was carried over to the United States by an act of Congress, which allowed federal courts to make fee awards if allowed by the practice of the state in which the federal court sat. By 1800, those statutes had either expired or been repealed, but the practice of awarding fees based on state rules continued until 1853 when Congress, concerned with a diversity in practice among the courts and losing litigants having to pay "exorbitant fees for the victor's attorney" limited the fees recoverable by a prevailing party to a maximum of $20, and in most cases less.[3]

While Congress has allowed for recovery of fees by statute in certain circumstances, the intent to do so must be expressed, not implied. The Supreme Court rejected a Court of Appeals holding that the provision in the Miller Act that claimants recover "sums justly due" was intended to provide for an award of attorneys' fees. Instead the court held that Miller Act suits were subject to the American Rule, unless Congress were to declare otherwise.[4]

1. See www.sonomarisk.com.
2. 421 U.S. 240 (1975).
3. 421 U.S. at 247–254.
4. Rich 417 US 116,131 (1974).

With the notable exception of Alaska,[5] the law in most states is the same, i.e., the American Rule applies unless an applicable statute or rule provides otherwise.

STATE FEE SHIFTING BY LAW OR COURT RULE

The primary source of fee shifting provisions applicable to construction disputes is found in the prompt payment laws enacted by many states. These laws generally establish time frames within which owners must pay contractors and when those downstream must be paid. A 2008 survey of such statutes found that all states, with the exception of New Hampshire, had some version of a prompt pay law and that 24 of those 49 states' laws provided for fee shifting.[6]

Other examples of fee shifting provisions are New York's State Finance Law governing payment bonds on public projects[7] allowing recovery of fees if "it appears that either the original claim or the defense interposed to such claim is without substantial basis in fact or law" and Texas' statute allowing recovery of fees in some actions, including those for labor performed or materials furnished.[8]

Fee shifting may also occur under "offer of judgment" rules. According to a survey conducted by the American College of Trial Lawyers,[9] as of 2004 the federal courts and courts in 47 states had some version of a rule that shifted fees and costs in favor of a party whose offer to settle a case was not accepted but whose offer was better, as defined by the rule, than the result ultimately obtained. Most, like the federal rule can only be invoked by a party against whom an affirmative claim has been made.[10]

Under Federal RCP 68, a party defending against a claim may serve notice that it will allow a judgment to be taken for the amount of the offer. If the offer is not accepted and the judgment obtained is "not more favorable than the unaccepted offer," the offeree must pay the "costs" incurred after the offer was made. Those costs do not include attorneys' fees unless the statute under which the claim is made provides for fees to the prevailing party.[11]

The offer of judgment rules in the states are variations of the federal rule. In New Jersey, any party can offer to take a judgment in its favor or allow a judgment to be taken against it. If the offer of a claimant is not accepted and the claimant obtains a judgment at least 120% of the offer, the claimant can recover legal fees incurred after the offer is made. If it is a party other than a claimant making the offer that is not accepted, the claimant will be responsible for the offerer's attorneys' fees incurred after the offer is made if the judgment obtained is favorable to the offeror, defined as 80 percent of the offer or less.[12] In Arizona, if the judgment is not more favorable than the offer, the offeree must pay the expert witness fees and double the costs of the offeror, plus prejudgment interest. Attorneys' fees are not included in costs that can be recovered.[13] South Carolina's offer of judgment rule does not provide for attorneys' fees,[14] but in a lien foreclosure action a reasonable fee may be recovered by the prevailing party, defined as the party whose offer is closer to the verdict.[15] Alaska, which as was noted earlier[16] does not follow the American Rule, enhances the attorneys' fee allowable to any prevailing party if the judgment is at least 5 percent less favorable to the offeree than the offer, or, if there are multiple defendants, at least 10 percent less favorable.[17]

5. See Alaska R. Civ. P 68. This provision limits the fees recovered to a fixed percentage of the judgment awarded on a sliding scale. A court has the power to vary a fee award based on several factors set forth in the rule.
6. Tricker, George and Gerdes, Survey of Prompt Pay Statutes, Journal of the ACCL, Winter 2009.
7. N.Y. State Fin Law §137.
8. Tex. Civ. Prac. & Rem. Code § 38.001.
9. Survey of State Offer of Judgment Provisions, American College of Trial Lawyers, Federal Civil Procedure Committee, October 2004. In the introduction to the survey, the ACTL asks why, if provided with more than one forum in which to bring an action, is it considered evil to shop for the forum that best advances the clients interest? For those who don't believe forum shopping is evil they offer the survey "as a tool for helping to decide where to shop."
10. The ACTL Survey found that in 16 states the rule could be invoked by any party in a litigation.
11. See. Marek v. Chesny, 473 U.S. 1, 9 (1985).
12. N.J. Court Rule 4:58-3, et seq.
13. Ariz. Rule Civ. Proc 68.
14. S.C. Rule Civ. Proc. 68.
15. S.C. Code Ann 29-5-10
16. See fn 5.
17. Alaska Statutes, Title 9, Chapt. 30 Sec. 9.

CONTRACT CLAUSES

A recent informal survey of construction lawyers found that 80 percent of the respondents have handled matters where the contract contained a prevailing party clause, suggesting use of such clauses is widespread. The AIA forms have never included such a clause, but they were found in many of the AGC contract documents. The substance of the AGC fee shifting concept, carried over to the ConsensusDOCS forms when they were introduced in 2007, provides:

The costs of any binding dispute resolution procedures shall be borne by the non prevailing party, as determined by the adjudicator of the dispute.

The ConsensusDOCS drafters included this provision "for the purpose of dissuading frivolous claims" and encouraging settlement. They recognized the language gave considerable discretion to the adjudicator, such as deciding whether attorneys' fees are to be considered "costs."[18]

The drafters of the 2010 editions of the ConsensusDOCS made a significant change to the clause:

> The costs of any binding dispute resolution procedures **and reasonable attorneys' fees** shall be borne by the non prevailing party, as determined by the adjudicator of the dispute.

Determining the "non-prevailing" party is still left to the discretion of the adjudicator.

THE INFORMAL SURVEY

In an informal survey, approximately 270 construction lawyers were sent a questionnaire asking for their experiences with fee shifting provisions. About one-third, 88, responded. Some of the results:

- 80 percent had handled matters where the contract at issue had a prevailing party clause
- 48 percent of those matters resulted in an award or judgment
- 52 percent of those matters resulted in a fee award
- 13 percent of the fee awards were equal to the amount requested
- 50 percent of the fee awards were less than the amount requested
- 53 percent felt arbitrators were likely to award fees where the contract allowed it
- 51 percent felt judges were likely to award fees where the contract allowed it
- 48 percent felt prevailing party clauses are becoming more prevalent
- 45 percent felt prevailing party clauses encourage settlement
- 13 percent felt prevailing party clauses discourage settlement

WHO IS THE PREVAILING PARTY?

Several arbitrators who answered the survey commented on what makes a prevailing party. Some approach determining a prevailing party strictly on a mathematical basis, for example awarding a percentage of the fees sought based on the percentage of the original claim actually awarded. Others look at the merits and the difficulty of making out the proofs. Inflated claims or defenses will almost always have a negative effect on a fee claim request, even if the party asserting them is the prevailing party on all other issues. One arbitrator suggested that in a bona fide dispute it is likely there will be no prevailing party.

Many suggested incorporating procedures found in offer of judgment statutes into contract clauses. The thought is that an offer to accept or pay a sum certain creates a more realistic benchmark from which the prevailing party can be determined. There is a divergence of opinion on whether the offer should be within a certain percentage of the award or whether it should be whichever is closer. The percentage approach would seem to lead to the best results.

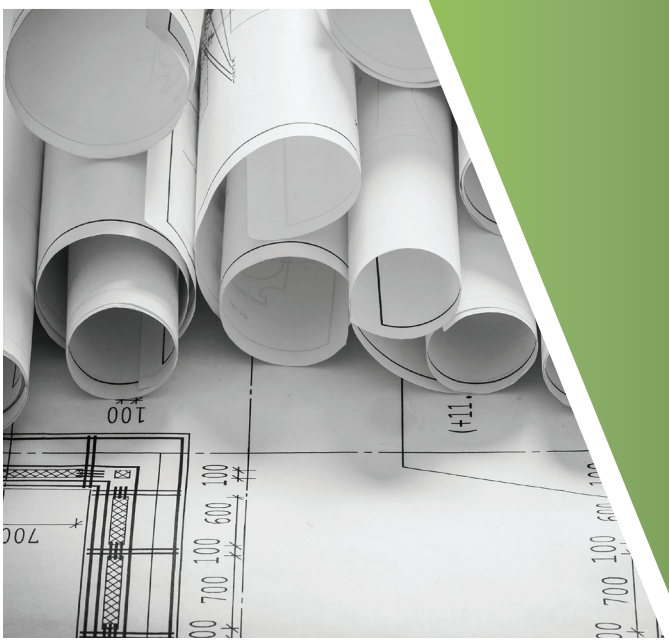
INSURANCE COVERAGE FOR FEE AWARDS

Owners who insist on fee shifting clauses in contracts with their design professionals may not be getting what they think they bargained for. Some carriers writing professional liability insurance are telling insureds that fee awards under contract clauses may not be covered. The argument is that the fee award does not arise out of the professional's negligence but rather their contractual obligations. For those concerned about an exposure to a contractual fee shifting provision, insurance coverage is now available to cover that risk.[19]

18. McCallum, "Getting Directly To The Point of The Contested Matter: Dispute Mitigation & Resolution In The ConsensusDOCS Construction Forms," Forum on the Construction Industry, Fall 2008 paper.
19. See fn 1.

DO PREVAILING PARTY CLAUSES ENCOURAGE SETTLEMENT?

Forty-five percent of the survey respondents say fee shifting provisions promote settlement while 13 percent said they did not. All who commented agreed that to be effective as a settlement incentive both sides must have the ability to recover fees. An attorney who regularly represents owners includes such clauses to "even the field." Contractors are entitled to fee shifting under their state's lien law and they find giving their owner clients the right to collect fees makes settlement easier.[20]



CONCLUSION

The fact that ConsensusDOCS included a clause allowing for the recovery of attorneys' fees in its forms may be interpreted as being contrary to ConsensusDOCS' collaborative approach to risk allocation. Having both parties responsible for their own attorneys' fees, would discourage litigation and foster mutual problem-solving. If the parties know they will not recover their legal fees they may be more willing to invest what they would have spent on lawyers in a settlement. Rewarding a party who pursues litigation instead of resolution seems contrary to the philosophy behind ConsensusDCOS. However, after researching and writing this article, I am not sure I still think that way. While I have not quite gotten where former Justice Robert Clifford of the New Jersey Supreme Court once found himself when he switched sides on an issue:

> "Much as I would prefer to announce that my change of position is attributable to some epiphany, to some deeply moving event that produced a sudden startling cerebral awakening, to some lightning bolt of cognitive awareness and intellectual enrichment, the plain truth of the matter is that I have thought more about it and have changed my mind."[21]

I am not far behind.

20. Recall that in only 16 states can the offer of judgment rules (see fn 9 and 10) be invoked by either party.
21. In The Matter Of The Arbitration Between: Tretina Printing, Inc., and Hi-Tech Properties, 135 N.J. 349, 366-7 (1994).