Study J-901 June 17, 1999

Memorandum 99-32

Award of Costs and Contractual Attorney's Fees to Prevailing Party

The Commission is authorized to study the law relating to the payment and shifting of attorney's fees between litigants. The Commission commenced work on this topic in 1990 at the request of the California Judges Association ("CJA"), but tabled the project pending input from CJA on the direction of the study, which was not forthcoming.

In 1998, Commissioner Skaggs alerted the Commission to *Sears v. Baccaglio*, 60 Cal. App. 4th 1136, 70 Cal. Rptr. 2d 769 (1998), a 2-1 decision in which the court struggled to harmonize the standards for determining the prevailing party and awarding statutory costs and contractual attorney's fees under Code of Civil Procedure Sections 1032 and 1033.5 (the general provisions on recovery of costs) and Civil Code Section 1717 (a provision specifically pertaining to contractual attorney's fees). These statutes establish different standards for determining the prevailing party, which has created confusion, generated litigation, and produced awkward results. Commissioner Skaggs suggested that the Commission study and attempt to clarify this confusing area of the law. The Commission decided to undertake this project and give it priority. (Minutes, Feb. 4-5, 1999, p. 3.).

This memorandum introduces the topic, raises issues, and suggests possible approaches. After discussing the law on determination of the prevailing party, we also present a number of other issues relating to contractual attorney's fees.

The memorandum is organized as follows:

TERMINOLOGY

Throughout this memorandum, we use the following terminology:

(1) **"Contractual attorney's fees."** Shifting of attorney's fees pursuant to a contract between the parties (e.g., a contract providing that in the event of litigation to enforce the contract, the loser will reimburse the prevailing party's attorney's fees). Depending on how it is worded, the contractual attorney's fee clause can be limited to fees for contract claims, or can also encompass fees for noncontract claims. "'[P]arties may validly agree that the prevailing party will be awarded attorney fees incurred in any litigation between themselves, whether such litigation sounds in tort or in contract.'" *Santisas v. Goodin*, 17 Cal. 4th 599, 608, 951 P.2d 399, 71 Cal. Rptr. 2d 830 (1998), *quoting Xuereb v. Marcus & Millichap, Inc.*, 3 Cal. App. 4th 1338, 1341, 5 Cal. Rptr. 2d 154 (1992).

(2) **"Nonstatutory litigation expenses."** Litigation expenses that are neither attorney's fees nor statutory costs (e.g., fees of experts not ordered by the court).

(3) **"Statutory costs."** Litigation expenses that are listed as allowable in Code of Civil Procedure Section 1033.5 (e.g., filing fees). The loser of a lawsuit typically is required to reimburse the prevailing party for these amounts.

(4) **"Unilateral attorney's fee clause."** A contract clause that gives only one of the contracting parties the right to recover attorney's fees upon prevailing in litigation to enforce the contract and / or litigation relating to the contract.

STATUTES GOVERNING CONTRACTUAL ATTORNEY'S FEES

The key statutes governing contractual attorney's fees are (1) Code of Civil Procedure Section 1021, (2) Code of Civil Procedure Sections 1032 and 1033.5, and (3) Civil Code Section 1717.

Code of Civil Procedure Section 1021. Attorney's Fees

Code of Civil Procedure Section 1021 establishes a general rule that each party to a lawsuit has to pay its own attorney's fees ("the American Rule"):

> 1021. Except as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the parties; but parties to actions or proceedings are entitled to their costs, as hereinafter provided.

This rule is subject to a multitude of exceptions. "Literally hundreds of California statutes authorize an award of attorney fees to the prevailing party, or to one party …." *Damian v. Tamondong*, 65 Cal. App. 4th 1115, 1124 n. 11, 77 Cal. Rptr. 2d 262 (1998).

Code of Civil Procedure Sections 1032 and 1033.5. Recovery of Costs

Code of Civil Procedure Section 1032, enacted in 1986, defines "prevailing party" and provides that the prevailing party (as so defined) is entitled to an award of statutory costs. It provides in pertinent part:

> 1032. (a) As used in this section, unless the context clearly requires otherwise:
>
> ….
>
> (4) "Prevailing party" includes the party with a net monetary recovery, a defendant in whose favor a dismissal is entered, a defendant where neither plaintiff nor defendant obtains any relief, and a defendant as against those plaintiffs who do not recover any relief against that defendant. When any party recovers other than monetary relief and in situations other than as specified, the "prevailing party" shall be as determined by the court, and under those circumstances, the court, in its discretion, may allow costs or

not and, if allowed may apportion costs between the parties on the same or adverse sides pursuant to rules adopted under Section 1034.

(b) Except as otherwise expressly provided by statute, a prevailing party is entitled as a matter of right to recover costs in any action or proceeding.

….

(The full text of Section 1032 is set forth at Exhibit p. 1.)

Code of Civil Procedure Section 1033.5 specifies which litigation expenses are recoverable as statutory costs. Section 1033.5(a)(10) provides that attorney's fees are allowable as costs under Section 1032 when authorized by contract, statute, or law. Thus, "recoverable litigation costs do include attorney fees, but only when the party entitled to costs has a legal basis, independent of the cost statutes and grounded in an agreement, statute, or other law, upon which to claim recovery of attorney fees." *Santisas*, 17 Cal. 4th at 606.

(The full text of Section 1033.5 is set forth at Exhibit pp. 1-3.)

Civil Code Section 1717. Award of Attorney's Fees in Contract Action

Civil Code Section 1717 was enacted in 1968. It now provides in pertinent part:

1717. (a) 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.

Where a contract provides for attorney's fees, as set forth above, that provision shall be construed as applying to the entire contract, unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract.

Reasonable attorney's fees shall be fixed by the court, and shall be an element of the costs of suit.

Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract which is entered into after the effective date of this section. Any provision in any such contract which provides for a waiver of attorney's fees is void.

(b)(1) The court, upon notice and motion by a party, shall determine who is the party prevailing on the contract for purposes of this section, whether or not the suit proceeds to final judgment.

> Except as provided in paragraph (2), the party prevailing on the contract shall be the party who recovered a greater relief in the action on the contract. The court may also determine that there is no party prevailing on the contract for purposes of this section.
>
> (2) Where an action has been voluntarily dismissed or dismissed pursuant to a settlement of the case, there shall be no prevailing party for purposes of this section.
>
> ….

(The full text of Section 1717 is set forth at Exhibit pp. 3-4.)

The classic situation addressed by Civil Code Section 1717 is the unilateral attorney's fee clause: A contract clause that gives only one of the contracting parties (typically the one with superior bargaining power) the right to recover attorney's fees upon prevailing in litigation to enforce the contract and/or litigation relating to the contract. "This places the other contracting party at a distinct disadvantage. Should he lose in litigation, he must pay legal expenses of both sides and even if he wins, he must bear his own attorney's fees." *Coast Bank v. Holmes*, 19 Cal. App. 3d 581, 596, 97 Cal. Rptr. 30 (1971). To ensure that attorney's fee clauses do not operate in such an unfairly one-sided manner, the Legislature enacted Section 1717. *Santisas*, 17 Cal. 4th at 602. This statute essentially makes a unilateral fee clause reciprocal: "[T]he 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…." Civ. Code § 1717(a) (emphasis added.) To further protect the party in the weaker bargaining position, Section 1717 also specifies that this statutory protection cannot be waived.

A second situation in which Section 1717 makes an otherwise unilateral right reciprocal is where a person sued on a contract with an attorney's fee clause successfully defends the claim by arguing the inapplicability, invalidity, unenforceability, or nonexistence of the contract. "Because these arguments are inconsistent with a contractual claim for attorney fees under the same agreement, a party prevailing on any of these bases usually cannot claim attorney fees as a contractual right." *Santisas*, 17 Cal. 4th at 611. "If section 1717 did not apply in this situation, the right to attorney fees would be effectively unilateral — regardless of the reciprocal working of the attorney fee provision allowing attorney fees to the prevailing attorney — because only the party seeking to affirm and enforce the agreement could invoke its attorney fee provision." *Id.*; *see also Reynolds Metals Co. v. Alperson*, 25 Cal. 3d 124, 128, 599 P.2d 83, 158 Cal. Rptr.

1 (1979). To achieve its goal of mutuality of remedy, "the statute generally must apply in favor of the party prevailing on a contract claim whenever that party would have been liable under the contract for attorney fees had the other party prevailed." *Hsu v. Abbara*, 9 Cal. 4th 863, 870-71, 891 P.2d 804, 39 Cal. Rptr. 2d 824 (1995); *Real Property Services Corp. v. City of Pasadena*, 25 Cal. App. 4th 375, 382, 30 Cal. Rptr. 2d 536 (1994).

The goal of mutuality of remedy would also be undermined if a party with superior bargaining strength could limit an attorney's fee provision to certain aspects of a contract (e.g., providing attorney's fees to the prevailing party if the general contractor sues for nonpayment, but not if the homeowner sues for construction defects). *Myers Bldg. Industries v. Interface Technology, Inc.*, 13 Cal. App. 4th 949, 971, 17 Cal. Rptr. 2d 242 (1993). Thus, the Legislature amended Section 1717 in 1983 to state that an attorney's fee provision within its scope "shall be construed as applying to the *entire* contract, unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract." Civ. Code § 1717(a) (emphasis added).

Given the focus on achieving mutuality of remedy in contexts of unequal bargaining strength, some courts construed Section 1717 to apply only where contractual attorney's fees would (absent Section 1717) only be available to one of the parties. *See Kelley v. Bredelis*, 45 Cal. App. 4th 1819, 1828-29, 53 Cal. Rptr. 2d 536 (1996); *Honey Baked Hams, Inc. v. Dickens*, 37 Cal. App. 4th 421, 426, 43 Cal. Rptr. 2d 595 (1995); *see also Sears*, 60 Cal. App. 4th at 1160-65 (Kline, P.J., concurring and dissenting). Other courts interpreted the statute more broadly, applying to all contractual attorney's fee provisions. *See Sears*, 60 Cal. App. 4th at 1143-49. The Supreme Court recently resolved this conflict, concluding that "section 1717 applies to contracts containing reciprocal as well as unilateral attorney fee provisions, including provisions … authorizing recovery of attorney fees by a 'prevailing party.'" *Santisas*, 17 Cal. 4th at 614. The court relied on the portion of the statute referring to situations "where the contract specifically provides that attorney's fees and costs … shall be awarded either to one of the parties *or to the prevailing party* …." Civ. Code § 1717(a) (emphasis added). Three justices took a different view, maintaining that "section 1717 does not govern all contractual fee claims." *Santisas*, 17 Cal. 4th at 614 (Baxter, J., concurring and dissenting).

Although the Supreme Court's decision in *Santisas* gives guidance on this and some other points, serious ambiguities and inconsistencies in the statutory scheme governing contractual attorney's fees remain, particularly regarding determination of the prevailing party.

DETERMINATION OF THE PREVAILING PARTY: EXISTING LAW

Civil Code Section 1717 and Code of Civil Procedure Section 1032 establish different standards for determining the prevailing party:

Key Criteria in Determining the Prevailing Party

Civil Code Section 1717. Under Civil Code Section 1717, in an action on a contract including an attorney's fee clause, "the party prevailing on the contract" is entitled to recover attorney's fees. "[T]he party prevailing on the contract shall be the party who recovered a greater relief in the action on the contract." Civ. Code § 1717(b)(1). A party may recover "greater relief in the action on the contract" and thus be the prevailing party under Section 1717, even if it "fail[s] to recover a net monetary judgment." *Sears*, 60 Cal. App. 4th at 1139. "In the event one party received earlier payments, settlements, insurance proceeds or other recovery, the court has discretion to determine whether the party required to pay a nominal net judgment is nevertheless the prevailing party entitled to attorney's fees pursuant to section 1717." *Id.*

"Where a cause of action based on the contract providing for attorney's fees is joined with other causes of action beyond the contract, the prevailing party may recover attorney's fees under section 1717 only as they relate to the contract action." *Reynolds Metals*, 25 Cal. 3d at 129. "A litigant may not increase his recovery of attorney's fees by joining a cause of action in which attorney's fees are not recoverable to one in which an award is proper." *Id.* Where, however, a litigant incurs fees for an issue "common to both a cause of action in which fees are proper and one in which they are not allowed," all of those fees are recoverable. *Id.* "When an action involves multiple independent contracts, each of which provides for attorney fees, the prevailing party for purposes of Civil Code section 1717 must be determined as to each contract regardless of who prevails in the overall action." *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.*, 47 Cal. App. 4th 464, 491, 54 Cal. Rptr. 2d 888 (1996).

Code of Civil Procedure Section 1032. Under Code of Civil Procedure Section 1032, "a prevailing party is entitled as a matter of right to recover costs in any action or proceeding." Unless the context clearly requires otherwise, "prevailing party" includes: (1) a party with a net monetary recovery, (2) a defendant in whose favor a dismissal is entered, (3) a defendant where neither the plaintiff nor the defendant obtains any relief, and (4) a defendant as against those plaintiffs who do not recover any relief against that defendant. Code Civ. Proc. § 1032(a)(4). "When any party recovers other than monetary relief and in situations other than as specified, the 'prevailing party' shall be as determined by the court, and under those circumstances, the court, in its discretion, may allow costs or not …." *Id.*

In determining the prevailing party under Section 1032, the court assesses who prevailed in the action as a whole, rather than determining who prevailed on a claim-by-claim basis. *See Michell v. Olick*, 49 Cal. App. 4th 1194, 1198, 57 Cal. Rptr. 2d 227 (1996) (when defendant and plaintiff have competing claims, "the party in whose favor the net amount is due qualifies as the prevailing party"). The successful party "is entitled to recover the whole of his or her costs, despite a limited victory." *Id.* at 1200. The other side "is not entitled to an offset, even though [it] prevailed to some (lesser) extent." *Id.*

A number of courts have concluded that a party in one of the four categories enumerated in Section 1032 (party with net monetary recovery, defendant in whose favor dismissal is entered, defendant where neither plaintiff nor defendant obtains relief, or defendant as against those plaintiffs who do not recover relief against that defendant) "is entitled to costs as a matter of right; the trial court has no discretion to order each party to bear his or her own costs." *Id.* at 1198; *see also Building Maintenance Service Co. v. AIL Systems, Inc.*, 55 Cal. App. 4th 1014, 1025, 64 Cal. Rptr. 2d 353 (1997); *Chaparral Greens v. City of Chula Vista*, 50 Cal. App. 4th 1134, 1151-53, 58 Cal. Rptr. 2d 152 (1996); *Lincoln v. Schurgin*, 39 Cal. App. 4th 100, 105, 45 Cal. Rptr. 2d 874 (1995). A few judges have interpreted Section 1032 less rigidly, such that whether a party falls in one of the four categories is not determinative, but only a factor to be considered in identifying the prevailing party. *See Sears*, 60 Cal. App. 4th at 1155; *id.* at 1165-66 (Kline, P.J., concurring and dissenting).

Option of Deciding That There Is No Prevailing Party

Civil Code Section 1717. Section 1717 expressly gives the court the option of determining that there "is no party prevailing on the contract for purposes of this section." Typically, such a determination results when both sides seek relief but neither prevails, or when one party obtains only part of the relief sought. "By contrast, when the results of the litigation on the contract claims are *not* mixed — that is, when the decision on the litigated contract claims is purely good news for one party and bad news for the other — … a trial court has no discretion to deny attorney fees to the successful litigant." *Hsu v. Abbara*, 9 Cal. 4th at 875-76 (emphasis in original).

Code of Civil Procedure Section 1032. If a party is in one of the four categories enumerated in Section 1032, and those categories are determinative (as appears to be the majority view), the court does not have the option of determining that there is no prevailing party. In other situations, however, the court has discretion to determine that there is no prevailing party for purposes of awarding costs: "When any party recovers other than monetary relief and in situations other than as specified, the 'prevailing party' shall be as determined by the court, and under those circumstances, the court, in its discretion, may allow costs or not …." Code Civ. Proc. § 1032(a)(4); *see also United States Golf Ass'n v. Arroyo Software Corp.*, 69 Cal. App. 4th 607, 81 Cal. Rptr. 2d 708, 718 (1999); *Texas Commerce Bank-El Paso, N.A. v. Garamendi*, 28 Cal. App. 4th 1234, 1248-49, 34 Cal. Rptr. 2d 155 (1994).

Effect of Dismissal

Civil Code Section 1717. Under Civil Code Section 1717(b)(2), where an action "has been voluntarily dismissed or dismissed pursuant to a settlement of the case, there shall be no prevailing party" for purposes of Section 1717. This rule cannot be undone by contract. The statute overrides or nullifies conflicting contractual provisions, "such as provisions expressly allowing recovery of attorney fees in the event of voluntary dismissal or defining 'prevailing party' as including parties in whose favor a dismissal has been entered." *Santisas*, 17 Cal. 4th at 617; *Exxess Electronixx v. Heger Realty Corp.*, 64 Cal. App. 4th 698, 707, 75 Cal. Rptr. 2d 376 (1998).

Code of Civil Procedure Section 1032. In contrast, one of the four categories of prevailing party enumerated in Section 1032 is "a defendant in

whose favor a dismissal is entered." This rule may be altered by contract. *Santisas*, 17 Cal. 4th at 602, 617, 622.

Where a contract is silent as to the effect of dismissal, Section 1032 can be construed to mean that the defendant is automatically entitled to costs upon dismissal of the plaintiff's case, regardless of the circumstances of the dismissal. *See Santisas*, 17 Cal. 4th at 606 (because plaintiffs voluntarily dismissed action with prejudice, defendants are entitled to recover costs under Section 1032); *Crib Retaining Walls, Inc. v. NBS/Lowry, Inc.*, 47 Cal. App. 4th 886, 54 Cal. Rptr. 2d 850 (1996) (cross-defendant entitled to costs upon dismissal of cross-complaint for indemnity, even though dismissal was due to cross-defendant's good faith settlement with plaintiff).

In *Damian*, however, the court took quite a different view. "[W]e are not prepared to hold that every defendant as to whom a voluntary dismissal has been entered is also invariably a 'defendant *in whose favor* a dismissal is entered' (Code Civ. Proc., § 1032, subd. (a)(4), italics added), and, therefore, as a matter of law, the 'prevailing party' for purposes of a statutory fee award." 65 Cal. App. 4th at 1129. Although the Supreme Court in *Santisas* "appeared to equate the two terms … the issue was not clearly raised because the plaintiffs did not contest the point." *Id.* at 1129 n.4. It seems inaccurate to characterize the defendant as the prevailing party when dismissal occurs after the plaintiff obtains all or most of the requested relief, or learns that the defendant is insolvent. *Id.* at 1129. "[T]he issue whether a voluntary dismissal was truly entered 'in favor ' of the defendant can arise in a variety of procedural settings, may involve questions of fact, … and is in any event a matter best left to the sound discretion of the trial court." *Id.* at 1130. Trial courts should fashion "efficient procedures for making a 'pragmatic' determination whether the defendant 'has realized its litigation objectives' and is, thus, the 'prevailing party' in a voluntary dismissal case." *Id.* at 1129 n. 15.

Equitable Considerations

Civil Code Section 1717. Equitable considerations are of great importance in applying Section 1717. The statute "reflects legislative intent that equitable considerations must prevail over both the bargaining power of the parties and the technical rules of contractual construction." *International Industries, Inc. v. Olen*, 21 Cal. 3d 218, 224, 577 P.2d 1031, 145 Cal. Rptr. 691 (1978). Thus, in determining litigation success, "courts should respect substance rather than form, and to this extent should be guided by 'equitable considerations.'" *Hsu*, 9

Cal. 4th at 877; *Foothill Properties v. Lyon/Copley Corona Associates*, 46 Cal. App. 4th 1542, 1555, 54 Cal. Rptr. 2d 488 (1996); *Sears*, 60 Cal. App. 4th at 1152-55. "For example, a party who is denied direct relief on a claim may nonetheless be found to be a prevailing party if it is clear that the party has otherwise achieved its main litigation objective." *Hsu*, 9 Cal. 4th at 877.

In "deciding whether there is a 'party prevailing on the contract,' the trial court is to compare the relief awarded on the contract claim or claims with the parties' demands on those same claims and their litigation objectives as disclosed by the pleadings, trial briefs, opening statements, and similar sources." *Hsu*, 9 Cal. 4th at 876. The determination is to be made only upon reaching a final resolution of the contract claim, and only by comparing the extent to which each party has succeeded or failed to succeed in its contentions. *Id.*; *Mustachio v. Great Western Bank*, 48 Cal. App. 4th 1145, 1150, 56 Cal. Rptr. 2d 33 (1996). "The trial court may not invoke equitable considerations unrelated to litigation success, such as the parties' behavior during settlement negotiations or discovery proceedings, except as expressly authorized by statute." *Hsu*, 9 Cal. 4th at 877; *Deane Gardenhome Ass'n v. Denktas*, 13 Cal. App. 4th 1394, 1398, 16 Cal. Rptr. 2d 816 (1993). "To admit such factors into the 'prevailing party' equation would convert the attorney fees motion from a relatively uncomplicated evaluation of the parties' comparative litigation success into a formless, limitless attack on the ethics and character of every party who seeks attorney fees under section 1717." *Hsu*, 9 Cal. 4th at 877.

Code of Civil Procedure Section 1032. Some courts have also focused on equitable considerations in applying Section 1032. *Damian*, directing trial courts to make a pragmatic determination of the prevailing party following a voluntary dismissal, is a good example. *Sears* provides another example: Instead of deciding that Section 1032 strictly requires a costs award to "a party with a net monetary recovery," the court concluded that the statute includes "its own broad provision for equitable relief where net monetary recovery may not be the best measure of who prevailed …." 60 Cal. App. 4th at 1155. "Nothing in the statute limits the court's inquiry solely to net monetary recovery; to do so would be to ignore, among others, the problems presented by contract-derived claims against multiple parties and net recoveries which were actually Pyrrhic victories." *Id.* "Obviously this inquiry is fact intensive and therefore requires us to give considerable deference to the fully informed determinations of the trial court." *Id.*

"While the trial court cannot arbitrarily deny fees to a less-than-sympathetic party, it remains free to consider all factors which may reasonably be considered to indicate success in the litigation." *Id.*; *see also id*. at 1166 (Kline, P.J., concurring and dissenting) (In Section 1032, the Legislature "specifically authorized trial courts to depart from the specified criteria when it would be inequitable to adhere strictly to any particular specified criterion, such as the 'net monetary recovery' test.").

DETERMINATION OF THE PREVAILING PARTY: PROBLEMS

The standards for determination of the prevailing party under Civil Code Section 1717 and Code of Civil Procedure Section 1032 entail a number of problems:

Tension Between the Statutes: Divergent Results

Although equitable considerations may be important in determining the prevailing party under both Civil Code Section 1717 and Code of Civil Procedure Section 1032, the statutes do not always yield the same result. "Courts have consistently held the prevailing party for the award of costs under section 1032 is not necessarily the prevailing party for the award of attorney's fees in contract actions under section 1717." *Sears*, 60 Cal. App. 4th at 1142.

The Supreme Court's recent decision in *Santisas* is a good example of the disparity between the standards. In *Santisas*, the plaintiffs brought, but later voluntarily dismissed, both tort and contract claims relating to the purchase of a home. The contract in question included an attorney's fee clause, which was broad enough to cover not only the plaintiffs' contract claim, but also the tort claims.

The court determined that

> (1) The defendants were the prevailing party for purposes of awarding *statutory costs other than attorney's fees* under Section 1032, because they were "defendants in whose favor a dismissal has been entered." 17 Cal. 4th at 606.
>
> (2) The defendants were *not* entitled to *attorney's fees on the contract claim*, because Section 1717(b)(2) precludes a fee award in the event of a voluntary dismissal, this rule cannot be overridden by contract, and Section 1717 and not Section 1032 governs the recovery of contractual attorney's fees on a contract claim. 17 Cal.

> 4th at 615-17; *see also Sears*, 60 Cal. App. 4th at 1157 (Section 1717 "is the applicable statute when determining whether and how attorney's fees should be awarded under a contract. It is the statute that expressly deals with attorney's fees under a contract, and to apply section 1032 is such cases would obviate section 1717").
>
> (3) The action *would have to be remanded to determine whether the defendants were entitled to attorney's fees on the tort claims*. Tort claims are "outside the ambit" of Section 1717 and are governed by Section 1032. 17 Cal. 4th at 615, 617-19. Under Section 1032, whether "attorney fees incurred in defending tort or other noncontract claims are recoverable after a pretrial dismissal depends upon the terms of the contractual attorney fee provision." *Id.* at 602. If, as in *Santisas*, "the contract allows the prevailing party to recover attorney fees but does not define 'prevailing party' or expressly either authorize or bar recovery of attorney fees in the event an action is dismissed, a court may base its attorney fees decision on a pragmatic definition of the extent to which each party has realized its litigation objectives, whether by judgment, settlement, or otherwise." *Id.* at 622.

In other words, although the court considered the same litigation outcome — voluntary dismissal — in each of the three contexts (statutory costs other than attorney's fees, attorney's fees on the contract claim, and attorney's fees on the tort claims), it reached a different result in each context (defendants are prevailing party entitled to fees, defendants are not prevailing party and not entitled to fees, and defendants may be prevailing party, depending on whether they realized their litigation objectives).

Recognizing the absurdity of the situation, Justice Mosk joined the majority opinion, but also wrote a concurrence urging the Legislature to reconsider how Civil Code Section 1717 and Code of Civil Procedure Section 1032 treat dismissals. *Santisas*, 17 Cal. 4th at 623-24 (Mosk, J., concurring). Three other justices disagreed with the majority's denial of attorney's fees on the contract claim, reasoning that Section 1717, and its bar to recovery of fees upon dismissal, is inapplicable to reciprocal fee clauses. *Santisas*, 17 Cal. 4th at 624-31 (Baxter, J., concurring and dissenting).

Although *Santisas* is perhaps the most dramatic example of disparate results under Civil Code Section 1717 and Code of Civil Procedure Section 1032, it is not the only example. The problem is not limited to the outcome of dismissal, but also occurs with other litigation outcomes. See Exhibit pp. 5-6 (describing other

cases). Statutory reform appears necessary to avoid anomalous results in awarding costs and contractual attorney's fees under Civil Code Section 1717 and Code of Civil Procedure Section 1032.

Unresolved Issues and Other Problems

Statutory reform also appears appropriate to address a number of ambiguities and other problems regarding determination of the prevailing party under these statutes, including:

(1) ***Effect of dismissal under Section 1032.*** As previously discussed, it is unclear whether a voluntary dismissal automatically makes the defendant the prevailing party for purposes of Section 1032. Is the defendant necessarily the prevailing party in the event of a dismissal, or is the court entitled to consider the circumstances of the dismissal and determine as a pragmatic matter who prevailed?

(2) ***Effect of four categories of prevailing party in Section 1032***. As previously discussed, there is conflicting authority on the effect of being in one of the four categories enumerated in Section 1032 (party with net monetary recovery, defendant in whose favor dismissal is entered, defendant where neither plaintiff nor defendant obtains any relief, or defendant as against those plaintiffs who do not recover any relief against that defendant). Is a party necessarily the prevailing party if it fits in one of these categories, or is that merely a factor for the court to consider in determining the prevailing party?

(3) ***Full costs award for partial victory under Section 1032***. If a party prevails on the central claim (or claims) in a case, but loses on other claims or otherwise fails to obtain all of the relief sought, should that party's recovery of costs under Section 1032 be the same as if the party had achieved a total victory? As previously discussed, the court in *Michell* , 49 Cal. App. 4th at 1200, concluded that the prevailing party is entitled to a full costs award under Section 1032, despite achieving only a partial victory. The court reached this result reluctantly, and pleaded for legislative reform:

> We … are troubled by the fact that Michell's cross-complaint was a shotgun blast; she sued for numerous unrelated grievances — legal malpractice, breach of the fee-splitting agreement, and personal injury at the vending machine. She prevailed on only one. To permit Michell to recover even those costs which relate solely to causes of action upon which she did not prevail would unfairly

> reward her for joining patently unmeritorious claims (assault and battery at the vending machine) with a single meritorious (legal malpractice) claim.
>
> Nevertheless, we are compelled to apply the statutory directive. ….
>
> We leave it to the Legislature to set limits on allowable costs, perhaps by imposing a requirement that the costs be related to the theories or causes of action upon which the party prevailed. We reiterate our concern that under the existing statute a prevailing plaintiff may be unjustly rewarded for joining patently unmeritorious — and expensive to prove — claims with a single meritorious claim.

Id. at 1200-01.

(4) ***Partial victory on noncontract claims covered by attorney's fee clause***. Partial victories also pose another problem. Suppose a party asserts multiple noncontract claims covered by an attorney's fee clause. For purposes of awarding contractual attorney's fees under Section 1032, should the court make a separate determination of who prevailed (if anyone) on each noncontract claim, or an overall assessment of who prevailed (if anyone) on the noncontract claims taken collectively? This issue has not been squarely addressed in the case law.

In *McLarand, Vasquez & Partners, Inc. v. Downey Savings & Loan Ass'n*, 231 Cal. App. 3d 1450, 282 Cal. Rptr. 828 (1991), however, neither the plaintiff/cross-defendant nor the defendant/cross-complainant obtained any relief. The court rejected the argument that both sides were prevailing parties for purposes of awarding *statutory costs* under Section 1032:

> The practical effect of such a result would be to conclude the prevailing party is the one who spends the most, for only that party would recover anything after the claims were offset. It is fundamental that a statute should not be interpreted in a manner that would lead to absurd results.

231 Cal. App. 3d at 1453; *see also Building Maintenance Service Co.*, 55 Cal. App. 4th at 1026. Does that logic carry over to a request for *contractual attorney's fees* where the fee provision covers noncontract claims and the court renders mixed results on the noncontract claims (e.g. a judgment for the plaintiff on one claim and a judgment for the defendant on another)? If a separate prevailing party and fee award were determined for each claim, would the situation be any different than when judgments on different claims are offset, resulting in a net monetary award to one side or the other?

(5) ***Consequences of failure to prove damages under Section 1032***. Can a plaintiff be the prevailing party under Section 1032 if the plaintiff establishes liability but fails to prove damages? Compare *Childers v. Edwards*, 48 Cal. App. 4th 1544, 1549-51 (1996) (plaintiff who wins on liability but fails to prove damages cannot be the prevailing party under Section 1032) with *Pirkig v. Dennis*, 215 Cal. App. 3d 1560, 264 Cal. Rptr. 494 (1996) ("Prevailing on the issue of liability may be deemed sufficient in itself to determine a prevailing party under the broad definition of section 1032.") (dictum).

(6) ***Standard of review***. Cases applying Civil Code Section 1717 and Code of Civil Procedure Section 1032 contain potentially confusing statements regarding the standard of review on appeal from a determination of costs and attorney's fees. Some authorities favor de novo review, at least to some extent. *See Childers*, 48 Cal. App. 4th at 1547 ("The determination of the legal basis for an award of attorney fees is a question of law which we review de novo); *Exxess Electronixx*, 64 Cal. App. 4th at 705 & n. 9 (Fee award reviewed de novo, but court acknowledges that other courts have used abuse of discretion standard in reviewing fee awards). Other decisions broadly proclaim that the abuse of discretion standard applies. *Sears*, 60 Cal. App. 4th at 1158 (We will not disturb the trial court's determination of the prevailing party absent a clear abuse of discretion."); *Hilltop Investment Associates v. Leon*, 28 Cal. App. 4th 464, 466, 33 Cal. Rptr. 2d 552 (1994) (trial court's determination that there is no prevailing party on the contract is an exercise of discretion and should be overturned only upon a clear showing of abuse).

In light of this unclear and imprecise case law, it may be helpful to state the standard of review by statute, differentiating as necessary between factual determinations, legal conclusions, exercises of discretion, and the like.

(7) ***Interrelationship with Code of Civil Procedure Section 1033***. Another unclarity is how Civil Code Section 1717 interrelates with Code of Civil Procedure Section 1033, which makes a costs award purely discretionary where the prevailing party in a case other than a limited civil case recovers an amount that could have been awarded in a limited civil case. This issue has been addressed in *Dorman v. DWLC Corp.*, 35 Cal. App. 4th 1808, 42 Cal. Rptr. 2d 459 (1995), but it may be helpful to revise the statutes accordingly.

(8) ***Dismissal after adverse award in judicial arbitration***. If a plaintiff dismisses a contract action after an adverse award in judicial arbitration, is the

defendant entitled to contractual attorney's fees, or does Civil Code Section 1717 bar such recovery? The court of appeal upheld a fee award to the defendant in *Kelley v. Bredelis*, 45 Cal. App. 4th 1819, 53 Cal. Rptr. 2d 536 (1996), but there was a vigorous dissent, *see id.* at 1834-45 (McKinster, J., dissenting).

DETERMINATION OF THE PREVAILING PARTY: PRELIMINARY ANALYSIS AND RECOMMENDATION

Civil Code Section 1717 and Code of Civil Procedure Section 1032 are ripe for reform to improve clarity and consistency and promote sound policy in determining the prevailing party for purposes of awarding costs and contractual attorney's fees. **Here are the staff's preliminary thoughts on how to proceed**:

(1) ***Standard for Determining the Prevailing Party.*** The law should be revised so that the standard for determining the prevailing party is the same for purposes of awarding statutory costs other than attorney's fees, contractual attorney's fees on a contract claim covered by an attorney's fee clause, and contractual attorney's fees on noncontract claims covered by an attorney's fee clause. The standard should include concrete guidelines, but should be flexible and include the option of determining that there is no prevailing party. For the next meeting, the staff would examine the various alternative standards for determining the prevailing party, assess the pros and cons of these standards, and perhaps draft a proposed standard that attempts to address the issues and problems identified in this memorandum. As under existing law, the standard should apply to different claims depending on the type of award sought (e.g., in determining the prevailing party for purposes of awarding contractual attorney's fees on a contract claim, the court should examine the outcome of the contract claim; in determining the prevailing party for purposes of awarding statutory costs other than attorney's fees, the court should examine the outcome of the entire action).

(2) ***Preserving the Benefits of Existing Case Law.*** Any proposal the Commission develops should attempt to preserve the benefits of existing case law, so issues are not unnecessarily relitigated.

(3) ***Dismissal.*** Voluntary dismissal of a contract claim should be treated the same way as voluntary dismissal of a tort claim. We tentatively suggest establishing a general rule that where a claim covered by an attorney's fee clause

is voluntarily dismissed, the court should determine the prevailing party based on the extent to which each party realized its litigation objectives.

(4) ***Unilateral Attorney's Fee Clause.*** A unilateral attorney's fee clause presents special considerations, which may warrant special rules, such as a non-waivable rule that the party not benefited by the clause can voluntarily dismiss a claim covered by the clause without incurring liability for the other side's attorney's fees and costs.

We elaborate on each of these suggestions below.

(1) Standard for Determining the Prevailing Party

Establishing sensible and effective guidelines for determining the prevailing party will be challenging. From previous efforts, particularly the attempt to enumerate four categories of prevailing party in Code of Civil Procedure Section 1032, it is clear that cases come in many permutations and do not always fit cleanly in statutorily prescribed categories. It is hard to anticipate and account for all possible situations, especially where there are multiple claims, cross-claims, multiple parties, partial victories, and mixed motives for litigation tactics such as voluntary dismissal.

For example, probably no one anticipated that in a contract action the "party with a net monetary recovery" might differ from the party recovering "greater relief in the action on the contract." Yet that distinction was critical in *Sears*, in which the court concluded that a party who has received earlier payments, settlements, insurance proceeds, or other recovery, "can fail to recover a net monetary judgment and yet prevail for purposes of collecting fees in an action founded in contract." 60 Cal. App. 4th at 1139, 1154-55.

Similarly, Section 1032(a)(4) defines "prevailing party" to include "a defendant where neither plaintiff nor defendant obtains any relief." At first, this may seem appropriate. After all, the plaintiff initiated the fruitless litigation. Suppose, however, a buyer and a seller sue each other for breach of contract, and neither party recovers any relief. In determining the prevailing party, should it really matter who sued first, or should the court be able to decide that neither side was the prevailing party? Again, this is not a hypothetical problem, but an issue that actually arose in *McLarand*, 231 Cal. App. 3d at 1453-56 (in action where neither side recovered relief, defendant was prevailing party for award of

statutory costs under Section 1032, but there was no prevailing party for award of contractual attorney's fees under Section 1717). (See Exhibit p. 5.)

Given the difficulties in defining categories of prevailing parties, the staff is tentatively inclined to establish a flexible standard, rather than using the approach of Section 1032(a)(4), which has been described as "more mechanical." R. Pearl, California Attorney Fee Awards, § 2.3, at 2-5 (Cal. Cont. Ed. Bar 1998). Under a flexible approach, courts would not have to strain to avoid the literal language of Section 1032(a)(4), as occurred in *Sears*, 60 Cal. App. 4th at 1155-58, and *Damian*, 65 Cal. App. 4th at 1128-30. To promote flexibility, we would include the option of determining that there is no prevailing party, instead of requiring the court to identify a prevailing party in all cases.

Although a flexible standard seems desirable, trial courts should not have unfettered discretion in determining the prevailing party. In part, we can avoid this by selecting a standard with concrete guidelines, rather than a mere directive to determine the prevailing party in light of unspecified equitable considerations. As Justice Jefferson observed in *Olen*, the concept of equitable considerations, has "different meanings, dependent upon the eyes and ideas of the beholder." 21 Cal. 3d at 218 (Jefferson, J., dissenting); *see also Sears*, 60 Cal. App. 4th at 1161 (Kline, P.J., concurring and dissenting) (warning that "the majority has in effect converted section 1717 into a roving judicial authorization to do almost anything a judge desires with respect to awarding or denying attorney fees if the determination can be characterized as 'equitable.'").

We could, for example, codify a standard like the one enunciated *Hsu v. Abbara* for awarding attorney's fees on a contract claim under Civil Code Section 1717:

> [I]n deciding whether there is a "party prevailing on the contract," the trial court is to compare the relief awarded on the contract claim or claims with the parties' demands on those same claims and their litigation objectives as disclosed by the pleadings, trial briefs, opening statements, and similar sources. The prevailing party determination is to be made only upon final resolution of the contract claims and only by "a comparison of the extent to which each party ha[s] succeeded and failed to succeed in its contentions."

9 Cal. 4th at 876, *quoting Bank of Idaho v. Pine Avenue Associates*, 137 Cal. App. 3d 5, 15, 186 Cal. Rptr. 695 (1982); *see also Santisas*, 17 Cal. 4th at 622; *Mustachio*, 48

Cal. App. 4th at 1150. With slight modifications, this standard could be adapted to address statutory costs for the entire action:

> In deciding whether there is a ~~"party prevailing on the contract,"~~ "prevailing party," the trial court is to compare the relief awarded ~~on the contract claim or claims~~ in the action or proceeding with the parties' demands ~~on those same claims~~ in the action or proceeding and their litigation objectives as disclosed by the pleadings, trial briefs, opening statements, and similar sources. The prevailing party determination is to be made only upon final resolution of the ~~contract claims~~ action or proceeding and only by a comparison of the extent to which each party has succeeded and failed to succeed in its contentions.

The standard could be similarly adapted to address attorney's fees for noncontract claims covered by a fee clause, perhaps by directing the court to determine a single prevailing party for all claims (contact and noncontract) covered by the clause.

There are, however, other alternatives, which we could use instead of, or in addition to, the *Hsu* standard quoted above. For example, we could list factors for the court to consider in determining the prevailing party, either in statutory text or in Comments. To preserve flexibility, we would need to make clear that the list of factors is not exclusive and does not preclude a court from considering other factors as appropriate in the circumstances of a particular case.

We could also draw on standards used in other areas, such as the Civil Right Attorney's Fees Awards Act of 1976 (42 U.S.C. § 1988). In *Texas State Teachers Ass'n v. Garland Independent School Dist.*, for example, the United States Supreme Court set forth the following principles:

> A plaintiff is entitled to a fee award under the Act if "the plaintiff has succeeded on 'any significant issue in litigation which achieve[d] some of the benefit the parties sought in bringing suit.'" 489 U.S. 782, 791-92 (1989), *quoting Nadeau v. Helgemoe*, 581 F.2d 275, 278-79 (1st Cir. 1978).
>
> It is not necessary to show success on the "central issue" in the litigation and recovery of the "primary relief sought." *Texas State Teachers*, 489 U.S. at 784, 790-91.
>
> In general, "the degree of the plaintiff's overall success goes to the reasonableness of the award, … not to the availability of a fee award …." *Id.* at 792. Where, however, a plaintiff's success on a

> legal claim is "purely technical or de minimis," it may not support a determination that the plaintiff is the prevailing party. *Id.*
>
> If the plaintiff's claims "are based on different facts and legal theories, and the plaintiff has prevailed on only some of those claims, … these unrelated claims [must] be treated as if they had been raised in separate lawsuits, and therefore no fee may be awarded for services on the unsuccessful claim.'" *Id.* at 789, *quoting Hensley v. Eckerhart*, 461 U.S. 424, 435 (1983). Where, however, the plaintiff achieves partial success on claims that "arise out of a common core of facts, and involve related legal theories, the inquiry is more complex." *Texas State Teachers*, 489 U.S. at 789. The most critical factor is the degree of success obtained. *Id.*

We may want to incorporate some or all of these principles into whatever standard we propose.

Similarly, California cases interpreting statutes such as Code of Civil Procedure Section 1021.5 (private attorney general) may be helpful in developing a standard. For example, in *Folsom v. Butte County Ass'n of Governments*, 32 Cal. 3d 668, 652 P.2d 437, 186 Cal. Rptr. 589 (1982), the court considered whether there was a cause-effect relationship between the plaintiffs' litigation activities and changes in the defendant's approach to transit issues. The court concluded that the plaintiffs were "successful parties" under Section 1021.5 because "the litigation was demonstrably influential" in achieving the reforms plaintiffs sought. *Id.* at 687. It may make sense to borrow this or other principles from cases interpreting Section 1021.5 or other attorney's fee statutes.

(2) Preserving the Benefits of Existing Case Law

As should be obvious from the discussion thus far, there has been an abundance of litigation construing Civil Code Section 1717 and Code of Civil Procedure Section 1032. Some of the rules articulated in the cases should be changed, because they reflect faulty judicial reasoning or inadequacies in the statutory schemes. But the case law provides much useful guidance, such as the following:

> When the results of litigation are mixed, as when both parties seek relief, but neither prevails, or when a litigant recovers only part of the relief sought, it may be appropriate to determine that there is no prevailing party under Civil Code Section 1717. "By contrast, when the results of the litigation are *not* mixed — that is, when the decision on the litigated contract claims is purely good

> news for one party and bad news for the other — …a trial court has no discretion to deny attorney fees to the successful litigant." *Hsu*, 9 Cal. 4th at 875-76 (emphasis in original).
>
> In determining litigation success, "courts should respect substance rather than form, and to this extent should be guided by 'equitable considerations.' For example, a party who is denied direct relief on a claim may nonetheless be found to be a prevailing party if it is clear that the party has otherwise achieved its main litigation objective." *Id.* at 877.
>
> In determining the prevailing party, "the trial court may not invoke equitable considerations unrelated to litigation success, such as the parties' behavior during settlement negotiations or discovery proceedings, except as expressly authorized by statute." *Id.*

In attempting to clarify and improve the standards for determining the prevailing party, we should be careful to preserve the benefits (but not the detriments) of existing case law, so issues do not have to be needlessly relitigated. Much of this could be achieved through Comments stating that specific principles from specific cases remain unchanged.

(3) Dismissal

Voluntary dismissals present some of the most difficult issues in developing a standard for determining the prevailing party. Courts have repeatedly addressed this subject.

On initial consideration, it seems only natural to regard the defendant as the prevailing party in the event of a voluntary dismissal. For example, Justice Mosk has written:

> Is an award of attorney fees fair for the party who prevails not in a trial but by virtue of his opponent's voluntary dismissal? In my view, the answer is affirmative.
>
> It is true that counsel was not required to participate in the travail of a contested trial, with all of its time-consuming complexities and uncertainties. Nevertheless the attorney whose client is the beneficiary of a dismissal has necessarily interviewed the client, perhaps numerous times, may have sought witnesses, prepared pleadings, perhaps taken depositions and, in short, performed many or all of the preparations in anticipation of a contested trial. Although the trial did not materialize, substantial attorney services may have been performed and the desired result has prevailed.

> Therefore I see no basic unfairness in an award of attorney fees to the party whose position prevails in the absence of a formal trial.

Santisas, 17 Cal. 4th at 624 (Mosk, J., concurring). Similarly, Justice Jefferson wrote:

> In my view the recovery of attorney's fees by a defendant upon a voluntary dismissal of the action by plaintiff would be in the interest of sound public policy and in accord with equitable principles, since it would tend to discourage the *filing* of nonmeritorious actions by a party to a contract containing an attorney's fee clause. With knowledge that a voluntary dismissal will result in fees to the defendant, one party to the contract is not likely to start litigation based on the contract unless such party feels he has a reasonable opportunity of prevailing.

Olen, 21 Cal. 3d at 229 (Jefferson, J., dissenting) (emphasis in original).

On reflection, however, the situation is more complicated. Voluntary dismissal can result from a great variety of circumstances. Sometimes it may be due to damaging testimony in discovery, an adverse ruling on a legal issue, or other factors going to the merits of the plaintiff's case. Other times, the dismissal may result because the plaintiff has already obtained all or most of the relief sought (through settlement, insurance proceeds, voluntary corrective action, or other sources). In still other instances, the dismissal may bear no relation to the merits of the case, as when the defendant becomes insolvent, the plaintiff can no longer afford to pursue the litigation, the plaintiff becomes unable to endure the stress of litigation, the claim becomes moot, or a member of the plaintiff's family becomes ill, causing the plaintiff to abandon the litigation to care for the sick person.

As the Supreme Court observed in *Santisas*, 17 Cal. 4th at 621, it "seems inaccurate to characterize the defendant as the 'prevailing party' if the plaintiff dismissed the action only after obtaining, by means of settlement or otherwise, all or most of the requested relief, or if the plaintiff dismissed for reasons, such as the defendant's insolvency, that have nothing to do with the probability of success on the merits." In other words, it may be inequitable to permit the defendant to automatically recover fees when the plaintiff has voluntarily dismissed before trial. *Olen*, 21 Cal. 3d at 224.

An alternative approach would require the court to "determine whether, and to what extent, the complaint is meritorious and award attorney fees

accordingly." *Id.* In 1978, the Supreme Court criticized this approach on judicial economy grounds:

> [T]o arrive at that determination would require the court to try the entire case. The purpose of litigation is to resolve participants' disputes, not compensate participating attorneys. Our courts are sufficiently burdened without combat kept alive solely for attorney fees.

Id. at 224. At the time, Civil Code Section 1717 was silent on the matter of dismissal, and the Court concluded that in pretrial dismissal cases, it was "faced with a Hobson's choice of either (1) adopting an automatic right to attorney fees, thereby encouraging the maintenance of pointless litigation and violating the equitable principles which should govern attorney fee clauses, (2) providing for application of equitable considerations, requiring the use of scarce judicial resources for trial of the merits of dismissed actions, or (3) … denying attorney fees …." *Id.* at 225. The Court opted for the third alternative, requiring each side to bear its own attorney's fees in the event of dismissal. *Id.* The statute was later amended accordingly. 1981 Cal. Stat. ch. 888.

When the Supreme Court revisited the issue in *Santisas*, however, it took a different view:

> [U]pon fresh consideration of the matter, we are of the view that the practical difficulties associated with contractual attorney fee cost determinations in voluntary pretrial dismissal cases are not as great as suggested by the majority in [*Olen*]. …. The *Olen* majority … soundly reasoned that scarce judicial resources should not be used to try the merits of voluntarily dismissed actions merely to determine which party would or should have prevailed had the action not been dismissed. But we do not agree that the only remaining alternative is an inflexible rule denying contractual attorney fees as costs in all voluntary pretrial dismissal cases. Rather, a court may determine whether there is a prevailing party, and if so which party meets that definition, by examining the terms of the contract at issue, including any contractual definition of the term "prevailing party" and any contractual provision governing payment of attorney fees in the event of dismissal. If, as here, the contract allows the prevailing party to recover attorney fees but does not define "prevailing party" or expressly either authorize or bar recovery of attorney fees in the event an action is dismissed, a court may base its attorney fees decision on a pragmatic definition of the extent to which each party has realized its litigation objectives, whether by judgment, settlement, or otherwise.

17 Cal. 4th at 621-22. In other words, the Court rejected all three of the alternatives discussed in *Olen*, and endorsed a fourth approach to voluntary dismissals: Basing the prevailing party determination "on a pragmatic definition of the extent to which each party has realized its litigation objectives, whether by judgment, settlement, or otherwise." *Id.* at 622; *see also Damian*, 65 Cal. App. 4th at 1129 n. 15. As previously discussed, the Court limited that approach to *noncontract* claims covered by an attorney's fee clause, because Civil Code Section 1717 now expressly disallows contractual attorney's fees upon voluntary dismissal of a *contract* claim.

In revising Civil Code Section 1717 and Code of Civil Procedure Section 1032, it may be appropriate to eliminate this distinction. We could, for example, propose a general rule that upon voluntary dismissal of a claim covered by an attorney's fee clause — whether a contract claim or a noncontract claim — the court is to determine the prevailing party based on the extent to which each party realized its litigation objectives.

In suggesting this approach, the staff is not unsympathetic to the judicial economy concerns voiced in *Olen*. At best, it will require considerable effort to develop workable, efficient, and effective ways of determining as a pragmatic matter who prevailed in the event of a voluntary dismissal. Judicial economy is only one consideration, however, and it should not readily override the interest in achieving equitable results. Based on what we know thus far, we would at least give the suggested approach (or a similar one) a try.

Moreover, where parties are of roughly equal bargaining strength, it might also be appropriate to expressly permit them to agree in advance (as part of their contract) that each party is to bear its own costs and attorney's fees upon voluntary dismissal of a claim covered by the attorney's fee clause in their contract. *See generally Santisas*, 17 Cal. 4th at 602, 617, 621. This may help reduce the number of cases in which courts have to examine the circumstances of a voluntary dismissal, alleviating the burden on the courts.

Additionally, many dismissals are pursuant to a settlement agreement between parties to a lawsuit. To forestall confusion over the effect of any legislation we propose on dismissal, the legislation should explicitly state that such a settlement agreement may specify which party is to bear the attorney's fees, costs, and expenses, or may require each party to bear the party's own attorney's fees, costs, and expenses. If a settlement agreement is silent on this matter, the court should have authority to allocate responsibility for the

attorney's fees, costs, and expenses, based on the extent to which each party has realized its litigation objectives. *See generally Folsom* , 32 Cal. 3d at 679.

These proposed approaches should not, however, be inflexible rules. In some situations, it may be appropriate to deviate from them, as where a contract includes a unilateral attorney's fee clause.

(4) Unilateral Attorney's Fee Clause

A unilateral attorney's fee clause is compelling evidence that the contracting parties are of unequal bargaining strength. Due to this unequal relationship, the weaker party (the party not benefited by the unilateral clause) may be inhibited from asserting meritorious claims against the stronger party.

To offset this disincentive to sue (and thereby promote equal access to justice), it seems reasonable to give the weaker party assurance that if it asserts claims against the stronger party, it can later dismiss them without incurring liability for the other side's attorney's fees and costs. Further, parties should not be able to override this rule by contract, because any ostensible waiver is likely to be the product of the unequal bargaining relationship. *See generally Santisas*, 17 Cal. 4th at 616-17 (Section 1717's requirement that each side bear its own costs and fees upon dismissal cannot be overridden by contract, because that "would result in exactly the sort of one-sided enforcement of contractual attorney fee provisions that section 1717 was intended to preclude") A possible exception would be where "each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract." Civ. Code § 1717(a).

EXPERT WITNESS FEES AND OTHER NONSTATUTORY LITIGATION EXPENSES

If the Commission proposes legislation on the "prevailing party" standards in Civil Code Section 1717 and Code of Civil Procedure Section 1032, it should also consider addressing another confusing area: Recovery of litigation expenses that are neither attorney's fees nor statutory costs. Such nonstatutory litigation expenses may include fees of experts not ordered by the court, photocopying charges for documents other than exhibits, investigation expenses, telephone and postage charges, and other litigation expenses that are not listed in Section 1033.5(a) as allowable statutory costs. Some of these items are specifically disallowed in an award of statutory costs. Section 1033.5(b). Other items (those

not enumerated in Section 1033.5) "may be allowed or denied in the court's discretion." Section 1033.5(c)(4).

Several cases address reimbursement of nonstatutory litigation expenses pursuant to contract:

***Bussey v. Affleck*: Nonstatutory Litigation Expenses Recoverable as "Attorney's Fees" Pursuant to Clause for Reimbursement of "Costs and Attorney's Fees"**

In *Bussey v. Affleck*, 225 Cal. App. 3d 1162, 275 Cal. Rptr. 646 (1990), the First District Court of Appeal considered whether nonstatutory litigation expenses are recoverable as "attorney's fees" pursuant to a contract providing for reimbursement of costs and attorney's fees. The court concluded that these expenses *were* recoverable as contractual attorney's fees, regardless of whether they were disallowed in Section 1033.5, so long as they "represent expenses ordinarily billed to a client and … not included in the overhead component of counsel's hourly rate." *Id.* at 1166. In part, the court reasoned that an "agreement for attorney's fees and costs would be less than effectual if it could not cover the actual costs of litigation, including disbursements of counsel, and a contrary conclusion would mean that the party prevailing on the contract could never be made whole." *Id.*

***Ripley v. Pappadopoulos*: Disallowed Nonstatutory Litigation Expenses Are Not Recoverable in a Cost Award**

Four years later, the Third District Court of Appeal reached the opposite result in *Ripley v. Pappadopoulos*, 23 Cal. App. 4th 1616, 28 Cal. Rptr. 2d 878 (1994). With regard to items not enumerated in Section 1033.5, the court concluded that these could properly be awarded as statutory costs in the discretion of the trial court. *Id.* at 623. With regard to items disallowed in Section 1033.5, however, the court determined that they cannot be awarded as *either* statutory costs *or* contractual attorney's fees *in a cost award.*

In particular, the court focused on fees of experts not ordered by the court. From Section 1033.5(b)(1) and other statutes governing recovery of such fees, the court deduced that the "Legislature has reserved to itself the power to determine selectively the types of actions and circumstances in which expert witness fees should be recoverable as costs and such fees may not otherwise be recovered in a cost award." *Id.* at 625; *see also Davis v. KGO-T.V., Inc.*, 17 Cal. 4th 436, 950 P.2d

567, 71 Cal. Rptr. 2d 452 (1998). The court then distinguished expert fees from attorney's fees:

> In *Bussey* the court attempted to avoid the statutory prohibition against the inclusion of expert witness fees in a cost award by equating expert witness fees and other nonallowable costs of litigation with attorney fees and by concluding that such costs may be included in an award of contractual attorney fees. We cannot adhere to that approach. In the absence of some specific provision of law otherwise, *attorney fees and the expenses of litigation, whether termed costs, disbursements, outlays, or something else, are mutually exclusive, that is, attorney fees do not include such costs and costs do not include attorney fees.*

Ripley, 23 Cal. App. 4th at 625-26 (emphasis added).

The court did not go so far, however, as to determine that expert fees are never recoverable pursuant to a contractual provision for reimbursement:

> [W]e are here concerned with the items of expense which may be included in a cost award after judgment and are not concerned with contractual remedies. Special contract damages are subject to pleading and proof in the main action and cannot be recovered by mere inclusion in a memorandum of costs. … As an exception to this rule, the Legislature has chosen to provide for the recovery of contractual attorney fees in a cost award. … But the Legislature has declined to adopt that procedure for the recovery of expert witness fees. … Accordingly, *assuming expert witness fees may be recovered under a contractual provision, they must be specially pleaded and proven at trial rather than included in a memorandum of costs.*

Id. at 627 (emphasis added).

Robert L. Cloud & Associates v. Mikesell*: First District Repudiates *Bussey* and Follows *Ripley

The First District Court of Appeal recently revisited the matter of expert's fees and decided that *Bussey* was wrongly decided. "For all the reasons stated in *Ripley*, the *Bussey* decision should not be followed." *Robert L. Cloud & Associates v. Mikesell*, 69 Cal. App. 4th 1141, 82 Cal. Rptr. 2d 143, 150 (1999). "Instead, in light of the Legislature's express prohibition against inclusion of expert witness fees within a cost award (Code Civ. Proc., § 1033.5, subd. (b)(1)), we shall modify the judgment to delete the expert witness fees of $18,217." *Id.*

This recent decision eliminates the conflict between the First District and the Third District.

Arntz: Disallowed Nonstatutory Litigation Expenses Are Recoverable Under Broad Reimbursement Clause If Specially Pleaded and Proven at Trial

In *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.*, 47 Cal. App. 4th 464, 491, 54 Cal. Rptr. 2d 888 (1996), however, the First District considered a situation slightly different from the ones in *Bussey* and *Ripley*:

> We recognize there is authority holding that an undefined general contractual provision entitling the prevailing party to "reasonable attorney's fees and costs" must be interpreted in light of Code of Civil Procedure section 1033.5's limited definition of costs. … However, *Ripley* expressly declined to address the situation of a broad contractual cost provision where litigation expenses are specially pleaded and proven at trial. …That situation is presented here, since the contracts authorize recovery of all "costs, charges and expenses" and litigation expenses were pleaded and proven pursuant to a procedure stipulated by the parties. While it is reasonable to interpret a general contractual cost provision by reference to an established statutory definition of costs, we do not discern any legislative intent to prevent sophisticated parties from freely choosing a broader standard authorizing recovery of reasonable litigation charges and expenses.

47 Cal. App. 4th at 491-92. *Arntz* thus permits recovery of nonstatutory litigation expenses (including fees of experts not ordered by the court), but only where (1) the contractual reimbursement provision is broadly worded to encompass such expenses, and (2) the expenses are specially pleaded and proven at trial, as opposed to being sought in a costs award.

Preliminary Recommendation

As a commentator has pointed out, "requiring litigants to specially plead and prove litigation expenses pursuant to a contractual provision during trial may … be inefficient …." Huron, *Recover Losses: Are Costs Obtainable Under Attorney Fee Provisions*, San Francisco Daily Journal, p. 5 (April 29, 1999). To address this concern and provide clarification on reimbursement of nonstatutory litigation expenses, **the staff suggests the following statutory reforms based on the research we have done thus far**:

(1) **Expressly permitting parties to contractually agree to shift reasonable nonstatutory litigation expenses to the loser.** If parties can contractually agree to shift attorney's fees to the losing party, they should also be able to shift the other expenses of litigation, so long as those expenses are reasonable. Our research to date has not disclosed any policy reason for drawing a distinction. As the court observed in *Bussey*, a contrary conclusion "would mean that the party prevailing on the contract could never be made whole." 225 Cal. App. 3d 1166.

(2) **Allowing a party to recover nonstatutory litigation expenses in a costs award**. This would eliminate the need to specially plead and prove such expenses at trial.

(3) **Clarifying (by statute or in a Comment) that a contract clause providing for shifting of "attorney's fees" or "costs" does not encompass nonstatutory litigation expenses**. If parties desire to cover nonstatutory litigation expenses in their contract, they should make that intention clear, as by providing for recovery of all "costs, charges and expenses" (as was done in *Arntz*).

(4) **Applying the same rules for determination of the "prevailing party" to a contractual provision covering nonstatutory litigation expenses as to a contractual attorney's fee clause**. Again, we are unaware of any policy reason to apply different rules in this context.

RECIPROCITY OF UNILATERAL CLAUSE COVERING NONSTATUTORY LITIGATION EXPENSES AND/OR ATTORNEY'S FEES FOR NONCONTRACT CLAIMS

Some unilateral attorney's fee clauses cover not only attorney's fees for contract claims, but also nonstatutory litigation expenses and/or attorney's fees for noncontract claims. Reciprocity of such a contract clause is an important issue, which the Commission should consider addressing in this study.

Existing Law

In *Arntz*, the court considered the argument that "Civil Code section 1717 relates to attorney fees alone, so that a contractual cost provision authorizing one party's recovery of litigation expenses beyond statutory costs benefits that party alone, and is not a reciprocal right." 47 Cal. App. 4th at 492. The court rejected that contention with little discussion: "We are satisfied that the Legislature's express reference to 'attorney's fees *and costs*' [in Section 1717] makes contractual

provisions reciprocal as to both fees and costs." *Id.* (emphasis in original). "Any other interpretation would render the costs reference surplusage." *Id.*

In *Moallem v. Coldwell Banker Commercial Group, Inc.*, 25 Cal. App. 4th 1827, 31 Cal. Rptr. 2d 253 (1994), however, the contract essentially provided: "If Broker is required to institute legal action against Owner relating to this contact, Broker shall be entitled to reasonable attorney's fees and costs." *See id.* at 1829-30. Owner's assignee (Moallem) prevailed on a tort claim against Broker, and sought attorney's fees from Broker pursuant to this unilateral fee clause favoring Broker. The court of appeal rejected the claim, concluding that although the clause was broad enough to cover the tort claim, the reciprocity requirement of Civil Code Section 1717 did not extend to the tort claim. *Id.* at 1830-32.

In reaching this conclusion, the court considered Moallem's reliance on a public policy that unilateral attorneys' fees provisions should be bilaterally enforced. *Id.* The court concluded that the "existence of such a public policy cannot be denied." *Id.* at 1832. The court also acknowledged that "Moallem's position sounds a strong call of fairness," because the policy considerations supporting reciprocity apply equally to attorney's fees for a tort claim as to attorney's fees for a contract claim. *Id.*

The court was persuaded, however, that the plain language of Civil Code Section 1717 makes the provision inapplicable to a tort claim. "In section 1717, the Legislature has prescribed with clarity that the public policy Moallem seeks to invoke presently applies only to attorney fees for contract actions, not tort claims." *Id.*

The court reached this conclusion with obvious reluctance, emphasizing the need for legislative reform:

> In this case the asymmetry of statutory rights between contract and tort litigants painfully appears, because Moallem could have invoked section 1717 had he prevailed on his contract claim instead of his tort claims. But that situation is a consequence only of the Legislature's enactment as it now stands. Although we can suggest that the statute be rewritten to take into account *Xuereb* and its progeny, we cannot perform that revision. The public policy underlying section 1717 may be clear. But a court is not free to advance the public policy that underlies a statute by extending the statute beyond its plain terms and established reach.

Id. at 1833; *see also Sears*, 60 Cal. App. 4th at 1166-67 (Kline, P.J., concurring and dissenting).

Preliminary Analysis and Recommendation

Any unilateral requirement to reimburse attorney's fees or other litigation expenses distorts access to the courts: It burdens one side with a financial risk that the other side does not have to bear in pursuing justice. Such manipulation of the judicial process should not be permitted. *See generally Kinney v. United Healthcare Services, Inc.*, 70 Cal. app. 4th 1322, 1332, 83 Cal. Rptr. 2d 348 (1999) (Unilateral obligation to arbitrate deprives party of benefits and protections of judicial forum and thus "is itself so one-sided as to be substantively unconscionable."); *see also California Teachers Ass'n v. State of California*, 20 Cal. 4th 327, 975 P.2d 622, 84 Cal. Rptr. 2d 425 (1999) ("[R]equirement that dismissed or suspended teachers pay half the cost of the hearing, including the costs of the administrative law judge, necessarily and impermissibly deters teachers from exercising their due process right to a hearing.").

Civil Code Section 1717 "is part of an overall legislative policy designed to enable consumers and others who may be in a disadvantageous contractual bargaining position to protect their rights through the judicial process by permitting recovery of attorney's fees incurred in litigation in the event they prevail." *Coast Bank v. Holmes*, 19 Cal. App. 3d 581, 597 n.3, 97 Cal. Rptr. 30 (1971). To effectively promote the policy of equal access to justice, a clause for reimbursement of attorney's fees and/or other litigation expenses — whether for a contract claim or any other type of claim — should not operate in a one-sided manner, no matter how it is worded.

We could achieve this result by more than one means. A first possibility would be to revise Section 1717 to invalidate any unilateral clause for reimbursement of attorney's fees and/or other litigation expenses. While this approach may be appropriate for future contracts, applying it to preexisting contracts may prove problematic. When Section 1717 was first enacted, application of its reciprocity requirement to preexisting contracts was challenged on constitutional grounds. *See Coast Bank*, 19 Cal. App. 3d at 593-97. Although this challenge was rejected, we could expect a similar, perhaps more successful, challenge to a retroactive ban on unilateral fee clauses. We would not pursue such an approach without more carefully researching the likelihood of a successful challenge.

A safer approach would be to **extend the reciprocity requirement of Section 1717 to (1) contractual attorney's fees for noncontract claims and (2) nonstatutory litigation expenses**. Such an approach is likely to be upheld even if

it is applied to existing contracts. *See San Luis Obispo Bay Properties v. Pacific Gas & Elec. Co.*, 28 Cal. App. 3d 556, 570, 104 Cal. Rptr. 733 (1972); *Coast Bank*, 19 Cal. App. 3d at 593-97; *System Inv. Corp. v. Union Bank*, 21 Cal. App. 3d 137, 162-63, 98 Cal. Rptr. 735 (1971).

Regardless of which approach the Commission takes, we need to carefully differentiate between a unilateral attorney's fee clause and an indemnity provision covering attorney's fees. "An indemnitor in an indemnity contract generally undertakes to protect the indemnitee against loss or damage through liability *to a third person*, *Myers Bldg. Industries v. Interface Technology, Inc.*, 13 Cal. App. 4th 949, 968, 17 Cal. Rptr. 2d 242 (1993) (emphasis added). The indemnitor's obligation may include reimbursement of attorney's fees that the indemnitee incurs in litigation *against a third person*. *Id.* "Indemnification agreements are intended to be unilateral agreements." *Id.* at 973. "The Legislature has indicated no intent to make them reciprocal by operation of law." *Building Maintenance*, 55 Cal. App. 4th at 1029. This principle should be preserved, perhaps by means of an appropriate Comment.

ISSUES FOR FUTURE STUDY

This project focuses on contractual attorney's fees, so we have not explored issues relating to statutory attorney's fees. But we have become aware of the following issues, which may deserve future consideration.

Definition of Prevailing Party in Statutory Fee-Shifting Provisions

To what extent should the definition(s) of prevailing party in Civil Code Section 1717 and Code of Civil Procedure Section 1032 apply to other fee-shifting provisions? How do these sections interrelate with other fee-shifting provisions? How do the various statutory fee-shifting provisions interrelate with each other? There has been considerable confusion on these points. *See, e.g., Murillo v. Fleetwood Enterprises, Inc.*, 17 Cal. 4th 985, 994, 953 P.2d 858, 73 Cal. Rptr. 2d 682 (1998) (relation of Song-Beverly Consumer Warranty Act to Code Civ. Proc. § 1032); *Coltrain v. Shewalter*, 66 Cal. App. 4th 94, 77 Cal. Rptr. 2d 600 (1998) (relation of SLAPP statute to Code Civ. Proc. § 1032); *Gilbert v. National Enquirer, Inc.*, 55 Cal. App. 4th 1273, 64 Cal. Rptr. 2d 659 (1997) (relation of Civ. Code § 3344 to Code Civ. Proc. § 1032); *Heather Farms Homeowners Ass'n v. Robinson*, 21 Cal. App. 4th 1568, 26 Cal. Rptr. 2d 758 (1994) (relation of Civ. Code § 1354 to Civ. Code § 1717 & Code Civ. Proc. § 1032); R. Pearl, California Attorney Fee

Awards, § 2.14, at 2-17 to 2-19 (Cal. Cont. Ed. Bar 1998) (discussing cases on interrelationship of different statutory fee-shifting provisions).

Addressing these issues would be an enormous and difficult project, because there are hundreds of fee-shifting statutes, each of which would raise its own set of political issues. Clarification may be very useful, however, even if we are only able to achieve it in selected areas.

The staff recommends deferring decision on whether to undertake such work. We should be in a better position to evaluate the prospect of such a study after we complete work on contractual attorney's fees and the related issues discussed in this memorandum.

SLAPP Procedural Issue

Code of Civil Procedure Section 425.16 is intended to deter lawsuits that are "brought primarily to chill the valid exercise of the constitutional rights of freedom of speech and petition for the redress of grievances." Code Civ. Proc. § 425.16(a). Also known as the SLAPP law (Strategic Lawsuit Against Public Participation), this statute provides that a "cause of action against a person arising from any act of that person in furtherance of the person's right of petition or fee speech under the United States or California Constitution in connection with a public issue *shall be subject to a special motion to strike*, unless the court determines that the plaintiff has established that there is a probability that the plaintiff will prevail on the claim." Code Civ. Proc. § 425.16(b)(1) (emphasis added). If the defendant prevails on the special motion to strike, the defendant is entitled to attorney's fees and costs under the SLAPP statute. Code Civ. Proc. § 425.16(c).

Suppose, however, that the plaintiff dismisses the lawsuit before the special motion to strike is resolved. Is the defendant entitled to attorney's fees under those circumstances?

In *Coltrain*, the court concluded that "where the plaintiff voluntarily dismisses an alleged SLAPP suit while a special motion to strike is pending, the trial court has discretion to determine whether the defendant is the prevailing party for purposes of attorney's fees [based on]which party realized its objectives in the litigation." 66 Cal. App. 4th at 107. In *Moore v. Liu*, __ Cal. App. 4th __, 81 Cal. Rptr. 2d 807, 811 (1999), however, the court criticized *Coltrain* and held that "a defendant who is voluntarily dismissed, with or without prejudice, after filing a section 425.16 motion to strike, is nevertheless entitled to have the merits of such

motion hear as a predicate to a determination of the defendant's motion for attorney's fees and costs under subdivision (c) of that section."

The staff is not sure whether resolution of this conflict would be an appropriate topic for the Commission. **We will seek more information on this point and report back to the Commission**.

Respectfully submitted,

Barbara S. Gaal
Staff Counsel

Exhibit

STATUTES GOVERNING CONTRACTUAL ATTORNEY'S FEES

Code Civ. Proc. § 1032. Recovery of costs by prevailing party

1032. (a) As used in this section, unless the context clearly requires otherwise:

(1) "Complaint" includes a cross-complaint.

(2) "Defendant" includes a cross-defendant or a person against whom a complaint is filed.

(3) "Plaintiff" includes a cross-complainant or a party who files a complaint in intervention.

(4) "Prevailing party" includes the party with a net monetary recovery, a defendant in whose favor a dismissal is entered, a defendant where neither plaintiff nor defendant obtains any relief, and a defendant as against those plaintiffs who do not recover any relief against that defendant. When any party recovers other than monetary relief and in situations other than as specified, the "prevailing party" shall be as determined by the court, and under those circumstances, the court, in its discretion, may allow costs or not and, if allowed may apportion costs between the parties on the same or adverse sides pursuant to rules adopted under Section 1034.

(b) Except as otherwise expressly provided by statute, a prevailing party is entitled as a matter of right to recover costs in any action or proceeding.

(c) Nothing in this section shall prohibit parties from stipulating to alternative procedures for awarding costs in the litigation pursuant to rules adopted under Section 1034.

Code Civ. Proc. § 1033.5. Allowable costs

1033.5. (a) The following items are allowable as costs under Section 1032:

(1) Filing, motion, and jury fees.

(2) Juror food and lodging while they are kept together during trial and after the jury retires for deliberation.

(3) Taking, videotaping, and transcribing necessary depositions including an original and one copy of those taken by the claimant and one copy of depositions taken by the party against whom costs are allowed, and travel expenses to attend depositions.

(4) Service of process by a public officer, registered process server, or other means, as follows:

(A) When service is by a public officer, the recoverable cost is the fee authorized by law at the time of service.

(B) If service is by a process server registered pursuant to Chapter 16 (commencing with Section 22350) of Division 8 of the Business and Professions Code, the recoverable cost is the amount actually incurred in effecting service, including, but not limited to, a

stakeout or other means employed in locating the person to be served, unless such charges are successfully challenged by a party to the action.

(C) When service is by publication, the recoverable cost is the sum actually incurred in effecting service.

(D) When service is by a means other than that set forth in subparagraph (A), (B) or (C), the recoverable cost is the lesser of the sum actually incurred, or the amount allowed to a public officer in this state for such service, except that the court may allow the sum actually incurred in effecting service upon application pursuant to paragraph (4) of subdivision (c).

(5) Expenses of attachment including keeper's fees.

(6) Premiums on necessary surety bonds.

(7) Ordinary witness fees pursuant to Section 68093 of the Government Code.

(8) Fees of expert witnesses ordered by the court.

(9) Transcripts of court proceedings ordered by the court.

(10) Attorney fees, when authorized by any of the following:

(A) Contract.

(B) Statute.

(C) Law.

(11) Court reporters fees as established by statute.

(12) Models and blowups of exhibits and photocopies of exhibits may be allowed if they were reasonably helpful to aid the trier of fact.

(13) Any other item that is required to be awarded to the prevailing party pursuant to statute as an incident to prevailing in the action at trial or on appeal.

(b) The following items are not allowable as costs, except when expressly authorized by law:

(1) Fees of experts not ordered by the court.

(2) Investigation expenses in preparing the case for trial.

(3) Postage, telephone, and photocopying charges, except for exhibits.

(4) Costs in investigation of jurors or in preparation for voir dire.

(5) Transcripts of court proceedings not ordered by the court.

(c) Any award of costs shall be subject to the following:

(1) Costs are allowable if incurred, whether or not paid.

(2) Allowable costs shall be reasonably necessary to the conduct of the litigation rather than merely convenient or beneficial to its preparation.

(3) Allowable costs shall be reasonable in amount.

(4) Items not mentioned in this section and items assessed upon application may be allowed or denied in the court's discretion.

(5) When any statute of this state refers to the award of "costs and attorney's fees," attorney's fees are an item and component of the costs to be awarded and are allowable as costs pursuant to subparagraph (B) of paragraph (10) of subdivision (a). Any claim not based upon the court's established schedule of attorney's fees for actions on a contract shall bear the burden of proof. Attorney's fees allowable as costs pursuant to subparagraph (B) of paragraph (10) of subdivision (a) may be fixed as follows: (A) upon a noticed motion, (B) at the time a statement of decision is rendered, (C) upon application supported by affidavit made concurrently with a claim for other costs, or (D) upon entry of default judgment. Attorney's fees allowable as costs pursuant to

subparagraph (A) or (C) of paragraph (10) of subdivision (a) shall be fixed either upon a noticed motion or upon entry of a default judgment, unless otherwise provided by stipulation of the parties.

Attorney's fees awarded pursuant to Section 1717 of the Civil Code are allowable costs under Section 1032 as authorized by subparagraph (A) of paragraph (10) of subdivision (a).

Civil Code § 1717. Award of attorney's fees in contract action

1717. (a) 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.

Where a contract provides for attorney's fees, as set forth above, that provision shall be construed as applying to the entire contract, unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract.

Reasonable attorney's fees shall be fixed by the court, and shall be an element of the costs of suit.

Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract which is entered into after the effective date of this section. Any provision in any such contract which provides for a waiver of attorney's fees is void.

(b)(1) The court, upon notice and motion by a party, shall determine who is the party prevailing on the contract for purposes of this section, whether or not the suit proceeds to final judgment. Except as provided in paragraph (2), the party prevailing on the contract shall be the party who recovered a greater relief in the action on the contract. The court may also determine that there is no party prevailing on the contract for purposes of this section.

(2) Where an action has been voluntarily dismissed or dismissed pursuant to a settlement of the case, there shall be no prevailing party for purposes of this section.

Where the defendant alleges in his or her answer that he or she tendered to the plaintiff the full amount to which he or she was entitled, and thereupon deposits in court for the plaintiff, the amount so tendered, and the allegation is found to be true, then the defendant is deemed to be a party prevailing on the contract within the meaning of this section.

Where a deposit has been made pursuant to this section, the court shall, on the application of any party to the action, order the deposit to be invested in an insured, interest-bearing account. Interest on the amount shall be allocated to the parties in the same proportion as the original funds are allocated.

(c) In an action which seeks relief in addition to that based on a contract, if the party prevailing on the contract has damages awarded against it on causes of action not on the contract, the amounts awarded to the party prevailing on the contract under this section shall be deducted from any damages awarded in favor of the party who did not prevail on the contract. If the amount awarded under this section exceeds the amount of damages awarded the party not prevailing on the contract, the net amount shall be

awarded the party prevailing on the contract and judgment may be entered in favor of the party prevailing on the contract for that net amount.

DIVERGENT RESULTS UNDER CIVIL CODE SECTION 1717 AND CODE OF CIVIL PROCEDURE SECTION 1032

(1) ***McLarand, Vasquez & Partners, Inc. v. Downey Savings & Loan Ass'n*, 231 Cal. App. 3d 1450, 282 Cal. Rptr. 828 (1991)**. In *McLarand*, the plaintiff recovered no relief on its complaint for breach of contract, "related claims", and tortious denial of the contract, and the defendant recovered no relief on its cross-complaint against the plaintiff for breach of contract, negligence, interference with contractual relationship, and prospective economic advantage. The court determined that

> The defendant was entitled to an award of *statutory costs other than attorney's fees* under the portion of Section 1032(a)(4) defining prevailing party to include "a defendant where neither plaintiff nor defendant obtains any relief." When "neither the plaintiff nor the defendant who has filed a cross-complaint prevails, *the defendant is the prevailing party* entitled to costs." *Id.* at 1454 (emphasis added).
>
> For purposes of awarding *attorney's fees on the contract claims, there was no prevailing party on the contract*, because neither side breached the contract. The court "emphatically reject[ed] the contention that the prevailing party for the award of costs under section 1032 is necessarily the prevailing party for the award of attorney's fees." *Id.* at 1456.

(2) ***Nasser v. Superior Court*, 156 Cal. App. 3d 52, 202 Cal. Rptr. 552 (1984)**. This case was a declaratory relief action by a lessee against the lessor concerning the terms of the lease. The trial court reached a mixed result: Although a renewal option asserted by the lessee was validated, the lessee "was forced to pay a rental amount higher than he requested in his declaratory relief action and higher than previously offered." *Id.* at 60.

The trial court awarded *statutory costs other than attorney's fees* to the lessee pursuant to Section 1032, but denied the lessee's request for *contractual attorney's fees* pursuant to Section 1717. The court of appeal affirmed, explaining:

> With regard to *statutory costs other than attorney's fees, the award was discretionary*. "The instant action would seem to fall within subdivision (c) of section 1032 which reads: 'In other actions that those mentioned in this section costs may be allowed or not, and, if allowed, may be apportioned between the parties, on the same or adverse sides, in the discretion of the court.'" *Id.*
>
> With regard to *contractual attorney's fees* under Section 1717, the recipient of a discretionary award of costs pursuant to Section 1032 is not necessarily the prevailing party for purposes of awarding fees. "[T]here is

> nothing to suggest that the Legislature intended that a discretionary award of costs under subdivision (c) of Code of Civil Procedure section 1032 should automatically elevate the litigant to prevailing party status." *Id.* at 61. Because the result in *Nasser* was good news and bad news for each party, *the trial court did not abuse its discretion in determining that neither party was entitled to attorney's fees under Section 1717. Id.* at 59-60.

(3) ***Sears v. Baccaglio*, 60 Cal. App. 4th 1136, 70 Cal. Rptr. 2d 769 (1998)**. The tension between the definitions of prevailing party in Civil Code Section 1717 and Code of Civil Procedure Section 1032 is also painfully evident in *Sears*, an action and cross-action concerning the enforceability and extent of liability on a guaranty. The trial court found the guaranty enforceable, but entered a judgment for over $67,000 in favor of the guarantor and against the assignee of the guaranty. The guarantor was entitled to this sum, because by the time the judgment was rendered the assignee had already recovered (from a variety of sources) more than the amount of its damages. 60 Cal. App. 4th at 1141.

Despite the judgment in favor of the guarantor, the trial court awarded contractual attorney's fees under Civil Code Section 1717 *to the assignee*. The trial court viewed the assignee as the prevailing party, because the whole thrust of its decision was to give effect to the guaranty, an issue that was hotly contested. *Id.*

On appeal, the guarantor argued that the fee award to the assignee was improper and instead *he* was entitled to costs and contractual attorney's fees as a matter of right pursuant to Code of Civil Procedure Section 1032, because he obtained a net monetary recovery. The court of appeal disagreed, upholding the award to the assignee and justifying this result under both Civil Code Section 1717 and Code of Civil Procedure Section 1032. *Id.* at 1142-59.

Although the court of appeal reached the same result under both statutes, it had to strain to avoid "net monetary recovery" language in Section 1032 and explain why the statutes set forth different standards for determining the prevailing party and what those differences are. Id. at 1156-58. The court of appeal acknowledged, for example, that "one of the permutations suggested by the differences between the statutes" is that "*one party can be the prevailing party for purposes of costs under Code of Civil Procedure section 1032 while another is determined to have prevailed for purposes of awarding fees on a contract claim under Civil Code section 1717*." *Id.* at 1157 (emphasis added).