Study J-901 June 21, 2000

Second Supplement to Memorandum 2000-29

Award of Costs and Contractual Attorney's Fees to Prevailing Party (Comments on Staff Draft Statute)

The Commission has received the following comments on the staff draft statute attached to the First Supplement to Memorandum 2000-29:

These comments are discussed below.

TENDER BEFORE ACTION

The staff draft statute includes the following amendment of Code of Civil Procedure Section 1025, which pertains to tender of the amount due and deposit of that amount in court:

> **Code Civ. Proc. § 1025 (amended). Tender of deposit in action on a contract or action for recovery of money only**
>
> SEC. ____. Section 1025 of the Code of Civil Procedure is amended to read:
>
> 1025. ~~When, in~~ (a) In an action on a contract or an action for the recovery of money only, where the defendant alleges in ~~his~~ the answer that before the commencement of the action ~~he~~ the defendant tendered to the plaintiff the full amount to which ~~he~~ the plaintiff was entitled, and ~~thereupon~~ at the time of filing the answer the defendant deposits in court, for the plaintiff, the amount tendered, and the allegation is found to be true, the plaintiff cannot recover costs, but must pay costs to the defendant, including any reasonable attorney's fees and nonstatutory litigation expenses pursuant to Section 1717 of the Civil Code.
>
> (b) Where a deposit has been made pursuant to this section, the court shall, on the application of a 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.

Comment. Subdivision (a) of Section 1025 is amended to continue material that was formerly in the second paragraph of Civil Code Section 1717(b)(2), with revisions to encompass nonstatutory litigation expenses.

Subdivision (b) continues and broadens material that was formerly in the third paragraph of Civil Code Section 1717(b)(2). The procedure is made expressly available not only in an action on a contract, but also in any action for the recovery of money only.

Section 1025 is also amended to make technical changes.

According to Mark Lomax (Management Analyst, Alameda County Superior Court), a frequent issue is whether a court order is required for a deposit under this provision. (Exhibit p. 1.) To clarify this point, he recommends that language along the following lines be added: "The amount tendered may be deposited by the defendant with the clerk of the court at the time of filing the answer, without first obtaining a court order for deposit." (*Id.*) Mr. Lomax explains that this proposed language is patterned after similar wording in Code of Civil Procedure Section 386(c) and "would eliminate any confusion and promote economy of judicial resources by eliminating the need for applying for a routine court order." (*Id.*)

The staff agrees with the concept of this suggestion but has not yet determined precisely how to implement it. In addition to revising Section 1025 as Mr. Lomax suggests, it may also be appropriate to amend Code of Civil Procedure Section 573, which governs deposits generally. Unless the Commission directs otherwise, the staff will address this point in its next draft.

APPLICATION OF SECTION 1717 TO ATTORNEYS WHO DO NOT CHARGE A FEE OR CHARGE ONLY A NOMINAL FEE

In May, the California Supreme Court ruled that "an entity that is represented by in-house counsel may recover attorney fees under Civil Code section 1717." *PLCM Group, Inc. v. Drexler,* __ Cal. App. 4th __, __ P.2d __, 95 Cal. Rptr. 2d 198 (2000). The Court expressly disapproved the notion that fees under Section 1717 "can be recovered only when, and to the extent that, a litigant incurs fees on a fee-for-service basis." *Id.* at 207 n.5. In ruling that a party represented by in-house counsel may recover fees, the Court stressed that trial courts have broad authority to determine the amount of a reasonable fee. *Id.* at 206. The Court upheld an award that was based on the number of hours expended multiplied by the prevailing market rate for comparable legal services. *Id.* at 207.

After this decision, the staff received a letter from Lauren Saunders on behalf of Bet Tzedek Legal Services ("Bet Tzedek") and Western Center on Law and Poverty ("Western Center"), urging the Commission to codify the proposition that public interest and pro bono attorneys may recover fees under Section 1717 "even if their clients do not 'incur' fees in the sense of being liable to pay them." (Exhibit p. 4.) Bet Tzedek and Western Center suggest that the following language be added to Section 1717(a):

> Attorney's fees and costs shall be deemed to be incurred for purposes of this section even if the attorney charges the party no fee or a nominal fee for his or her services. In such cases, attorneys' fees awarded should be based on the prevailing market rate for comparable legal services in the attorney's community.

Id. They point out that providing fees to public interest or pro bono attorneys is "fully consistent with, and in fact required by, the reciprocity rationale underlying section 1717." *Id.* at 1. "Providing attorneys' fees to poor litigants represented free of charge ensures that both sides have access to counsel and both sides bear an equal risk of paying the other side's fees if they breach the contract." *Id.*

As previously explained (Memorandum 2000-29, pp. 1-2), the staff considers it inevitable that the Commission will have to confront issues relating to how Section 1717 applies to in-house counsel, public interest and pro bono attorneys, and others who do not charge a traditional fee. **The Commission should address these issues now, instead of in the heat of the legislative process.**

Denying recovery under Section 1717 because the prevailing party's attorney did not charge a traditional fee is grossly inconsistent with the equitable purpose of the statute. The history of the provision consistently adheres to the theme of equity in awarding fees. *PLCM,* 195 Cal. Rptr. 2d at 203. Consistent with this statutory purpose, **Section 1717 should be revised to clarify that it applies regardless of whether the prevailing party's attorney charged a traditional fee.** If the Commission concurs, the staff will implement this approach in the next draft, raising issues as needed.

COMMENTS OF THE STATE BAR COMMITTEE ON ADMINISTRATION OF JUSTICE

The State Bar Committee on Administration of Justice ("CAJ") has provided extensive comments on the staff draft statute (Exhibit pp. 5-20). CAJ interprets the draft to overturn *Damian v. Tamondong,* 65 Cal. App. 4th 1115, 1129-30, 77 Cal.

Rptr. 2d 262 (1998), which says that courts should take the circumstances of a voluntary dismissal into account in determining the prevailing party for purposes of a statutory fee award (e.g., whether the defendant became insolvent, whether a dispositive motion was pending at the time of dismissal, whether the plaintiff obtained the relief sought through other means).

That is not the intent, as is clear from the Comment to proposed Code of Civil Procedure Section 1039.20, which states in part:

> Under subdivision (a)(5), the defendant ordinarily is the prevailing party in the event of a voluntary dismissal. But a voluntary dismissal can result from circumstances other than an impending loss on the merits. Santisas v. Goodin, 17 Cal. 4th 599, 621, 951 P.2d 399, 71 Cal. Rptr. 2d 830 (1998); International Indus., Inc. v. Olen, 21 Cal. 3d 218, 224, 577 P.2d 1031, 145 Cal. Rptr. 691 (1978). For example, the defendant may have become insolvent, the claim may have become moot, or the plaintiff may have obtained relief through voluntary corrective action or insurance proceeds. Where the plaintiff moves to tax costs pursuant to Section 1039.30, the court must pragmatically assess the circumstances of the voluntary dismissal in determining the prevailing party. Damian v. Tamondong, 65 Cal. App. 4th 1115, 1129-30 & n.15, 77 Cal. Rptr. 2d 262 (1998).

CAJ's confusion is understandable, however, because similar language does not appear in the Comment to proposed Code of Civil Procedure Section 1039.30 and the draft does not yet include a narrative explanation (preliminary part). In addition, proposed Section 1039.30 states that in determining the prevailing party the court "shall not consider factors unrelated to litigation success." As the Comment points out, this language is drawn from *Hsu v. Abbara*, 9 Cal. 4th 863, 877, 891 P.2d 804, 39 Cal. Rptr. 2d 824 (1995). It is intended to convey that in determining the prevailing party, the court should focus only on litigation success, not on factors such as recalcitrance in discovery or lack of cooperation in settlement negotiations. "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." *Id.*

The staff believes that this is an important principle, but clarification is necessary to ensure that courts *can* consider factors such as a defendant's

insolvency in the context of a voluntary dismissal. **The staff will attempt to provide greater clarity regarding voluntary dismissals in the next draft.**

CAJ also makes specific suggestions pertaining to proposed Sections 1040.30 (items allowable except where expressly authorized by law) and 1040.60 (partial recovery). **We will discuss these points in the next draft.**

Respectfully submitted,

Barbara S. Gaal
Staff Counsel

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April 24, 2000

Nathaniel Sterling, Esq.
California Law Revision Commission
4000 Middlefield Road, Room D-1
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Re: Study J-901

Dear Mr. Sterling:

PROPOSED REORGANIZATION OF CHAPTER 6 (COSTS) OF TITLE 14 OF PART 2 OF THE CODE OF CIVIL PROCEDURE

I am writing to comment on the draft statute renaming and reorganizing chapter 6, title 14, part 2, of the Code of Civil Procedure.

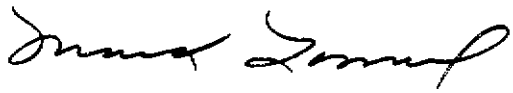
We recommend that wording substantially as follows be added to draft amended section 1025:

> *The amount tendered may be deposited by the defendant with the clerk of the court at the time of filing the answer, without first obtaining a court order for deposit.*

The question of whether a court order for deposit under section 1025 is required frequently arises. This proposed wording, which is patterned after similar wording in subdivision (c)

of section 386 of the Code of Civil Procedure, would eliminate any confusion and promote economy of judicial resources by eliminating the need for applying for a routine court order.

Very truly yours,



MARK LOMAX
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May 23, 2000

Barbara S. Gaal
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Re: Study of Attorneys' Fees and Related Issues

Dear Ms. Gaal:

On behalf of Bet Tzedek Legal Services and the Western Center on Law and Poverty, we are writing to urge the California Law Revision Commission to make clear that parties represented by public interest organizations or pro bono attorneys are entitled to attorneys' fees under Civil Code section 1717.

We previously explained how providing fees to public interest or pro bono attorneys was fully consistent with, and in fact required by, the reciprocity rationale underlying section 1717. Providing attorneys' fees to poor litigants represented free of charge ensures that both sides have access to counsel and both sides bear an equal risk of paying the other side's fees if they breach the contract.

We also believe that it is a fairly straightforward task to revise section 1717 to clarify that it is consistent with the larger body of law governing awards attorneys' fees to public interest attorneys. This is consistent with the Commission's aim of establishing uniform standards for awards of attorneys' fees, whether under contract or statute.

It has long been the law, both in California and in the federal courts, that public interest firms are entitled to statutory fee awards at market rates regardless whether they charge their clients. See Serrano v. Priest, 20 Cal.3d 25, 47-48,141 Cal.Rptr. 315, 327 (1977) (Serrano III); Blum v. Stenson, 465 U.S. 886 (1984). That has also been the rule for attorneys' fees awarded under a contract under section 1717. See Beverly Hills Properties v. Marcolino, 221 Cal.App.3d Supp. 12, 270 Cal.Rptr. 605 (1990).

This clear body of law had been called into question by dicta in San Dieguito Partnership v. San Dieguito River Valley Reg'l Open Space Park Joint Powers Authority, 61 Cal.App.4th 910, 91 Cal.Rptr.2d 91 (1998). That case questioned Marcolino in light of language in Trope v. Katz, 11 Cal.4th 274, 45 Cal.Rptr. 2d 241 (1995), stating that

"'attorney's fees ... [are] the consideration that *a litigant* actually pays or becomes liable to pay in exchange for legal representation.'" San Dieguito, 72 Cal.Rptr.2d at 95 (emphasis added by San Dieguito, quoting Trope, 11 Cal.4th at 280).

San Dieguito was always questionable authority, and it was recently expressly disapproved by the Supreme Court in PCLM Group, Inc. v. Drexler, 2000 Daily Journal D.A.R. 4831, 4835 n.5 (May 8, 2000). PCLM also limited the Trope language to "the 'narrow issue' whether pro se attorney litigants could recover attorney fees." Id. at 4835. Finally, PCLM cited Marcolino favorably as "affirming an award of reasonable attorney fees for pro bono legal services." Id. at 4834.

Although it did not directly address the issue, the PCLM decision makes clear that Marcolino is good law and that public interest and pro bono attorneys may recover fees under section 1717 even if their clients do not "incur" the fees in the sense of being liable to pay them. We would like the Law Revision Commission to codify this proposition in its revisions to section 1717.

We suggest the following amendment to section 1717(a):

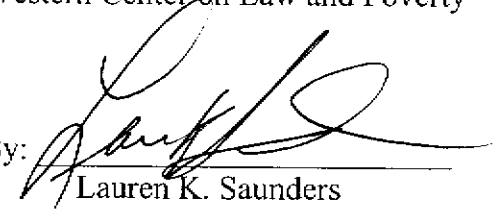
"Attorneys' fees and costs shall be deemed to be incurred for purposes of this section even if the attorney charges the party no fee or a nominal fee for his or her services. In such cases, attorneys' fees awarded should be based on the prevailing market rate for comparable legal services in the attorney's community."

Thank you very much for your consideration of this proposal.

Yours very truly,

Bet Tzedek Legal Services

Western Center on Law and Poverty

By: 
Lauren K. Saunders

/lks

MEMORANDUM

Date: May 18, 2000

From: John M. Daley

To: Committee on Administration of Justice

Subject: CLRC Memorandum 2000-29 (First Supplement, dated April 10, 2000); Contractual Attorneys' Fees

COMMITTEE POSITION:

x	**Technical Comments and/or recommended amendments**
x	**Support**
x	**Support if Amended**
x	**Oppose Unless Amended**
	Oppose
	Other

Date Position recommended: **May 25, 2000**
Committee Vote: **Ayes** **Noes** **N.V.**
(Not Applicable-votes were taken on individual items)

ANALYSIS:

(1) Summary of Existing Law

Under existing law, there are different standards for determining whether a party is the "prevailing party" for purposes of awarding statutory costs, attorneys fees and expenses under a contract claim, and attorneys' fees and expenses on a tort claim, even if all such claims are covered by the same attorneys' fee clause in a contract, particularly with respect to parties which have been dismissed from an action. The different standards are summarized in *Santisas v. Goodin*, 17 Cal.App.4th 599 (1998).

For statutory costs, a party in whose favor is dismissed is considered the "prevailing party" under Section 1032 of the Code of Civil Procedure, except perhaps under the limited circumstances described in *Damian v. Tamondong*, 65 Cal.App.4th 1115 (1998) (e.g., where the defendant is dismissed because it is insolvent).

For awards of attorneys' fees and expenses with respect to *contract* causes of action covered by an attorneys' fee clause, Section 1717(b)(2) of the Civil Code provided that *neither party* is the "prevailing party" when the plaintiff voluntarily dismisses its claim.

For awards of attorneys' fees and expenses with respect to *tort* causes of action covered by an attorneys' fee clause, the courts have held that Section 1717(b)(2) of the Civil Code does not apply, and that the dismissed party *may be* the prevailing party, depending upon the particular terms of the attorneys' fee clause in issue. *Santisas v. Goodin*, 17 Cal.App.4th 599 (1998).

Under existing case law, moreover, it has been held that (1) the reciprocality provisions of Civil Code Section 1717 (which deem a "one-way" attorneys' fee clause to apply to *all* parties to the contract) extend only to *contract* claims, and *not* to tort claims, even if both types of claims are covered by the attorneys' fee clause in issue and (2) certain litigation expenses, such as expert witness fees, cannot be proved up as part of a motion for attorneys' fees, but must instead be specially pleaded and proved during the course of the trial.

(2) Changes to Existing Law Proposed by Memorandum 2000-29

The draft legislation which the CAJ considered at its May 25, 2000 meeting is that which is attached to the First Supplement to Memorandum 2000-29 dated April 10, 2000. This legislation would completely reorganize and substantially modify the law with respect to awards of attorneys' fees and expense under a contract.

Although the reorganization itself is not intended to change the existing law, the reorganization *does* make it difficult to locate and understand what changes to existing law are being proposed in the draft legislation. As is explained below, the difficulty in determining what changes are being proposed, along with the absence of any *explanation* for the particular changes proposed, is a major source of concern to the CAJ.

So far as the CAJ has been able to discern, the proposed legislation would make the following changes to existing law, ranked in order of importance:

(1) the legislation would delete existing Civil Code Section 1717(b)(2), which provides that attorneys' fees are not available on a contract action when the action has been voluntarily dismissed or settled; although the staff originally suggested that the court be given discretion to award attorneys' fees in such cases, the proposed legislation would instead require the courts to award attorneys' to dismissed parties in most cases, and would at least allow parties to seek an award of fees even in cases which have been settled;

(2) the legislation would codify a portion of the holding of the California Supreme Court decision in *Santisas v. Goodin*, 17 Cal.App.4th 599 (1998), wherein the Court held that a dismissed party may be awarded attorneys' fees on tort causes of action which arise out of a contract, even though it may not recover on the contract claims which have been dismissed;

(3) the legislation would change existing law by providing that a contractual attorneys' fees provision is reciprocal as to all actions arising out of the contract, including non_statutory causes of action which arise under the contract;

(4) the legislation is intended to, but may not, change or at least clarify existing law by providing that "nonstatutory litigation expenses" are recoverable so long as the contract provides that they are recoverable; the legislation would also specify that claims for such expenses are an element of "costs" which should be awarded on a motion for attorneys' fees;

(5) the legislation would change existing law by providing the Courts with the discretion to reduce a cost award, including attorneys' fees and "non_statutory expenses," when the "prevailing party" is only partially successful; and

(6) the legislation would nullify the decision in *Damian v. Tamondong*, 65 Cal.App.4th 1115 (1998), wherein the court held that a party who has been dismissed may not even be the "prevailing party" even for the purpose of awarding statutory costs under some circumstances.

As we shall explain below, some of these proposed changes come as a complete surprise, since the draft legislation attached to the original Memorandum 2000-29, would *not* have changed the law to the extent now proposed.

Summary of Recommendations

At its May 25 meeting, the CAJ voted to comment upon the proposed legislation as follows:

(1) **Deletion of the Prohibition Against Attorneys' Fees Awards in Voluntarily Dismissed Cases.** There was considerable disagreement among the CAJ with respect to the wisdom of permitting awards of attorneys' fees in cases which have been voluntarily dismissed. Accordingly, the CAJ takes no position on the need for a change in the law on this particular issue.

However, the members unanimously or nearly unanimously opposed the manner in which the draft legislation proposes to change the law on this subject for the following reasons:

(a) the legislation proposed would unfairly and unjustifiably require the court to award attorneys' fees to dismissed parties in virtually all cases; and

(b) the proposal to eliminate the prohibition against awarding attorneys' fees in voluntarily dismissed

cases (i) is not apparent from the draft legislation and (ii) is nowhere *justified or explained* in the record of the CLRC or the Comments to the proposed legislation.

(2)___**Codification of the Holding in *Santisas*, Which Allows Awards of Attorneys' Fees for Tort Claims in Voluntarily Dismissed Actions.** The CAJ believes that this issue is secondary to the issue of whether the prohibition of attorneys' fees awards in voluntarily dismissed cases should be eliminated altogether, as has been proposed. Although most members of the CAJ favor parallel treatment of contract and tort claims covered by an attorneys' fee clause, they would like to revisit this issue *after* the proposed legislation has been revised to take its comments concerning the first item into account.

(3)___**Extending Reciprocality to Tort Claims**. The CAJ takes no opinion on this proposed change.

(4)___**Recovering Non-Statutory Expense**. The CAJ notes that, if the intent of this provision is to make all expenses which may be covered by an attorneys' fee clause recoverable, the language of proposed Section 1040.30 should be changed to read: "The following items are not allowable as costs, except where expressly authorized by law or contract:"

(5)___**Discretion to Limit Attorneys' Fees and Cost Awards**. The CAJ opposes this proposed change unless the discretion to limit attorneys' fee awards (which includes non-statutory litigation expense) is modified, either in the text or in the Comments thereto, to make it clear that the Courts are not authorized to exercise their discretion to limit attorneys' fees awards in a manner which is contrary to existing case law.

(6)___**Elimination of Discretion to Find that a Dismissed Party is not the "Prevailing Party" for Purposes of a Cost or Fee Award.** The CAJ opposes the proposed legislation to the extent that it would nullify the decision in *Damian v. Tamondong*, 65 Cal.App.4th 1115 (1998), wherein the court held that a party who has been dismissed may not even be the "prevailing party" even for the purpose of awarding statutory costs under some circumstances.

Discussion

Item (1) Deletion of the Prohibition Against Attorneys' Fees Awards When an Action is Voluntarily Dismissed or Settled.

The members of the CAJ do not agree on the wisdom of deleting the prohibition against an award of attorneys' fees in an action which has been voluntarily dismissed.

Various members, including the undersigned, took the position that elimination of the existing prohibition against awarding attorneys' fees when cases have been voluntarily dismissed would deprive plaintiffs of the ability to dismiss litigation gone mad, would clog the courts with litigation where the sole or primary issue is attorneys' fees, and would lead to gross inequities. These members also (1) argued that there was no test short of a "trial on the merits" which would be equitable and (2) favored extending the prohibition of existing law to tort claims covered by a contractual attorneys' fee provision.

Other members strongly disagreed, contending that the courts should be given the freedom to enforce the intent of the parties, as expressed in the contract (or implied by the reciprocality provision of Civil Code Section 1717) and that the existing law results in gross inequity in some cases. These members would favor either eliminating or restricting the prohibition against an award of attorneys' fees in cases of voluntary dismissal.

Although there is strong disagreement among the members of the CAJ with regard to the wisdom of eliminating the existing prohibition against awards of attorneys' fees in cases of voluntary dismissal, the CAJ unanimously or nearly unanimously agreed that the draft legislation presented for its review does not address the issue properly.

(a) The proposed legislation would unfairly and unjustifiably require the court to award attorneys' fees to dismissed parties in virtually all cases.

In an effort to avoid establishing a rule which requires the court to try the "merits" of the action, the draft of the legislation proposed by the Commission staff provides that, in deciding whether or not a party (including a dismissed party) is the "prevailing party," the Court "may not consider factors other unrelated to litigation success." Proposed Section 1039.30(c).

The Commission staff apparently lifted this test directly from the majority's discussion of the issue in the *Santisas* decision in the belief that this test establishes a "middle ground" between an "automatic" award" of attorneys' fees, which the majority in *Santisas* said would *not* be appropriate, and a mini-trial "on

the merits," which the Court in *Olen* believed would be required if an fees were *not* automatically awarded.

In fact, however, application of the "litigation success" test to a voluntarily dismissed claim would "automatically" result in a finding that the dismissed party is the prevailing party in *almost* all cases which are voluntarily dismissed, which is precisely what the Supreme Court said would *not* be appropriate.

The "litigation success" standard suggested by the majority in *Santisas* comes from its earlier decision in *Hsu v. Abbara*, 9 Cal.4th 863 (1995), in which the question presented was the scope of the discretion afforded to the Court to determine the "prevailing party" *after the case had been tried to completion and a judgment rendered*. The "litigation success" standard makes sense in this context, since the court deciding the issue already has a *judgment on the merits, the pleadings, and a trial record upon which to make the determination*.

In a voluntary dismissal case, however, the only information which bears on the "litigation success" of the parties is *the dismissal itself*, since it establishes a *prima facie* case that the party dismissing its claim had ***no*** success in the litigation.

The only evidence which could be used to *overcome* this presumption is evidence that the dismissing party achieved its litigation objectives through a settlement or other direct or indirect exchange of consideration.

The fact that the plaintiff dismissed the case because of the defendants' insolvency, the defendants' discharge in bankruptcy, the expense of the litigation *or for any other reason which is unrelated to the merits of the claim* would be irrelevant, and could not be considered by the Court.

The court would also be precluded from taking into account *any other matter* relating to the merits of the litigation, but which the plaintiff could not reasonably have anticipated, such as a change in testimony by a critical witness or discovery of a significant document.

The CAJ understands that the goal of the proposed legislation is to serve "equity," and that it is the perception of the Commission, or at least the Commission staff, that the current prohibition against an award of attorneys' fees in all voluntarily dismissed cases is "inequitable."

However, the "litigation success" standard which is proposed in the legislation drafted by the Commission staff simply shifts the burden of "inequity" from dismissed parties to the dismissing parties, without *any* evidence that doing so would result in greater "equity" as a whole.

(b) The proposal to eliminate the prohibition against awarding attorneys' fees in voluntarily dismissed cases (i) is not apparent from the draft legislation and (ii) is nowhere *justified or explained* in the record of the CLRC or the Comments to the proposed legislation.

The proposal to eliminate the prohibition against awarding attorneys' fees in voluntarily dismissed cases is not apparent from the draft legislation and is nowhere justified or explained in the CLRC record or in the Comments to the proposed legislation.

In order to ascertain that the prohibition against awarding attorneys' fees in voluntarily dismissed cases has been completely eliminated, one has to go through the following analysis:

(1) the Comment to revised Section 1717 says that subsection (b)(2) has been "superseded by the second sentence of subdivision (c);"

(2) proposed Section 1717(c) says that the court shall determine who is the prevailing party "in accordance with Section 1039.40 of the Code of Civil Procedure;"

(3) Section 1039.40 says that, for the purpose of awarding attorneys' fees and non_statutory costs, the prevailing party shall be determined pursuant to Sections 1039.20 and 1039.30;

(4) Section 1039.20(a)(5) says that, when an action is voluntarily dismissed, other than pursuant to a settlement agreement, the defendant is presumed to be the prevailing party; and

(5) Section 1039.30 permits a party to challenge the applicability of the presumption, but says that, in ruling on the issue, "the court may not consider factors unrelated to litigation success."

In other words, one has to review all of these provisions before it becomes clear that Section 1717(b)(2) has not only been "superseded," but in fact eliminated from the code and replaced by a provision which, in essence, *requires* the Court to find that a dismissed party is the "prevailing party."

The absence of any mention of or explanation for the elimination of the substance of Section 1717(b)(2) also comes as a complete surprise, since

(1) the Comment to the original draft of revised Section 1717 which is attached to Memorandum 2000_13 (which, in turn, is attached to Memorandum 2000-29) would have made it clear that the court does have the discretion to find that a dismissed party is not the "prevailing party" under circumstances such as that described by the Supreme Court in the O*len* and *Santisas* decisions, and

(2) the directives in the Minutes of the Commission's February 10-11, 2000 meeting say nothing about eliminating this discretion.

The CAJ submits that, if the Commission proposes to change existing law on such an important topic, it should at least make its intention clear, then justify the proposed change, both to the public and to the legislature.

Accordingly, the CAJ opposes the elimination of the right to dismiss a contact action without incurring liability for the dismissed party's attorneys' fees unless and until the existence of and justification for the change is clearly explained, both in the Comments to the proposed legislation and in any proposal which is submitted to the legislature.

(c) Miscellaneous Comments Concerning the Dismissal Rule.

Although agreement among the members of CAJ was nowhere near unanimous, various members of the committee also expressed other concerns, both with respect to the merits of the proposal to eliminate the prohibition against awards of attorneys' fees for voluntarily dismissed cases and with respect to the apparent reasons for the proposal which appear in the CLRC record.

For example, some members pointed out that there are legitimate reasons for maintaining a difference between the definition of a "prevailing party" with regard to an award of statutory costs and an award of "attorneys' fees" and other litigation expense in the case of voluntarily dismissed cases.

In particular, the fact that a party who has been dismissed is entitled to statutory costs is not particularly unfair or surprising, since this rule at least permits such a party to recover certain costs he incurred in defending *the particular action which has been dismissed*, even if the action can later be re-filed and will be incurred for a *second* time. Thus, with respect to the recovery of statutory costs, it is relatively accurate to say that the dismissed party is the "prevailing party." Except under the limited circumstances described in the *Damian* case, moreover, the resulting requirement to pay statutory costs is fair, or at least not grossly unfair.

However, under Code of Civil Procedure Section 581(b)(1), a plaintiff is absolutely entitled to voluntarily dismiss an action until the "commencement of trial," upon payment of the statutory costs of suit. If the action is dismissed "without prejudice," the plaintiff has the right to *re-file* the action subject to any applicable statute of limitations or other bar to the filing. In other words, the filing of a voluntary dismissal does *not* presumptively or otherwise establish that the dismissed party is actually the "prevailing party" *with respect to the merits of the claim*. Thus, requiring the party which dismissed its claim to pay attorneys' fees to the dismissed party would be unfair, and perhaps *grossly unfair*, in *many cases*.

Moreover, a rule which produces "unfairness" with respect to awards of *statutory costs* is far less significant that a rule which produced "unfairness" with respect to awards of *attorneys' fees and non-statutory litigation expense*, since attorneys' fees and non_statutory expenses can be ten, twenty, thirty or more times as large as the statutory costs incurred.

Other members questioned the propriety of relying upon the *Santisas* decision as justification for the proposed rule. Although the Commission staff quotes from *dicta* in the *Santisas* decision to support the proposed new rule, there is nothing in the discussion which actually suggests that the majority was inviting the legislature to reconsider the rule it had adopted in Civil Code Section 1717(b)(2) and instead adopt the rule it outlined in the dicta.

In fact, the only suggestion for legislative reconsideration of the dismissal rule was made in the concurring decision by Justice Mosk. Justice Mosk's comments are hardly surprising, however, since he also *dissented* from the decision in which the rule was originally adopted, *International Industries, Inc. v. Olen*, 21 Cal.3d 218 (1978).

Furthermore, as is explained above, the Commission staff has apparently taken the proposed "litigation success" standard directly from the *dicta* in *Santisas*, *without* first critically examining whether this standard actually *is* the "middle ground" the majority suggests it would be in its decision.

Moreover, some members believe that the Commission staff have not taken into account the fact that, by *enacting* Civil Code Section 1717(b)(2), the legislature adopted the rationale for the rule express in the *Olen* decision, which were as follows:

> Prior to enactment of section 1717, a contractual provision providing for attorney fees in favor of defendant was not deemed to permit, on procedural grounds, recovery when the plaintiff voluntarily dismissed prior to trial. . . .

While the procedural bar to recovery of attorney fees in pretrial voluntary dismissal cases may have been removed [citation omitted], we are satisfied that sound public policy and recognized equitable considerations require that we adhere to the prior practice of refusing to permit recovery of attorney fees based on contract when the plaintiff voluntarily dismisses prior to trial.

* * *

Enactment of section 1717 commands that equitable considerations must rise over formal ones. Building a reciprocal right to attorney fees into contracts, and prohibiting its waiver, the section reflects legislative intent that equitable considerations must prevail over both the bargaining power of the parties and the technical rules of contractual construction.

Because award of contractual attorney fees is governed by equitable principles, we must reject any rule that permits a defendant to automatically recover fees when the plaintiff has voluntarily dismissed before trial. Although a plaintiff may voluntarily dismiss before trial because he learns that his action is without merit, obviously other reasons may exist causing him to terminate the action. For example, the defendant may grant plaintiff short of trial all or substantially all relief sought, or the plaintiff may learn the defendant is insolvent, rendering any judgment hollow. Such defendants may not recover attorney fees within the equitable principles of Ecco_Phoenix Electric Corp. Moreover, permitting recovery of attorney fees by defendant in all cases of voluntary dismissal before trial would encourage plaintiffs to maintain pointless litigation in moot cases or against insolvent defendants to avoid liability for those fees.

It has been suggested that in pretrial dismissal cases the court should determine whether, and to what extent, the complaint is meritorious and award attorney fees accordingly. However, to 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.
>
> In pretrial dismissal cases, we are 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 use of scarce judicial resources for trial of the merits of dismissed actions, or (3) continuing the former rule, denying attorney fees in spite of agreement. We are satisfied that concern for the efficient and equitable administration of justice requires that the parties in pretrial dismissal cases be left to bear their own attorney fees, whether claim is asserted on the basis of the contract or section 1717's reciprocal right.

Since the legislature essentially adopted this reasoning by enacting Civil Code Section 1717(b)(2), the issue presented to the Commission is whether there are sufficient grounds for proposing a new statute which effectively repeals this legislative enactment.

As is stated above, the CAJ takes no position on *whether* the law regarding the availability of attorneys' fees in cases which have been voluntarily dismissed should be changed. In addressing the question, however, the CAJ believes that the Commission should be careful to address both of the major, competing policy considerations at issue in these cases, which are:

> (1) The extent to which the proposed rule permits the court to distinguish between cases in which the dismissal really was on the merits and those in which the dismissal was entered for reasons which do *not* relate to the merits;
>
> (2) The burden which would be imposed on parties and the courts by requiring the courts to determine the "prevailing party" in cases which have been voluntarily dismissed.

(d) The Effect of the Proposed Rules on Cases Which Have Been Dismissed Pursuant to Settlement.

Finally, in addition to resolving this issue, the Commission should note that the proposed legislation appears to permit even parties who have been

dismissed *pursuant to a settlement* to recover attorneys' fees, even though this may not be what was intended.

Initially, one might think that a party who has been dismissed pursuant to a settlement agreement is *not* permitted to apply for fees, since Section 1039.20(a)(5) explicitly excludes parties who have been dismissed pursuant to a settlement from the list of parties who are "presumed" to be prevailing parties.

However, Section 1039.20(b) makes it clear that parties who are not included in the list of parties who are "presumed" to be the prevailing party may still claim that they are entitled to costs. (Section 1039.20(b) provides that the party claiming costs must specify which of the presumptions applies, "**if any**").

Although Section 1039.30 permits a party to challenge a party's claim that it is the "prevailing party," Section 1039.30(c) requires the court decide the issue based solely on factors relating to "litigation success." Thus, in order to determine which party was the "prevailing party," the court would have to examine the settlement agreement and compare it to the litigation objectives of the parties to the settlement.

Parties might be able to avoid a hearing on attorneys' fees if the settlement specifically provides that "each party shall bear his, hers or its own attorneys' fees and costs." However, many smaller cases are resolved by execution of a simple release, without negotiating a full blown settlement agreement. Moreover, proposed Section 1039.50 (which provides that parties entering into a contract cannot agree in advance to alter the manner in "prevailing party" rules established by the proposed legislation) could be construed to *negate* any such provision in a settlement agreement.

Since it is not clear whether the Commission staff even intended the court would have to decide which party or parties to settlements are the "prevailing party" or parties, this should be regarded as a technical comment only.

Item (2) Codification of the Holding in Santisas

The proposed legislation would codify the holding of *Santisas*, i.e., that parties who have been voluntarily dismissed may be awarded attorneys' fees on non_contract claims if the contract in issue supports such an award. In so holding, the Court disapproved of the holding in *Jue v. Patton*, 33 Cal.App.4th 456 (1995), which concluded that attorneys' fees could not be awarded on any claim arising out of a contract when the action is voluntarily dismissed.

The CAJ believes that this issue is secondary to the issue of whether the prohibition of attorneys' fees awards in voluntarily dismissed cases should be eliminated altogether, as has been proposed. Although many members of the CAJ favor parallel treatment of contract and tort claims covered by an attorneys' fee

clause, the CAJ would like to revisit this issue *after* the proposed legislation has been revised to take into account its comments concerning the first item discussed above.

Item (3)_Extension of the Reciprocality Provision of Civil Code Section 1717 to Tort Claims

The proposed legislation would amend Civil Code Section 1717 to provide that a contractual attorneys' fees provision is reciprocal as to all actions arising out of the contract, including causes of action which do not allege breach of contract.

This would apparently change existing law, since at least one court (and perhaps several) have held that Civil Code Section 1717 applies only to causes of action for breach of contract. *See Moallem v. Coldwell Banker Commercial Group, Inc*., 25 Cal.App.4th (1994); but see *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.*, 47 Cal.App.4th 464 (1996).

The CAJ expresses no opinion on this proposed change.

Item (4)_Recovery of Non_Statutory Litigation Expense

From the memoranda, it appears that the Commission staff intends to clarify existing law by providing that "nonstatutory litigation expenses" are recoverable so long as the contract provides that they are recoverable.

However, the provision by which this is accomplished, Code of Civil Procedure Section 1021.01(b), provides as follows:

> Except as otherwise provided by statute, payment of nonstatutory litigation expenses is left to the agreement, express or implied, of the parties.

Unfortunately, this provision could be construed to prohibit an award of the expenses listed in proposed Section 1040.30, which provides as follows in pertinent part:

> The following items are not allowable as costs, except where expressly authorized by law:
>
> (a) Fees of experts not ordered by the court.
>
> (b) Investigation expenses in preparing the case for trial.

Accordingly, the CAJ recommends that the first sentence of Section 1040.30 be rephrased to state as follows:

> The following items are not allowable as costs, except where expressly authorized by law or contract:

The proposed legislation would also specify that claims for "nonstatutory litigation expenses" are an element of "costs" which should be awarded on a motion for attorneys' fees. *See* proposed Code of Civil Procedure Section 1040.20.

These provisions are intended to nullify the decisions in *Ripley v. Pappadopoulos*, 23 Cal.App.4th 1616 (1994), and *Robert L. Cloud & Associates v. Mikesell*, 69 Cal.App.4th 143 (1999), which hold that items disallowed as costs in Section 1033.5 of the Code of Civil Procedure can be recovered only if specially pleaded and proved at trial.

As the Commission staff points out, requiring that items of litigation expense be specially pleaded and proved at trial is inefficient. These cases also lay a trap for he unwary, since most attorneys probably believe that such expenses are part of the "attorneys' fees" which may be awarded on motion after trial.

Accordingly, the CAJ supports this change to existing law.

Item (5)_Discretion to Reduce Cost Awards.

The legislation would change existing law by providing the court with the discretion to reduce a cost award, *including attorneys' fees and non_statutory litigation expenses*.

Proposed Section 1040.60 provides as follows in pertinent part:

> Where a prevailing party obtains only partial success, the court may adjust the amount of the cost award to reflect the degree of litigation success, instead of awarding the full amount of costs incurred.

Under existing law, a party who is deemed to be the "prevailing party" under Section 1032 is entitled to costs as a matter of right. *See Michell v. Olick*, 49 Cal.App.4th 1194 (1996). However, the Court expressed dissatisfaction with this result, as applied to the particular facts of that case.

In *Michell*, the plaintiff had joined several "patently unmeritorious claims" with a single meritorious legal malpractice claim, upon which she prevailed. In its decision, the Court of Appeals reversed a decision requiring each

party to bear his or her own costs on the ground that the "prevailing party" was entitled to recover all recoverable costs under Section 1032 as a matter of right.

Although the court believed it was compelled to reverse the decision of the trial court as a matter of law, the Court made it clear that it did not consider the result to be fair under the facts of the case. Accordingly, the Court suggested that the legislature might want to revisit the issue and provide that the only costs which may be recovered are those related to the theories or causes of action upon which the party prevailed.

The proposed legislation adopts and revises the Court's suggestion in the *Michell* case by proposing to give the court the discretion to reduce an award based upon "the degree of litigation success." Although *Michell* did not involve attorneys' fees, the Commission staff also proposes to extend this discretion to all cost awards, including an award of attorneys' fees.

Proposed Section 1040.60 is extremely dangerous, since it provides the court with no guidance with respect to when and why cost awards, *and particularly attorneys' fees awards*, may be reduced.

Thus, the provision could be interpreted to nullify existing case law, such as *Stokus v. Marsh*, 217 Cal.App.3d 647 (1990), which holds that a trial court's responsibility in ruling on a motion for an award of attorneys' fees in a contract case is "simply to determine whether the fees sought . . . are reasonable in light of the work required to be done," and *Reynolds Metals Co. v. Alperson*, 25 Cal.3d 124 (1979), which holds that, where a litigant incurs fees for an issue which is common to both a cause of action covered by an attorneys' fee clause and one which is not, the fees may not be reduced.

The statute might also be construed to give courts the discretion to reduce an award of fees or costs simply by comparing the judgment to the causes of action pled, and reducing the award proportionately for each cause of action not sustained in the judgment, even though the causes of action upon which relief was not granted were based on the same set of facts, asserted alternative bases for relief, or were based upon facts which were believed to be true, but turned out not to be supported by the evidence.

Accordingly, the Commission should not approve this provision unless it is modified to limit the discretion to reduce awards of attorneys' fees and non-statutory litigation expense in a manner which is consistent with prior case law, including *Stokus v. Marsh* and *Reynolds Metals Co. v. Alperson*.

Item (6)_Elimination of Discretion to Decide that a Dismissed Party is Not the "Prevailing Party"

The legislation would change existing law by eliminating the court's discretion to decide that a party which has been dismissed from the action is not the "prevailing party" for any purpose, including an award of statutory costs.

In *Damian v. Tamondong*, 65 Cal.App.4th 1115 (1998), the court held, despite the apparently inflexible language of existing Code of Civil Procedure Section 1032(a)(4), that there are some circumstances under which it would *not* be appropriate to consider a dismissed party the "prevailing party," such as when the plaintiff dismisses its claim because the defendant has become insolvent.

Again, this change in law is surprising, since the Comments to the *original* draft legislation attached to Memorandum 2000-13 would have made it clear that the legislation was intended to preserve the holding in *Damian*, and there is nothing in the February Minutes of the Commission which suggest that the draft legislation should be changed in this respect.

However, as revised, the proposed legislation leaves no room for the interpretation adopted in *Damian*. This is because Section 1039.40 provides that, in considering a challenge to a claim that the dismissed party is in fact the "prevailing party," the court "may not consider factors unrelated to litigation success." *See also* Section 1040.60 (discussed above). Since neither the insolvency of the defendant nor the other circumstances described by the court in *Damian* relate to "litigation success," the court could not consider them under the new rule.

Accordingly, the CAJ oppose this change to existing law unless the proposed legislation or the Comments to the proposed litigation are revised to make it clear that the holding in *Damian* remains good law.

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The CAJ believes that the issues presented by the proposed legislation discussed above are germane to the quality of legal services provided to the public because portions of the legislation upon which we are commenting could lead either to an increase in unnecessary and wasteful litigation, thereby delaying and impeding justice in other cases and forcing consumers to pay more for legal services than they would otherwise have to pay, both in litigation which is not dismissed and in other litigation, or to an increase in the perceived “fairness” and “equity” of the legal process, if the proponents of some of the suggested changes are correct, and may have a positive effect on the availability of legal services to certain parties.

The CAJ also believes that some of the changes proposed above are germane to the quality of legal services provided to the public because they will *decrease* the cost and complexity of litigation, such as the provision which would defer consideration of all awards of expenses until after trial.