

Contractual Indemnification Provisions and the Recovery of Attorneys' Fees

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Indemnification provisions are a common feature of agreements for design and construction-related services, yet it seems no two are the same. Standard form contracts published by the American Institute of Architects, Engineers Joint Contract Document Committee, ConsensusDOCS, Design-Build Institute of America and Construction Management Association of America all contain contractual indemnification provisions. Although frequently short on words, some indemnification provisions can create tremendous liability exposure and prove quite costly to the party discharging an indemnification obligation.

At its most simple, indemnification is the act of compensating another party for its loss or damage. The generally understood purpose of indemnification appears reasonable enough – if acts or omissions of Party A cause damage to Party B for which Party C becomes legally liable, it is only fair that Party A (the indemnitor) compensate Party C (the indemnitee) for the loss or damage sustained. Parties often have protection from this type of derivative third-party claim in mind when entering into indemnification agreements. Indemnification provisions typically allow the “innocent party” to pass through liability to the party actually responsible for causing the third-party damage. On occasion, however, an indemnitor may be surprised to discover its indemnitee using the indemnification provision not only to pass through third-party claims and damages, but also to recover its own, first-party attorneys' fees. This puts the indemnitor in the unenviable position of funding a legal battle against itself by being required to pay the legal costs of its adversary, the indemnitee, for direct claims such as the indemnitor's alleged breach of the parties' contract.

Part 1: Attorneys' Fees, the “American Rule,” and Prevailing Party Provisions

Litigation can be very expensive. There are occasions where a prevailing litigant may win the battle but lose the war by having its attorneys' fees and other litigation costs erode the total recovery to the point where, from at least a business perspective, the ultimate recovery proves not to be worth the effort. In most cases, a prevailing party in this position can thank the “American Rule” for its disappointing economic bottom line. Under the American Rule, absent a specific contractual provision or statutory grant, each party is responsible for its own attorneys' fees and other legal costs. The American Rule contrasts the “British Rule” under which the losing party pays the prevailing party's attorneys' fees. The rationale behind the American Rule is that society is better off promoting the advancement of meritorious claims

and the extension of existing law. Under the British Rule, a party facing the prospect of paying the other party's legal costs may be discouraged from advancing not only frivolous claims and actions, but also meritorious ones.

The standard and straightforward way for contracting parties to implement a loser-pays rule is to include a “prevailing party” or “attorneys' fees” provision that provides for the recovery of first-party attorneys' fees. The terms “prevailing party” and “attorneys' fees” often are used interchangeably in this context, but note that such provisions frequently address more than just attorneys' fees and can include related costs such as court costs, expert witness costs and staff time. The following is a fairly standard example of a prevailing party provision:

In the event litigation or any alternative form of dispute resolution between the parties arises from this Agreement or the services provided pursuant to this Agreement, the prevailing party shall be entitled to recover from the non-prevailing party all reasonable costs incurred relating to the litigation or alternative form of dispute resolution including court costs, attorneys' fees, and all other related expenses. In the event an alternative form of dispute resolution resolves a dispute between the parties, the term “prevailing party” and application of this provision shall be determined by that process.

Express prevailing party provisions present their own concerns for design professionals and construction managers, a chief one being a potential lack of insurability. Professional liability insurance policies typically exclude liability assumed by contract, unless the liability otherwise would exist in the absence of the contractual assumption. A prevailing party provision arguably is an assumption of liability by contract that otherwise *would not* exist. As previously discussed, absent such a contractual provision, the American Rule generally requires each party to bear its own attorneys' fees and costs. Because of this insurability concern, at least one AE professional liability insurance carrier now advises against entering into prevailing party provisions.

Part 2 of this article will address how some indemnification provisions can be used to shift responsibility not only for third-party claims and damages, but also for first-party attorneys' fees and legal costs. [CM](#)

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