When the American Rule Doesn't Apply:

Attorney's Fees as Damages in California Litigation

By Marc Alexander and William M. Hensley

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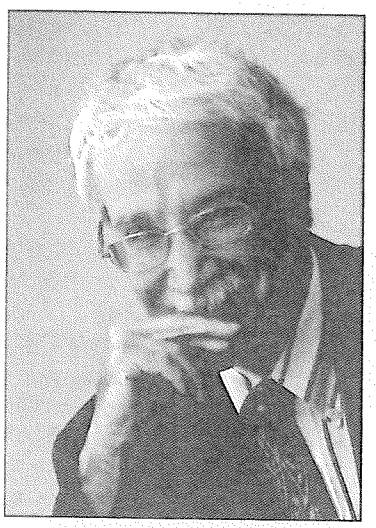

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The "American Rule" is that, absent a contract or statute providing otherwise, each party to litigation should bear his or her own attorney's fees. That is the opposite of the "English Rule," *i.e.*, that the loser pays. While the English Rule serves to weed out marginal cases by increasing the economic risk to a litigant who proceeds on weak grounds, the American Rule makes it easier for litigants to enter the courthouse by mitigating the consequences of losing. The California Legislature first adopted the American Rule in 1851. Stats.

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1851, ch. 5, § 494, p. 128.

This article discusses three judicially-created exceptions under California law to the American Rule: The "tort of another" doctrine, *Brandt* recovery, and damage recovery in malicious prosecution/false imprisonment cases. Where these exceptions apply, prevailing parties can be made whole by being compensated for attorney's fees — but the relief, rather than being treated as fees, *per se*, is given as an item of damages.

This difference has an important bearing on how and when fees need to be claimed. When attorney's fees are awarded pursuant to a contract or statute, they are considered in postjudgment costs proceedings. *See* Cal. Code Civ. Proc. § 1033.5(c)(5); Cal. Civ. Code § 1717(a). However, in those circumstances where fees can be recovered as *damages*, the claim must be presented to the trier of fact as part of plaintiff's case-in-chief (unless all parties stipulate to postjudgment consideration by the trial judge).

— Tort of Another —

In *Prentice v. North Amer. Title Guaranty Corp.*, 59 Cal. 2d 618 (1963), the California Supreme Court set forth the "tort of another" doctrine as an exception to the American Rule. The precise question addressed by the Supreme Court was this: "When a vendor of land has been required, because of the negligence of a paid escrow holder, to protect his interests by bringing a successful quiet title action against the purchaser and the holder of a first deed of trust, may he recover from the escrow holder the amount of attorney's fees paid in the quiet title action?" *Id.* at 620. The Supreme Court's answer: "Yes." *Id.*

The *Prentice* court restated the familiar general rule: "In the absence of some special agreement, statutory provision, or exceptional circumstances, attorney's fees are to be paid by the party employing the attorney." *Prentice v. North Amer. Title Guaranty Corp.*, 59 Cal. 2d at 620. Then, however, the court articulated the "tort of another" exception to that rule: "A person who through the tort of another has been required to act in the protection of his interests by bringing or defending an action against a third person is entitled to recover compensation for the reasonably necessary loss of time, attorney's fees, and other expenditures thereby suffered or incurred." *Id.*

In *Prentice* and its progeny, "there is no recovery of attorney fees qua attorney fees." *Heckert v. MacDonald*, 208 Cal. App. 3d 832, 838 (1989). Instead, recovery of attorney's fees represents an application of the usual measure of tort damages.

Judicial Caution and Reluctance to Expand Tort of Another Doctrine: Since *Prentice*, courts have been reluctant to expand the exception, carefully parsing the rule and proceeding with caution.

First, the damages must result from a "tort." This point is illustrated by *David v. Hermann*, 129 Cal. App. 4th 672 (2005), a family dispute between sisters Susan and Wendy concerning their mother's living trust. Susan filed a petition seeking an order finding the trust invalid on the ground of the mother's incapacity or Wendy's undue influence. The trial court declared the trust void and ordered Wendy to pay Susan's attorney fees on alternative grounds, one being as an element of damages under *Prentice*.

The Court of Appeal held *Prentice* did not apply because "Susan did not bring an action against Wendy for damages on a tort theory of liability but rather petitioned the court for an order declaring the testamentary documents invalid." *David v. Hermann*, 129 Cal. App. 4th at 689. In sum, recovery of attorney's fees, based on the "tort of another" must actually be based on a tort.

A pointer here is that the party seeking damages for the "tort of another" should

identify a "clear violation of a traditional tort duty between the tortfeasor who is required to pay the attorney fees and the person seeking compensation for those fees." *Sooy v. Peter*, 220 Cal. App. 3d 1305, 1310 (1990). Examples where such a duty has been found and the rule has been applied are cited in *David v. Hermann, supra*, 129 Cal. App. 4th at 689; *Bruckman v. Parliament Escrow Corp.*, 190 Cal. App. 3d 1051 (1987) (escrow holder's duty of care to seller); *Gray v. Don Miller & Associates, Inc.*, 35 Cal. 3d 498 (1984) (breach of real estate broker's fiduciary duty to client); *Slaughter v. Legal Process & Courier Service*, 162 Cal. App. 3d 1236 (1984) (fraudulent misrepresentation of process server); *Manning v. Sifford*, 111 Cal. App. 3d 7 (1980) (intentional interference with use of easement); *Vanguard Recording Society, Inc. v. Fantasy Records*, Inc., 24 Cal. App. 3d 410 (1972) (intentional interference with contract).

Second, the damage must result from the tort of "another" who is separate from the person that had to be sued or defended against in the underlying lawsuit. This point is also illustrated by *David v. Hermann, supra*, where the Court of Appeal noted that the case was "essentially a two-party lawsuit, though Wendy was sued both individually and as trustee." *David v. Hermann*, 129 Cal. App. 4th at 689. The point here is that even though there may be three nominal parties, there may really be only two sides — making it impossible to say that the opponent forced the plaintiff to bring an action against or defend an action from a "third" party.

Golden West Baseball Co. v. Talley, 232 Cal. App. 3d 1294 (1991) presents another variation of the theme that three parties may really constitute two sides — this time, because two of the parties were related by an employer-employee relationship. The plaintiff baseball club sued the defendant, a former city manager for Anaheim, for fraud, seeking as damages the fees incurred in an earlier action filed against the city, allegedly because the city manager made misrepresentations concerning interpretation of a lease between the club and the city. The Court of Appeal analyzed this as a two-sided dispute, because there was no evidence the manager acted outside the scope of his employment

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and his interests were no different than those of the city. Thus, recovery of attorney's fees, based on the "tort of another" requires not just a tort, but also "another" who can be practically distinguished from the opponent in the underlying litigation.

Third, there must be a causal link. This point was illustrated in *Lazy Acres Market, Inc. v. Tseng*, 152 Cal. App. 4th 1431 (2007). In *Lazy Acres Market, Inc.*, an insurance company agreed to defend its insured in a negligence action without reservation of rights. In other words, if there was a finding of liability, the insurer would accept responsibility for the negligence claim. However, the insured hired its own attorney to represent it, believing the insurance company's attorney had a conflict of interest. The insurance company settled the suit and the insured was dismissed.

Justice Gilbert tells the rest of the story: "The insured now wishes to recover its attorney fees. Does the insured have a cause of action for malpractice against the insurance company's attorney? No. The insurance company gave the insured a safety net. The insurance company's attorney does not have to pay for a second one. There is no causal relation between the attorney's alleged breach of duty and damages." *Lazy Acres Market, Inc. v. Tseng*, 152 Cal. App. 4th at 1433.

Distinction Between Tort of Another and Statutory Implied Indemnity: Recovery of attorney's fees based on the tort of another doctrine looks much like implied indemnity, which is governed by Code of Civil Procedure § 1021.6. Therefore, you must also consult that statute in cases where implied indemnity may give rise to a claim for attorney's fees. Section 1021.6 has its own set of requirements including (a) that the indemnitee through the tort of the indemnitor was required to act in the protection of his or her interest by bringing an action against or defending an action by a third person; (b) notification requirements; and (c) lack of fault of the indemnitee or a final judgment entered in his or her favor.

But the two are distinct. The duty to indemnify for the expenditure of attorney's fees arises out of a duty to provide *complete* indemnity which *includes* the duty to provide a defense to another. *Watson v. Department of Transportation*, 68 Cal. App. 4th 885, 895, n. 8 (1998).

— *Brandt* Fees as Damages —

The California Supreme Court has also created a narrow "second party tort" exception, but has applied it only in an insured-insurer context. The seeds for this were laid in *Gray v. Don Miller Associates, Inc.*, *supra*, 35 Cal. 3d 498, where the Court mentioned lower-court cases which had allowed for recovery of attorney's fees against insurance companies in bad faith actions while declining to expand such damages recovery against *all* fiduciaries. *Id.* at 507 n. 5. One year later, in *Brandt v. Superior Court*, 37 Cal. 3d 813 (1985), the Supreme Court held that insureds can recover attorney's fees in an implied covenant breach action to recover contractually-based policy benefits, critically delineating that attorney's fees in this context "are recoverable as *damages* resulting from a tort in the same way that medical fees would be part of damages in a personal injury action." *Id.* at 817, emphasis added.

The critical post-*Brandt* inquiry became how to apply the decision in practice, especially because insurance bad-faith litigation typically involves a simple breach of contract claim (not just a bad-faith claim), an implied covenant claim, and emotional distress/punitive damage components. In 2004, the California Supreme Court provided some further guidance on apportioning fee recovery in *Cassim v. Allstate Ins. Co.*, 33 Cal. 4th 780 (2004), a case that arose under a contin-

gency fee agreement. While refusing to shackle a trial court's apportionment discretion completely, *Cassim* did establish these guidelines:

> *"What about recoupment of fees that an insured expends to sustain a* Brandt *recovery on appeal against a losing insurer? There is a split of appellate thinking on the issue, though the prevailing view (if one considers unpublished decisions) is in favor of also awarding appellate fees to a* Brandt *victor."*

Fees spent on extra-contractual recovery, such as emotional distress and punitive damages, are not compensable under *Brandt*. *Id.* at 812.

Contractually-based recovery work should be added to "apportioned" work for joint contract/tort issues. *Id.* Example: (i) The matter is handled for a one-third contingency fee; (ii) the recovery is $1,000,000; (iii) 1,000 total hours are worked; (iv) 400 of those are for pure or intertwined contractual recovery-based work; (v) $250,000 of the recovery is tort-based; and (vi) the remaining $750,000 of the recovery is contract-based. In that example, the one-third contingency rate is multiplied by $750,000 (contractual-based recovery), and multiplied by 400/1000 (the proportion of hours devoted to contract issues), resulting in *Brandt* fees of $100,000.

The plaintiff bears the burden of apportionment. *Id.* at 813.

Brandt requires that the damages be awarded by the trier of fact — usually jurors — unless the parties stipulate to a post-allocation by the trial judge, which the Supreme Court deemed "preferable." *Brandt v. Superior Court*, 37 Cal. 3d at 819.

The dissent in *Cassim* bemoaned the fact that the Supreme Court offered no guidance on apportioning joint contract/tort work for *Brandt* recovery purposes. *Cassim v. Allstate Ins. Co., supra*, 33 Cal. 4th at 819 (conc. and dis. opn. of Baxter, J.).

Extensions of Brandt in an Insurance Context: What about recoupment of fees that an insured expends to sustain a *Brandt* recovery on appeal against a losing insurer? There is a split of appellate thinking on the issue, though the prevailing view (if one considers unpublished decisions) is in favor of also awarding appellate fees to a *Brandt* victor.

In *Burnaby v. Standard Fire Ins. Co.*, 40 Cal. App. 4th 787, 793-794 (1995), the Second District rejected awarding attorney's

fees on appeal to the insured, relying on the absence of guidance in *Brandt*. In *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 78 Cal. App. 4th 847, 909 n. 17 (2000), the First District cited *Burnaby* with no further analysis. However, in *Baron v. Fire Ins. Exch.*, 154 Cal.App.4th 1184 (2007), the Sixth District expressly parted company from *Burnaby* and agreed with a Ninth Circuit federal decision "that attorney fees the insured has incurred to defend a judgment against the insurer's appeal are a logical extension of the fees incurred in pursuing the recovery in the trial courts." *Id.* at 1197-1198. Though the divergence still exists, the prevailing judicial sentiment seems to favor *Baron*.

In line with the *Brandt* rationale to make insureds whole for recovery of contractual policy benefits, the California Supreme Court has held that assignees of an insured may recover *Brandt* fees despite being precluded from receiving the benefit of nonassignable emotional distress and punitive damages. *Essex Ins. Co. v. Five Star Dye House, Inc.*, 38 Cal. 4th 1252, 1263-1264 (2006).

Similarly, plaintiffs are not limited to just pursuing insurers for recovery of *Brandt* fees. In *Third Eye Blind, Inc. v. Near North Entertainment Ins. Serv., LLC*, 127 Cal. App. 4th 1311, 1324-25 (2005), *Brandt* principles were applied to allow an insured to recapture fees, as damages, from insurance brokers whose negligence caused the insured to incur fees for pursuing coverage against the insurer.

Reluctance to Extend Brandt to Noninsurance Fiduciaries: Courts, however, have been reluctant to apply *Brandt* to fiduciaries *outside* of the insurance context. In *Fuhrman v. California Satellite Sys.*, 179 Cal. App. 3d 408 (1986), plaintiff sued for tortious extortion and sought recovery of attorney's fees incurred in receiving advice on how to respond to defendant's alleged extortionist demands. In a sharply split 2-1 decision, the majority found *Brandt* should be limited to its insurance setting. *Id.* at 426-428. In contrast, the *Fuhrman* dissent posited that *Brandt* was not limited to insurance disputes and should allow recovery of attorney's fees incurred by defendant's tortious conduct as damages. *Id.* at 430-431 (dis. opn. of Sims, J.).

In *Schneider v. Friedman, Collard, Poswall & Virga*, 232 Cal. App. 3d 1276 (1991), former clients sued their former attorneys for breach of fiduciary duty and fraud in making them incur attorney's fees in separate proceedings where the former attorneys sought to enforce an unreasonable contingency fee. Plaintiffs' damages theory was tantamount to asking the court to endorse a *Brandt*-type recovery against lawyers as noninsurance fiduciaries. Though finding it tantalizing to extend *Brandt* to sting unscrupulous lawyers, the court refused to do so. *Schneider v. Friedman et al.*, 232 Cal. App. 3d at 1282-1284.

Malicious Prosecution and False Imprisonment Cases

Finally — and very briefly — other exceptions to the American Rule are in the areas of malicious prosecution and false imprisonment. Attorney's fees are allowable as compensatory damages under these claims "as sanctions against the abuse of process the two torts represent." *Brandt v. Superior Court, supra*, 37 Cal. 3d at 822 (dis. opn. of Davis, J.); *Cassim v. Allstate Ins. Co., supra*, 33 Cal. 4th at 806.

We end with a reminder of what we said at the outset: If pursuing any of these claims, do so in your case in chief — treating it like any other damages claim — unless the parties stipulate to post-judgment adjudication by the trial judge.