

Arizona Supreme Court Changes the Law Governing Contractual Attorneys' Fee-Shifting Provisions, with Immediate Implications for Arizona Businesses Both Inside and Outside the Courtroom

March 27, 2017

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Introduction and Background

The Arizona Supreme Court's March 23, 2017, decision in [*American Power Products v. CSK Auto*](#) changes the playing field for Arizonans entering into contracts, as well as lawyers litigating them.

Under A.R.S. § 12-341.01(A), courts can, and often do, award reasonable attorneys' fees to the "successful party" in contested contract actions. The statute provides,

In any contested action arising out of a contract, express or implied, the court may award the successful party reasonable attorney fees. If a written settlement offer is rejected and the judgment finally obtained is equal to or more favorable to the offeror than an offer made in writing to settle any contested action arising out of a contract, the offeror is deemed to be the successful party from the date of the offer and the court may award the successful party reasonable attorney fees. This section shall in no manner be construed as altering, prohibiting or restricting present or future contracts or statutes that may provide for attorney fees.

The "loser pays" feature of the statute, embodied in its first sentence, is not unique to Arizona, but it is close: Most jurisdictions instead follow the "American rule," with each party instead paying its own attorneys' fees for civil litigation, regardless of outcome. The near-uniqueness of the Arizona statute has led to many dozens of court decisions finely parsing its terms, including but not limited to how to define the "successful party" in many different contexts in which business disputes arise.

The statute's second sentence, which gives impact to rejected written settlement offers, confers potentially huge advantages on Arizona breach-of-contract defendants. Depending on the circumstances of a particular case, such a defendant can, by means of a written settlement offer, "raise the bar" on the recovery the plaintiff ultimately must win in order to be deemed the "successful party," as opposed to the losing party, for fee-shifting purposes, from the date of the offer. The underscored text bears emphasis. A breach-of-contract plaintiff with a "slam dunk" case to win at least some money, nevertheless can be deemed to be the losing party, and owe the defendant its attorneys' fees, beyond the point the defendant makes a written settlement offer, if the plaintiff's ultimate recovery does not exceed that offer.

Application of the Statutory “Written Settlement Offer” Provision Before *American Power*

Before *American Power*, however, the prevailing view was that § 12-341.01(A)'s written settlement offer provision (second sentence) did not apply where the parties' contract included its own fee-shifting provision. Based on the third sentence of § 12-341.01(A), the Court of Appeals repeatedly had refused to apply the statutory fee-shifting statute, including the written settlement offer provision, when the parties' contract included its own fee-shifting term. Since many Arizona contracts include fee-shifting provisions, the end result was that the statute's written settlement offer provision had limited effect.

***American Power's* New Paradigm**

American Power upended that prevailing view, with substantial implications for both extant contract disputes and contracts yet to be drafted or litigated.

In *American Power*, the parties' contract contained a fee-shifting provision that entitled the “prevailing party” to recover its attorney fees. The contract did not, however, define “prevailing party.” The contract also included a broad Arizona choice of law provision. In litigation, CSK Auto made an offer of judgment (qualifying as a statutory written settlement offer) to *American Power* for \$1,000,001, “inclusive of all damages, taxable court costs, interest and attorneys' fees.” Though judgment ultimately was entered in favor of *American Power*, its recovery fell short of the amount offered by CSK Auto. Nevertheless, the trial court held that *American Power* was the prevailing party for the purposes of the contract, and therefore awarded *American Power* its attorney fees. Applying the prevailing construction of § 12-341.01 discussed above, the Arizona Court of Appeals affirmed.

The Supreme Court disagreed, making new law. Because *American Power* had rejected CSK Auto's settlement offer, then failed to obtain a judgment at least as favorable as that offered by CSK Auto, the Court held, CSK Auto was the successful party for the purposes of § 12-341.01(A). The Court's decision hinged on the contract's failure to define the term “prevailing party.” Lacking a contractual definition, the Supreme Court likened the term to “successful party” in the statute, and held that the statute must be applied to supply the term's meaning. And under the statute's written settlement offer provision, the Court reasoned, identifying the prevailing party required consideration of CSK Auto's written settlement offer.

The Supreme Court observed, though, that where a contract's terms conflict with Arizona law, the contract terms must govern. “As long as a contract is legal and enforceable, parties of course may fashion all aspects of an attorney fee provision, including a definition of ‘prevailing party’ different from the statute, in whatever way they see fit.” Had the parties properly specified that determination of the “prevailing party” was to be made without consideration of the statute's written settlement offer term, the outcome of *American Power* might have been different.

Implications for Existing and Future Arizona Contracts

Arizona contracting parties, and the counsel who advise them, should take into account *American Power's* impacts on what otherwise may have been more or less rote decisions on how to draft choice of law and fee-shifting provisions. The law governing Arizona fee-shifting in contract cases was complex before this decision, and now is even more so. In the contract-drafting context, parties should, at a minimum, consider potential fee-shifting outcomes in the event of a breach, given *American Power's* injection, absent an express provision to the contrary, of the underlying written settlement offer statutory provision into the contract as, in effect, an implied term. In the litigation context, there are many variables including, for example, how to ensure apples-to-apples comparison — or for that matter, argue apples-to-oranges dissimilarity — between the written settlement offer and the statutory “judgment finally obtained.”

In short, to the extent fee-shifting matters to Arizona businesses and business litigants — and most often, it does — *American Power* matters too. All Arizona businesses and business litigators would be well-advised to consider its application in all existing or potential situations in which attorneys' fees may be awarded or awardable.

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