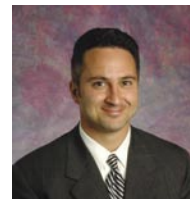


## Arizona's Fee-Shifting Statute for Contract Cases May Make a Big Difference in Resolving Your Business Disputes



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### I. INTRODUCTION.

No matter what you do, disputes will arise in the course of your business activities. An Arizona statute, A.R.S. § 12-341.01(A), may make a big difference in how those disputes get resolved. This statute generally provides that in breach of contract lawsuits, the loser may well have to pay the winner's attorneys' fees. Although a few other states (like Idaho and Texas) have similar "fee shifting" statutes, most do not, and instead adhere to the traditional "American rule" that each party bears his or her own attorneys' fees regardless of the lawsuit's outcome.

That seems simple enough, but the statute also includes a twist. For purposes of attorneys' fees, the defendant can be "deemed" the winner if he or she makes a written settlement offer which the plaintiff rejects, then fails to meet or exceed in the subsequent judgment. That provision has some very practical implications for negotiating business disputes.

People and companies doing business in Arizona should keep these rules in mind as they navigate the stormy waters of business dispute resolution.

### II. THE FEE-SHIFTING STATUTE.

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." As the statute later explains, such awards are "made to mitigate the burden of the expense of litigation to establish a just claim or a just defense."

The statute has been interpreted dozens of times by the Arizona courts since it was enacted in 1976. Those decisions have resulted in a lot of legal nuances, such as just what is a "contested" action; when does it "arise out of contract"; when is a party the "successful party"; what attorneys' fees are "reasonable"; when the trial court "may" (note that the statute does not say "must") award them; and others. Lawyers like me take great interest in those nuances, but clients tend to find them boring or even annoying. Suffice it to say for our purposes that, if you win your Arizona breach of contract case, you can—and often do—recover attorneys' fees too.

All other things being equal, section 12-341.01(A) makes it more feasible for the victims of breach in smaller contract cases to litigate those disputes, because the attorneys' fees incurred in litigating those cases might otherwise be prohibitive in comparison to the prospective damages recovery. Suppose, for a very simplified example, that you have a \$100,000 breach of contract case. Further suppose the outcome turns on whether the jury believes you, or your opponent, as to what a particular contract term means. If the jury believes you, then you will win all \$100,000 (and your attorneys' fees). If the jury believes your opponent, you will win nothing (and your opponent wins attorneys' fees). Under the assumption that it would take each party, say, \$80,000 to take the case through trial, then without the fee-shifting statute, you would need slightly more than an 80 percent likelihood of success to make suing even minimally worthwhile. With the statute, you would need just over a 60 percent likelihood of success.<sup>1</sup> Take care though. Even if you win a fee award along with the judgment, you don't collect any money for fees until you would otherwise collect on that judgment. Both the federal and state courts in Arizona have very detailed procedures for submitting fee award requests, and resolution of those requests takes time.

### III. THE TWIST.

In 1999, the Arizona Legislature added the following provision to section 12-341.01(A):

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.

Generally speaking, this amendment favors defendants. Why? Because who is the "successful party" in breach of contract cases typically is determined by something called the "net judgment rule," which means that whichever party obtains a net judgment in its favor is deemed to have won the suit for fee shifting purposes.

For another very simplified example, again suppose that A sues B for \$100,000 in breach of contract damages, and that litigating the case to conclusion will cost each party something like \$80,000 in attorneys' fees. If the jury finds in favor of A and awards it as little as \$1, then technically A would be the successful party under the net judgment rule and may apply for all its attorneys' fees. Being well advised by competent counsel, B knows all this in advance, and must analyze the case's settlement value not only based on the probability that A will win \$100,000 in damages, but also based on the probability that A will win at least some damages. For example, if B believes A is only 25 percent likely to win \$100,000 in damages, but is 75% likely to win something, then B confronts a likely outcome for purposes of analyzing settlement value of \$85,000 (25% x \$100,000 in damages + 75% x \$80,000 in attorneys' fees), not to mention paying B's own attorneys' fees.

Under the amendment to the statute, however, B's prospects change. Since B believes A is 25 percent likely to win \$100,000 in damages, B may elect to make an early written settlement offer of \$25,000. If A rejects the offer, then unless A does better than \$25,000 at trial, B is deemed to be the successful party—for fee shifting purposes—from that point on. Thus, if A rejects the offer and proceeds to win, say, only \$24,000 at trial, and in the meantime B has incurred \$80,000 in reasonable attorneys' fees, then the outcome is that A pays B \$56,000 (\$80,000 in fees minus the \$24,000 judgment). In the net, B has lost only the \$24,000, while A has lost \$136,000 (\$24,000 judgment - \$80,000 in A's attorneys' fees - \$80,000 for B's attorneys' fees).<sup>2</sup> You can easily see that the higher B makes the offer, the more the pressure increases on A to accept it for fear of the adverse fee award. (In contrast, the statutory amendment did nothing

for A, who only had to win some damages to be the successful party under the net judgment rule in the first place.)

#### IV. CONCLUSION.

The foregoing examples are very simplistic. They do not, for example, take into account your cost of capital; nor do they take into account the possible impacts of a decision to sue on your business relationship, or the other party's behavior going forward. Those "business side" factors are critical in making any decision whether to litigate. Your lawyer can analyze those factors with you and make recommendations as to how they bear on potential resolution of your dispute, whether before a complaint has been filed, in conjunction with alternative dispute resolution efforts, or otherwise. Keep in mind that, should your dispute ripen into a real lawsuit, some version of your lawyer's billing statements almost certainly will have to be submitted to the opposing party and the court in connection with any fee application down the road. Your lawyer should assume that the opposing party will seize on any glitch in the presentation of work done, or time spent, to argue that some or all of the fee request is not "reasonable." Your lawyer should exercise corresponding care in crafting the billing statements.

<sup>1</sup> With the statute, at approximately 61.5% likelihood of success, your probable recovery [61.5% x (\$100,000 in damages + \$80,000 in attorneys' fees paid by your opponent)] and your probable cost [\$80,000 in attorneys' fees you spend + (38.5% x \$80,000 in your opponent's attorneys' fees you pay should you lose)] net out to zero. Beyond that likelihood of success, the probable recovery exceeds the probable cost. Without the statute, your probable recovery [80% x (\$100,000 in damages + \$0 in attorneys' fees paid by your opponent)] and probable cost [\$80,000 in attorneys' fees you spend + (20% x \$0 in your opponent's attorneys' fees you pay should you lose)] obviously net out to zero at 80% likelihood of success.

<sup>2</sup> Here, \$160,000 went to the lawyers—hardly a result any businessperson would savor. The alternative, of course, is for A to accept the \$25,000 offer.

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