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Kent S. Scheidegger

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Attorney's Fees and Civil Code 1717

One-sided attorney's fee provisions¹ are a common feature of adhesion form contracts.² Civil Code Section 1717 was enacted in 1968 to prevent oppressive use of these provisions by providing mutuality of recovery of attorney's fees.³ Despite its noble motives and apparent simplicity, this section has been the source of considerable confusion and litigation in areas apparently not anticipated by the legislature.

This comment will examine the scope of Section 1717 as interpreted by the California courts. These interpretations have involved four questions: (1) To what types of litigation does the statute apply? (2) To which contracts does it apply? (3) What kinds of judgments will qualify a litigant as a "prevailing party" for the statute's purposes? (4) When can persons not parties to the contract sued on claim the statute's protection? This comment will begin with the law regarding recovery of attorney's fees in contract actions and the frequent misuse of that law via adhesion contracts.⁴ An examination of the statute follows, focusing on legislative history and the mechanics of its operation. After probing the scope of the statute, the comment will conclude with legislative recommendations designed to correct the remaining uncertainties and to fully implement the original intent of the legislature.

THE RIGHT TO RECOVER ATTORNEY'S FEES

A. *The American Rule*

The traditional rule in America is that attorney's fees generally are not recoverable as an element of costs.⁵ This rule is codified in California in the Code of Civil Procedure.⁶ Although the legislature has carved out many exceptions,⁷ the rule has generally withstood the at-

1. A typical provision might read "In the event that Buyer defaults on the payments due under this contract, Buyer agrees to pay all costs of collection, including reasonable attorney's fees," with no provision for Buyer's attorney's fees incurred to enforce the warranty, etc.

2. Slawson, *Mass Contracts: Lawful Fraud in California*, 48 S. CAL. L. REV. 1, 9 (1974) [hereinafter cited as Slawson].

3. See note 23 and accompanying text, *infra*.

4. See *Coast Bank v. Holmes*, 19 Cal. App. 3d 581, 596-97, 97 Cal. Rptr. 30, 39 (1971).

5. D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 194 (1973). For a summary of the arguments for and against the rule, see *id.* at 200-04.

6. CAL. CIV. PROC. CODE §1021.

7. See Taylor, *Resistance Stiffens to Abandonment of the American Rule*, 5 ORANGE COUNTY B. J. 343, 350 (1978) (listing 52 statutory exceptions in California).

tacks on it.⁸ The Board of Bar Governors had established a committee to study proposals to change the rule, but abolished the committee in 1978.⁹ Even when the plaintiff's claim is filed in bad faith, the California courts have denied the defendant attorney's fees, holding that such a change from the American rule is for the legislature alone to make.¹⁰

Several reasons for the rule have been advanced by the California courts.

The American rule is based upon the philosophy that 'one should not be penalized for merely defending or prosecuting a lawsuit, and that the poor might be unjustly discouraged from instituting actions to vindicate their rights if the penalty for losing includes the fees of their opponents' counsel.'¹¹

Conversely, it has been suggested that a broad policy of granting attorney's fees raises a "possibility that litigation might ensue for its own sake,"¹² and that a restrictive policy "avoid(s) the encouragement of needless litigation and encourage(s) settlement."¹³ For whatever reason, the American rule prevails in California, and the litigant seeking reimbursement for fees must find an applicable exception.

B. The Contract Exception

Perhaps the largest exception to the American rule is that it can be changed by "agreement, express or implied, of the parties."¹⁴ The drafters of form contracts customarily include fee clauses in their forms, generally benefitting only the person using the form.¹⁵

A chorus of commentators has questioned whether people who sign form contracts are, in fact, agreeing to the terms as written.¹⁶ One writer has suggested that the seller's representations, including advertisements but not the boiler-plate form, constitute the actual agreement.

8. *Young v. Redman*, 55 Cal. App. 3d 827, 834-35, 128 Cal. Rptr. 86, 91 (1976). *See, e.g., Taylor, It's Time to Allow Recovery of Attorney's Fees to the Prevailing Party in Any Civil Case*, 2 ORANGE COUNTY B. J. 645 (1975).

9. *Taylor, supra*, note 344.

10. 55 Cal. App. 3d at 838-39, 128 Cal. Rptr. at 93-94.

11. *Id.* at 835-36, 128 Cal. Rptr. at 91, (*quoting Fleischmann Corp. v. Maier Brewing*, 386 U.S. 714, 718 (1967)).

12. *Sciarrotta v. Teaford Constr. Co.* 110 Cal. App. 3d 444, 451, 167 Cal. Rptr. 889, 893 (1980). The contention is often scoffed at, but in at least one area it seems to be valid. One Mr. Blau has apparently made a career out of litigating §16(b) of the Securities Exchange Act. *See, e.g., Blau v. Lehman*, 368 U.S. 403 (1962); *Blau v. Lamb*, 363 F.2d 507 (2d Cir., 1966); *Blau v. Max Factor & Co.*, 342 F.2d 304 (9th Cir., 1965); *Blau v. Mission Corp.* 212 F.2d 77 (2d Cir., 1954).

13. 110 Cal. App. 3d at 452, 167 Cal. Rptr. at 894.

14. CAL. CIV. PROC. CODE §1021.

15. *See System Inv. Corp. v. Union Bank*, 21 Cal. App. 3d 137, 163, 98 Cal. Rptr. 735, 752 (1971); *Coast Bank v. Holmes*, 19 Cal. App. 3d 581, 596, 97 Cal. Rptr. 30, 39 (1971).

16. *See, e.g., J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS* §§1-3 (2d ed. 1977) [hereinafter cited as *CALAMARI & PERILLO*]; *K. LLEWELLYN, THE COMMON LAW TRADITION* 370-71 (1960); *Slawson, supra* note 2, at 3.

This, in effect, implies that the parol evidence rule should be reversed when applied to preprinted forms.¹⁷

Even in cases tried prior to the effective date of Section 1717, the courts found the necessity for softening the impact of one-sided attorney's fee clauses. A contract provision placing the costs on one party regardless of who brought the action, who made the action necessary, or who prevailed in the action "would be contrary to public policy as encouraging—and in fact indemnifying—vexatious or frivolous litigation."¹⁸ A literal application of the rule that attorney's fees are left to the agreement of the parties¹⁹ would give effect to such unconscionable contract provisions, with disastrous results. In the event of any dispute, the party benefitted by the provision could impose virtually any settlement on the opposing party simply by threatening to raise the costs of litigation above the amount in dispute.

In *Ecco-Phoenix Electric Corp. v. Howard J. White, Inc.*²⁰ the California Supreme Court was faced with such an oppressive attorney's fee clause. The Court avoided declaring the clause void by interpreting it, contrary to the trial court's interpretation, as applying only to litigation made necessary by the sub-contractor (the party required to bear the expenses). In making this interpretation, the Court applied the general rule of construction that ambiguities in the language of a contract will be resolved against the party responsible for the ambiguity.²¹ In avoiding mechanical application of both Section 1021 and oppressive attorney's fee provisions, the Court recognized that superior bargaining power at the time of the formation of the contract must not be allowed to distort the judicial process by enabling one party to deny the other a realistic opportunity to present his or her case. This same principle applies when construing and applying Section 1717.²²

C. Civil Code Section 1717

In 1968, the legislature added Section 1717 to the Civil Code as follows:²³

In any action on a contract where such contract specifically pro-

17. Slawson, *supra* note 2, at 21.

18. *Ecco-Phoenix Electric Corp. v. Howard J. White, Inc.*, 1 Cal. 3d 266, 272, 461 P.2d 33, 36, 81 Cal. Rptr. 849, 852 (1969). The clause read "(s)hould litigation be necessary to enforce any term or provision of this agreement, then all litigation and court costs and reasonable attorney's fees shall be borne wholly by the Sub-Contractor." *Id.*

19. CAL. CIV. PROC. CODE §1021.

20. 1 Cal. 3d 266, 461 P.2d 33, 81 Cal. Rptr. 849 (1969).

21. *Id.* at 275, 461 P.2d at 39, 81 Cal. Rptr. at 855.

22. *International Indus., Inc. v. Olen*, 21 Cal. 3d 218, 223-24, 577 P.2d 1031, 1034, 145 Cal. Rptr. 691, 694 (1978).

23. CAL. STATS. 1968, c. 266, §1, at 578.

vides that attorney's fees and costs, which are incurred to enforce the provisions of such contract, shall be awarded to one of the parties, the prevailing party, whether he is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to necessary costs and disbursements.

Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract which is entered into after the effective date of this section. Any provision in any such contract which provides for a waiver of attorney's fees is void.

As used in this section "prevailing party" means the party in whose favor final judgment is rendered.

Examination of the text of the statute raises some interesting questions. The section is applicable if the contract provides attorney's fees to "one of the parties." Does "one" mean "only one" or "one or more?"²⁴ The word "reasonable" was added by the Senate.²⁵ What happens if the contract provision provides more or less than is "reasonable?"²⁶

The definition of "prevailing" was changed by the Assembly Judiciary Committee; at the same time amendments in the bill to Civil Code Sections 1811.1 and 2983.4, which are also attorney's fee provisions containing definitions of "prevailing," were deleted.²⁷ Thus, it would appear that the difference between the definition of "prevailing" in Section 1717 and the definitions in the other sections was deliberate. The latter sections provide:

When the defendant alleges in his answer that he tendered to the plaintiff the full amount to which he was entitled and thereupon deposits in court, for the plaintiff, the amount so tendered, and the allegation is found to be true, then the defendant is deemed to be a prevailing party within the meaning of this article.

The bill was recommended for approval to then-Governor Reagan by his legislative secretary.²⁸ The secretary's memorandum is virtually the only available evidence of actual legislative intent.

The bill is intended to protect persons of limited means who sign contracts with those in a superior bargaining position.

The bill was not actively opposed before any committees. However, the State Bar feels that the bill could create legal problems.²⁹

Section 1717 addresses only the substantive right to recover fees and

24. See text accompanying notes 67-78 *infra*.

25. JOURNAL OF THE CALIFORNIA SENATE 1814 (1968 Reg. Sess.).

26. See text accompanying notes 43-48 *infra*.

27. JOURNAL OF THE CALIFORNIA ASSEMBLY 1426 (1968 Reg. Sess.).

28. Enrolled bill memorandum to governor, Assembly Bill No. 563, June 5, 1968 (chaptered bill file 68-AB563, California State Archives) [hereinafter cited as Enrolled Bill Memorandum].

29. Enrolled Bill Memorandum, *supra* note 28.

not the procedure for including them in the judgment. Prior to the enactment of Section 1717, fees could be awarded as costs or as special damages, depending on the source of the award, *i.e.*, whether authorized by statute or by contract.

ATTORNEY'S FEES AS DAMAGES AND COSTS

The traditional rule, both in California and elsewhere is that when attorney's fees are recoverable on a contract, they are recoverable only as special damages and not as costs.³⁰ They must be pleaded in the complaint and proved at trial.³¹ This is a cumbersome procedure, at best. The party must prove the amount of attorney's fees at the very time they are accruing. Both parties, in the case of a reciprocal clause, must present their proof since it is not known at trial which party will prevail. In a jury trial, the issue may distract the jury from the central issues in the case.³²

A simpler procedure is available for costs, including attorney's fees authorized by statute. The prevailing attorney files a memorandum of costs.³³ The other attorney may, if dissatisfied, file a motion to tax costs.³⁴ The clerk or judge then includes the costs in the judgment.³⁵

Section 1717 is a statutory attorney's fee provision that is dependent on a contractual provision. For the reasons noted above, the courts prefer to treat attorney's fees as costs. In the early Section 1717 cases which were *filed* before the section took effect but *tried* afterward, treating the fees as costs was necessary in order to apply the statute at all. The court in *System Investment Corp. v. Union Bank*³⁶ looked at other statutes authorizing attorney's fees³⁷ and noted that the fees were treated as costs. Thus, it was established early that the party required to *pay* attorney's fees by a contract could *recover* them under the statute as costs.

A more difficult problem arises when the party originally benefitted by the contract provision attempts to recover attorney's fees as costs rather than damages. Neither the legislative history of the statute nor a reading of the section as a whole indicates a legislative intent to confer any additional benefit on the party already benefitted by the contract

30. *Genis v. Krasne*, 47 Cal. 2d 241, 246, 302 P.2d 289, 292 (1956).

31. *Id.*

32. *See generally* *Beneficial Standard Properties, Inc. v. Scharps*, 67 Cal. App. 3d 227, 232, 136 Cal. Rptr. 549, 552 (1977).

33. CAL. CIV. PROC. CODE §1033.

34. *Id.*

35. *Id.*

36. 21 Cal. App. 3d 137, 98 Cal. Rptr. 735 (1971).

37. *Id.* at 162, 98 Cal. Rptr. at 752 (examining CAL. CIV. PROC. CODE §§796, 836, 1255a). Sections 796 and 1255a have since been repealed.

provision.³⁸ On the contrary, the statute was intended to reduce the advantage obtained by superior bargaining power and to place the weaker party on a more equal footing.³⁹ However, the section clearly states that "the prevailing party, *whether he is the party specified in the contract or not*, shall be entitled to reasonable attorney's fees"⁴⁰ The section does not, on its face, give the party specified in the contract any greater substantive right than he or she had before. It would seem that the legislature either did not consider the procedural difference, or concluded that attorney's fees were better handled as costs in any case.

For whatever reason, when Section 1717 is applicable, a statutory right to attorney's fees is given to both parties to the contract.⁴¹ Therefore, either party can recover attorney's fees as costs. Apparently, this leaves the party benefitted by the contract provision the option to recover attorney's fees as costs or damages.⁴² As a practical matter, these fees generally will be claimed as costs. The court must then determine the amount of recovery allowed under Section 1717.

AMOUNT OF RECOVERY

Section 1717 provides for recovery of "reasonable" attorney's fees. The section was intended to create a new substantive right for the adhering party, *i.e.*, the one not benefitted by the contract provision.⁴³ *T.E.D. Bearing Co. v. Walter E. Heller & Co.*⁴⁴ recognized that the section also created a statutory right for the party benefitted by the contract provision.⁴⁵ From this one might infer that either party to a contract with a unilateral attorney's fee clause has a statutory right to "reasonable" attorney's fees even if such fees are in excess of the amount of fees specified in the contract. If such a result were allowed, the adhering party might be held liable for even greater fees than those for which he or she had contracted.

The California Supreme Court dispelled any such notions in *Reynolds Metals, Co. v. Alperson*.⁴⁶ The court decided that "the statutory right should be no greater than the contractual right" by construing the word "reasonable," in light of the legislative intent, as falling "within

38. See *Coast Bank v. Holmes*, 19 Cal. App. 3d 581, 596-97, 97 Cal. Rptr. 30, 39 (1971).

39. *Id.*; Enrolled Bill Memorandum, *supra* note 28.

40. CAL. CIV. CODE §1717 (emphasis added).

41. *T. E. D. Bearing Co. v. Walter E. Heller & Co.*, 38 Cal. App. 3d 59, 63-64, 112 Cal. Rptr. 910, 913-14 (1974).

42. *Id.* at 64, 112 Cal. Rptr. at 914.

43. 19 Cal. App. 3d at 596-97, 97 Cal. Rptr. at 39.

44. 38 Cal. App. 3d 59, 112 Cal. Rptr. 910 (1974).

45. *Id.* at 63-64, 112 Cal. Rptr. at 914.

46. 25 Cal. 3d 124, 599 P.2d 83, 158 Cal. Rptr. 1, (1979).

the fundamental principle of reciprocity."⁴⁷ Since the promissory note sued on in *Reynolds Metals* limited recovery of attorney's fees to 15% of the amount of the note, defendants recovered only 15%.

In returning to the basic purpose of Section 1717 (to establish reciprocity), the court limited the reach of *T.E.D. Bearing*. Section 1717, as interpreted by *T.E.D. Bearing*, may remove a "procedural bar to recovery of attorney(s) fees"⁴⁸ as costs in some cases, but it does not create a new *substantive* right for the party benefitted by the contract provision, a right triggered by the contract but otherwise independent of it.

Before any amount can be recovered under Section 1717, the party seeking fees must show that the action, the contract, and the judgment are all within the scope of the statute. The following three sections will examine actions, contracts, and judgments which have been interpreted in light of Section 1717. These are followed by three more sections discussing the most vexing problem of the statute: its application to persons *alleged* to be parties to the contract who prove that they are not.

ACTIONS WITHIN THE SCOPE OF THE STATUTE

By its terms, Section 1717 applies only to *actions on contracts*. Many actions may be brought involving a contract other than the usual suits for damages for breach or for specific performance. The plaintiff may claim that the defendant has committed fraud in addition to breach of contract; the defendant may claim misrepresentation as a defense.⁴⁹ A defaulting party may transfer assets to keep them out of the hands of the plaintiff, creating a tort cause of action to set aside the transfer.⁵⁰ A party to a contract may exercise the right to rescind the contract and sue for restitution.⁵¹ A landlord may sue for rent based on privity of estate rather than privity of contract, although the amount of rent may be fixed by a contract.⁵² A defendant, on the other hand, may defend on the ground that the contract was never made, was made under duress, or is illegal.⁵³

When fraud and contract causes of action are joined, the right to and

47. *Id.* at 130, 599 P.2d at 86, 158 Cal. Rptr. at 4.

48. *International Indus., Inc. v. Olen*, 21 Cal. 3d 218, 223, 577 P.2d 1031, 1034, 145 Cal. Rptr. 691, 694 (1978).

49. *See* W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 689 (4th ed. 1971).

50. *See* CAL. CIV. CODE §§3429-3440.

51. *See* CALAMARI & PERILLO, *supra* note 16, at §15-3.

52. *See generally* *Canal-Randolph Anaheim, Inc., v. Wilkoski*, 78 Cal. App. 3d 477, 143 Cal. Rptr. 789 (1978).

53. *See generally* CALAMARI & PERILLO, *supra* note 16, at chs. 9, 22.

the amount of the attorney's fees depend only on the contract action. Thus, when plaintiffs prevail on a fraud theory and lose on a contract theory, the defendant is the "prevailing party" for the purpose of Section 1717. This occurred in *Babcock v. Omansky*⁵⁴ and can be a trap for the unwary attorney. Leon Omansky had signed promissory notes containing unilateral attorney's fee provisions. He transferred property gratuitously and, the jury found, fraudulently, to his wife, Bertha.⁵⁵ Plaintiffs brought suit to set aside the transfer and also alleged that Bertha was a joint venturer and therefore was personally liable on the notes.⁵⁶ Ironically, Babcock obtained the relief he really wanted, a setting aside of the transfer, but he was held liable for Mrs. Omansky's attorney's fees⁵⁷ due to an unnecessary, and apparently groundless, allegation in the complaint. When the contract action is questionable, this trap can be avoided by naming the additional party on the tort theory only, and then amending the complaint, through the use of a Doe defendant, if subsequent discovery reveals the contract claim has merit.

When a "total breach" of a contract has been committed, the aggrieved party has the right to cancel or rescind the contract⁵⁸ and seek restitution of payment.⁵⁹ Even though the contract has ceased to exist, the action for restitution still is deemed to be an "action on a contract" for the purposes of Section 1717⁶⁰ and the parallel provisions in Sections 2983.4⁶¹ and 1811.1.⁶² This broad construction is necessary to give buyers a choice of remedies without losing their right to attorney's fees.

Similarly, a defendant who successfully established that there was no enforceable contract could nevertheless recover,⁶³ although a defendant who established that the contract was unenforceable because it was illegal was denied attorney's fees.⁶⁴ The explanation that "where neither party can enforce the agreement there is no need for a mutual right to attorney's fees"⁶⁵ is unconvincing. Neither party can enforce a *nonexistent* contract, either. A better ground for the distinction is the principle

54. 31 Cal. App. 3d 625, 107 Cal. Rptr. 512 (1973).

55. *Id.* at 628, 107 Cal. Rptr. at 515.

56. *Id.* at 633, 107 Cal. Rptr. at 518.

57. *Id.*

58. CAL. CIV. CODE §1689(b)(2).

59. CAL. CIV. CODE §1692; CALAMARI & PERILLO, *supra* note 16, at §15-3.

60. Leaf v. Phil Rauch, Inc., 47 Cal. App. 3d 371, 378-79, 120 Cal. Rptr. 749, 754 (1975).

61. *Id.*

62. Morgan v. Reasor Corp., 69 Cal. 2d 881, 896-97, 447 P.2d 638, 749, 73 Cal. Rptr. 398, 409 (1968).

63. Care Constr., Inc. v. Century Convalescent Centers Inc., 54 Cal. App. 3d 701, 706, 126 Cal. Rptr. 761, 764 (1976).

64. Geffen v. Moss, 53 Cal. App. 3d 215, 227, 125 Cal. Rptr. 687, 694 (1975).

65. 54 Cal. App. 3d at 707, 126 Cal. Rptr. at 765.

that when the parties are *in pari delicto* the court will leave them as it found them.⁶⁶

If the action is one "on a contract" the contract must contain the type of provision required for operation of Section 1717. The next section examines the requirements relating to the contract itself.

CONTRACTS WITHIN THE SCOPE OF THE STATUTE

When the contract provision provides for attorney's fees for one party and not the other in any litigation concerning the contract, the section obviously applies. When the clause limits the rights of the benefitted party or provides for recovery of attorney's fees by the other party, however, the applicability of the section is not so clear.

A. Reciprocal Attorney's Fee Clauses

At first glance it would appear that Section 1717 simply makes all unilateral clauses reciprocal. If so, its applicability to reciprocal clauses would be irrelevant. This is not the case; a litigant may need to invoke the statute, even when the clause is reciprocal by its terms, for two reasons: (1) the prevailing party may need to recover fees as costs rather than as damages⁶⁷ or (2) the defendant may have defended against the contract action by proving that he or she was not a party to the contract.⁶⁸

The cases are in conflict regarding the section's applicability to contracts containing reciprocal attorney's fee provisions. This conflict results from the requirement in Section 1717 that the contract provide that fees "shall be awarded to *one* of the parties."⁶⁹ Does "one" mean "one or more" or "one but not the other?" Courts that have considered this point have deemed the answer obvious and devoted little discussion to it. Unfortunately, different courts have come to opposite conclusions.

*Beneficial Standard Properties, Inc. v. Sharps*⁷⁰ involved a lease providing for attorney's fees to the "successful" party. Both parties pleaded attorney's fees but Beneficial apparently did not include them as special damages in its successful motion for summary judgment. Beneficial then attempted to recover its fees by including them in the post-judgment memorandum of costs.⁷¹ The trial court, applying the

66. CAL. CIV. CODE §3524.

67. See text accompanying notes 30-42 *supra*.

68. See text accompanying notes 114-155 *infra*.

69. CAL. CIV. CODE §1717 (emphasis added).

70. 67 Cal. App. 3d 227, 136 Cal. Rptr. 549 (1977).

71. *Id.* at 229, 136 Cal. Rptr. at 550.

traditional contract rule,⁷² denied the fees on the ground that they were not recoverable as costs, but only as special damages. The Court of Appeal reversed and remanded the case for determination of the amount.⁷³ The opinion cites *T.E.D. Bearing* for the proposition that Section 1717 has broader application than traditionally ascribed to it,⁷⁴ but never mentions the section's requirement that the contract provide fees for "one of the parties."

*Canal-Randolph Anaheim, Inc. v. Wilkoski*⁷⁵ also involved a lease with a reciprocal provision. The court reviewed the purpose of the statute and declared "[i]t thus has no application to the case at bench in which the provision in the lease itself is reciprocal."⁷⁶ The California Supreme Court has also indicated, in another case,⁷⁷ that the legislature had no intent to change the rules regarding reciprocal clauses. "Section 1717 is obviously intended to create a reciprocal right to attorney's fees when the contract provides the right to one party *but not to the other*."⁷⁸

T.E.D. Bearing may be correct in extending the application of the statute beyond its original purpose when the the literal language of the statute requires it, but when the statutory language is ambiguous, reference to the purpose is essential. The legislative purpose was to correct the injustices resulting from one-sided attorney's fee provisions.⁷⁹ However cumbersome the present procedure for recovering fees on a reciprocal clause may be, *i.e.*, as special damages rather than as costs, this procedure may not be changed by distorting the intent of an unrelated statute. The holding of *Beneficial Standard*, that Section 1717 applies to reciprocal clauses, is erroneous and should be overruled.

If the clause itself meets the requirements of Section 1717, the next question to consider is whether the clause applies to that portion of the contract which is being litigated. If not, does Section 1717 nevertheless provide for fees for the prevailing party?

B. Clauses Limited To a Part of the Contract

Rather than providing for attorney's fees for *any* litigation on the contract, the drafter may provide for them only in the event litigation is

72. See note 30 and accompanying text, *supra*.

73. *Beneficial Standard Properties, Inc. v. Scharps*, 67 Cal. App. 3d at 232, 136 Cal. Rptr. at 552.

74. *Id.* at 231-32, 136 Cal. Rptr. at 551-52. *Accord*, *Sain v. Silvestre*, 78 Cal. App. 3d 461, 475-76, 144 Cal. Rptr. 478, 487-88 (1978) *disapproved on other grounds*, *Reynolds Metals, Co. v. Alpersen*, 25 Cal. 3d 124, 129, 599 P.2d 83, 86, 158 Cal. Rptr. 1, 3 (1979).

75. 78 Cal. App. 3d 477, 143 Cal. Rptr. 789 (1978).

76. *Id.* at 485, 143 Cal. Rptr. at 793.

77. *International Indus., Inc. v. Olen*, 21 Cal. 3d 218, 222-23, 577 P.2d 1031, 1033, 145 Cal. Rptr. 691, 693 (1978).

78. *Id.* (emphasis added).

79. *Id.*

necessary to enforce particular rights of one party. In practice, of course, these will necessarily be the rights of the party either retaining the drafter or purchasing the form. If the other party, the "adhering party" in the usual form contract case, then brings suit to enforce a right not covered by the clause, can the prevailing party in that suit recover attorney's fees? Does it matter whether the adhering party or the drafting party prevails?

Attorney's fee clauses applicable to only part of the contract are unilateral in an entirely different sense than those which provide that if A prevails against B, B must pay A's fees but provide B no such right. This latter kind of clause, unilateral on its face, was made reciprocal by the statute in no uncertain terms. The effect of the statute on these clauses is that in any one *lawsuit* one party cannot force the other party into settlement with the one-way attorney's fee provision.

The attorney's fee provision in *Sciarrotta v. Teaford Constr. Co.*⁸⁰ was unilateral in the sense that it provided for recovery of fees only by the drafting party; but it was also one-sided in its applicability to only one provision in the contract. The case involved a typical home construction agreement using a printed form contract. The contractor agreed to build the house according to certain plans and "in a substantial and workmanlike manner."⁸¹ The owners agreed to pay \$46,400.⁸² The attorney's fee provision applied only in the event that the contractor had to sue the owners for breach of the obligation to pay.⁸³ The owners paid the full price, moved in, and later sued the contractor for defective construction, *i.e.*, for breach of the covenant of workmanship.⁸⁴

The majority in *Sciarrotta* concluded that public policy favored a narrow construction of the section in this case.⁸⁵ If the defendant contractor had prevailed, the contract provision would not have been applicable. If Section 1717 does not apply in this case, because of the limited scope of the contract fee clause, neither party can recover attorney's fees. If the section does apply, both parties are potentially liable for fees for which they never contracted. The majority noted the restrictions placed on Section 1717 by the Supreme Court⁸⁶ and concluded that "policy considerations actually militate against a broad granting of attorney's fees in all instances to avoid the encouragement

80. 110 Cal. App. 3d 444, 167 Cal. Rptr. 889 (1980).

81. *Id.* at 446, 167 Cal. Rptr. at 890.

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.* at 452, 167 Cal. Rptr. at 894.

86. *Id.* at 451, 167 Cal. Rptr. at 893.

of needless litigation and to encourage settlement.”⁸⁷ The dissent rejected this logic, stating that this result “will effectively destroy the reciprocity the legislature intended to achieve by enacting Section 1717.”⁸⁸ The question is whether the legislature intended to achieve reciprocity in terms of *cases* or in terms of *contracts*.

The efficacy of Section 1717 as a consumer protection measure has been severely criticized because of the discretion it leaves the drafters of form contracts regarding recovery of attorney’s fees in actions to enforce the contract.⁸⁹ The plaintiff decides whether to have a dispute settled in court. Apparently, therefore, plaintiffs generally expect that they have a significantly better chance of prevailing than the defendants. Since lenders and sellers on credit perform at the time the contract is made and collect later, they are more likely to be plaintiffs.⁹⁰ Insurance companies, on the other hand, are paid in advance and perform much later, if ever, and are therefore more likely to be defendants.⁹¹ In support of this criticism, Professor Slawson maintains that “mass contractors” only include attorney’s fee clauses in contracts that they expect to enforce in court and omit them in contracts they expect the consumer to enforce.⁹²

This power to select the application of Section 1717 will be greatly expanded if the narrow construction in *Sciarrotta* is upheld in future decisions. Section 1717 will become ineffective as a sword to enforce consumer rights, although its use as a shield by consumer defendants will continue. Was such a result intended by the legislature? A review of the statute and of the cases suggests it was not.

The *Sciarrotta* decision is inconsistent with the well-settled rule of *Leaf v. Phil Rauch, Inc.*⁹³ that a party who rescinds a contract is nevertheless entitled to attorney’s fees under Section 1717. Rescission as a remedy for a material breach is surely outside the scope of the typical attorney’s fee provision. It is a right implied by law, regardless of whether it is stated in the contract.⁹⁴ If the rationale of *Sciarrotta* were followed, the plaintiff who has rescinded and is seeking restitution would not be entitled to attorney’s fees under Section 1717 since the defendant would not be entitled to attorney’s fees under the contract because the suit is not one seeking enforcement of a provision in the

87. *Id.* at 452, 167 Cal. Rptr. at 894.

88. *Id.* at 454, 167 Cal. Rptr. at 895.

89. Slawson, *supra* note 2, at 9.

90. Slawson, *supra* note 2, at 9.

91. Slawson, *supra* note 2, at 9.

92. Slawson, *supra* note 2, at 9.

93. See note 60 and accompanying text *supra*.

94. See note 59 and accompanying text *supra*.

contract. Yet the award of fees to the rescinding plaintiff was enthusiastically endorsed by the same court that decided *Sciarrotta*.⁹⁵

By its terms, Section 1717 applies to "any action on a contract"⁹⁶ with a certain type of attorney's fee provision. The section does not limit its application to portions of a contract covered by the requisite clause. In expressly prohibiting waiver of its provisions, the legislature unambiguously declared its awareness that contract drafters would attempt to defeat the section's purpose and also declared its intent that the drafters should not be allowed to do so. Section 1717 "reflects legislative intent that equitable considerations must prevail over both the bargaining power of the parties and the technical rules of contractual construction."⁹⁷ The consideration here is that "he who takes the benefit must bear the burden."⁹⁸ An attorney's fee provision applicable to a promise is a benefit to the promisee, even if reciprocal. The promisee who takes that benefit should shoulder the burden of a similar right attached to the consideration given in return for the promise.

The majority in *Sciarrotta* noted that if the construction in the dissenting opinion were followed and the plaintiffs had lost, the plaintiffs would be liable for attorney's fees in excess of their contractual obligation; they had not contracted to pay fees in the event they brought suit and lost. An examination of Section 1717 in context with other provisions of the Civil Code⁹⁹ reveals that the legislature considered making fees available to the prevailing party, whether buyer or seller, in certain contract disputes, preferable to giving the drafter free rein to determine the scope of recovery of attorney's fees. Unfortunately, the legislature has not been so consistent in defining "prevailing party."

JUDGMENTS WITHIN THE SCOPE—WHO IS "PREVAILING?"

Obtaining a "final judgment" is a prerequisite to recovery under Section 1717. A voluntary dismissal is not a final judgment for this purpose.¹⁰⁰ Unlike other attorney's fee provisions in the Civil Code,¹⁰¹ Section 1717 contains no provision enabling a defendant to shift liability for fees by depositing in court the amount not in dispute. This omission by the legislature was apparently intentional.¹⁰² A plaintiff

95. *Care Constr., Inc. v. Century Convalescent Centers, Inc.*, 54 Cal. App. 3d 701, 705-06, 126 Cal. Rptr. 761, 763-64 (1976).

96. CAL. CIV. CODE §1717 (emphasis added).

97. *International Indus., Inc. v. Olen*, 21 Cal. 3d 218, 224, 577 P.2d 1031, 1034, 145 Cal. Rptr. 691, 694 (1978).

98. CAL. CIV. CODE §3521.

99. *Id.* §§1811.1, 2983.4.

100. 21 Cal. 3d at 225, 577 P.2d at 1035, 145 Cal. Rptr. at 695.

101. CAL. CIV. CODE §§1811.1, 2983.4.

102. See note 27 and accompanying text *supra*.

can refuse defendant's tender of an amount not in dispute, assuring a final judgment for at least that amount. If the statute is interpreted literally, this tactic would also assure the award of attorney's fees. This is precisely the kind of oppressive use of attorney's fees that the statute was intended to prevent. Moreover, if the action is on a retail installment contract or on an automobile conditional sales contract, and if the defendant has deposited in court an amount equal to or greater than the plaintiff's judgment, the court might be faced with two "prevailing parties," both entitled to attorney's fees under different statutes.

An excellent illustration of the problems with Section 1717's definition of "prevailing" was provided by *National Computer Rental Ltd. v. Bergen Brunswick Corp.*¹⁰³ Under a contract for rental of computer equipment, plaintiff claimed three items of recovery: (1) \$4,123.60 unpaid rent; (2) \$884 taxes; and (3) \$22,100 fee for defendant's early termination of the contract.¹⁰⁴ Defendant, in answer, denied owing anything, but later made an offer to settle for the unpaid rent alone.¹⁰⁵ Neither the rent nor the taxes were argued at trial. Plaintiff obtained a judgment for the rent and taxes totalling \$5007.60, but the trial court awarded defendant \$2000 attorney's fees under Section 1717 finding that the defendant was the "prevailing party."¹⁰⁶

The Second District Court of Appeal affirmed,¹⁰⁷ Justice Jefferson dissenting.¹⁰⁸ Even the dissenting opinion did not suggest that the statute be interpreted literally by awarding fees to plaintiff simply because plaintiff recovered a judgment. Instead, the dissent's position was that since the plaintiff had recovered an amount greater than the amount the defendant had offered, plaintiff was "the party in whose favor final judgment is rendered."¹⁰⁹ This interpretation is consistent with the legislative policy on costs generally.¹¹⁰ Application of the costs rule to this case would have led to a very curious result. To award attorney's fees to plaintiff instead of defendant would have increased the net judgment by \$4,000¹¹¹ because of defendant's failure to offer an additional \$884—less than a fourth of the total fees and only three percent of the plaintiff's total claim. Looking at the case as a whole, there is little doubt that defendant "prevailed" as the word is commonly understood. The

103. 59 Cal. App. 3d 58, 130 Cal. Rptr. 360 (1976).

104. *Id.* at 61, 130 Cal. Rptr. at 362.

105. *Id.* at 63, 130 Cal. Rptr. at 363.

106. *Id.* at 62, 130 Cal. Rptr. at 362.

107. *Id.* at 63, 130 Cal. Rptr. at 363.

108. *Id.*

109. *Id.* at 70, 130 Cal. Rptr. at 367-68.

110. CAL. CIV. PROC. CODE §998.

111. Assuming the parties have approximately equal attorney's fees of \$2000 each, there is \$4000 at stake in determining which party will recover fees.

majority took a common sense approach, but appears to have disregarded the language of the statute and to have taken some liberties with the facts.

Defendant prevailed on the only issue in the case; it is the "prevailing party" within the meaning of Section 1717, even though plaintiff nominally holds a judgment for an amount never disputed and never litigated.¹¹²

Actually, the plaintiff held a judgment for nominally more than the amount not in dispute. The Supreme Court later cited *National Computer* for the proposition that "the form of the judgment is not necessarily controlling, but must give way to equitable considerations."¹¹³

These "equitable considerations" have proved especially compelling when a non-party to the contract is nonetheless sued as a party. The next section will review the various legal theories by which a non-party may become liable on a contract.

CONTRACT LIABILITY OF NON-SIGNATORIES

The most difficult aspect of Section 1717 has been its application to cases when a person who did not sign the contract, at least not on his or her own behalf, is nonetheless sought to be held liable. Can a party to the litigation, the defendant, alleged to be a party or successor to a party to the contract, successfully defend by proving he or she is not a party to the contract and still invoke the protection of Section 1717? Uncertainty as to parties may result from transactions involving successors to interests in land, agency, or corporations.

A. *Interests in Land*

Many contracts are made pursuant to a conveyance of an interest in land. They include leases, security for loans, equitable servitudes, and covenants running with the land. The latter were limited, at common law, to covenants which "touch and concern the land."¹¹⁴ California's codification of the rule requires that the covenant be "made for the direct benefit of the property."¹¹⁵ Recovery of attorney's fees does not benefit the property directly and therefore, arguably, cannot run with the land at law.

112. 59 Cal. App. 3d at 63, 130 Cal. Rptr. at 363.

113. *International Indus., Inc. v. Olen*, 21 Cal. 3d 218, 224, 577 P.2d 1031, 1034, 145 Cal. Rptr. 691, 694 (1978). The court did not state what these "equitable considerations" were, but apparently was referring to a general sense of fairness as opposed to the application of rigid rules. The result in this case is that the cost of the litigation falls on the party who made it necessary.

114. *Spencer's Case*, 77 Eng. Rep. 72 (1583).

115. CAL. CIV. CODE §1462 (emphasis added).

*Sain v. Silvestre*¹¹⁶ involved an attempt to enforce an equitable servitude which included a reciprocal attorney's fee clause. The court did not discuss whether the suit was an "action on a contract" for the purposes of Section 1717. Equitable servitudes began with the Court of Chancery's decision in *Tulk v. Moxhay*¹¹⁷ that equity could enjoin violation of an agreement by a successor to the promisor's interest without regard to whether the covenant could run at law.¹¹⁸ With this historical contract foundation, it seems reasonable to conclude that enforcement of servitudes is within the scope of Section 1717.

The defendants in *Sain* established that their land was not subject to the servitudes because their title was derived from a foreclosure of a mortgage senior to the declaration of restrictions.¹¹⁹ The court denied them attorney's fees. "Defendants are not, however, parties to or privies to, the contractual provisions providing for attorney's fees . . . ; defendants, therefore, cannot be awarded such fees."¹²⁰

In *Pas v. Hill*,¹²¹ plaintiffs brought suit to enjoin acceleration of the due date under a due-on-sale clause in a deed of trust¹²² which was executed concurrently with a promissory note by the plaintiffs' predecessor in interest. The plaintiffs, not parties to the note, were not subject to personal liability on the note nor were they personally liable on the attorney's fee provision. The court concluded that to allow plaintiffs to recover attorney's fees in this case would not further the intent of Section 1717 to make attorney's fee obligations reciprocal; "on the contrary, a unilateral right to recover attorney fees would have been created in favor of the plaintiffs."¹²³

The decision in *Pas v. Hill* was based on the lack of plaintiffs' *personal* liability for attorney's fees.¹²⁴ The decision did not address the potential liability of plaintiffs' *property* for the fees. If the deed of trust secured only the debt principal and interest, and not the original debtors' promise to pay attorney's fees, then the decision would have been unquestionably correct. But a secured party may recover attorney's fees out of foreclosure sale proceeds when the mortgage or deed of trust

116. 78 Cal. App. 3d 461, 144 Cal. Rptr. 478 (1978), *disapproved in part*, Reynolds Metals, Co. v. Alperson, 25 Cal. 3d 124, 599 P.2d 83, 158 Cal. Rptr. 1 (1979).

117. 41 Eng. Rep. 1143 (1848).

118. *Id.* at 1144-45.

119. 78 Cal. App. 3d at 472, 144 Cal. Rptr. at 485.

120. *Id.* at 476, 144 Cal. Rptr. at 488. This holding of *Sain* was disapproved by *Reynolds Metals, Co. v. Alperson*, 25 Cal. 3d 124, 599 P.2d 83, 158 Cal. Rptr. 1 (1979).

121. 87 Cal. App. 3d 521, 151 Cal. Rptr. 98 (1978).

122. *See generally* Wellenkamp v. Bank of America, 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

123. 87 Cal. App. 3d at 536, 151 Cal. Rptr. at 108.

124. *Id.* at 533, 151 Cal. Rptr. at 106.

so provides.¹²⁵ In times of escalating land values deficiencies are rare, and the ability to recover fees out of the sale of property is equally as detrimental to the property owner as would be a personal judgment. The purposes of Section 1717 would be served better by allowing recovery in this situation. Taking these considerations into account, the Fourth District Court of Appeal has apologetically overruled *Pas v. Hill*.¹²⁶

A similar case arose in a lease situation in *Canal-Randolph Anaheim, Inc. v. Wilkoski*.¹²⁷ The lessee law firm dissolved, and one of its associates remained in occupancy.¹²⁸ The landlord sued for allegedly unpaid rent and the trial court, finding for the defendant, awarded attorney's fees. The Fourth District Court of Appeal reversed for two reasons. First, the clause in the original lease was reciprocal; Section 1717 applies only to unilateral clauses.¹²⁹ Second, defendant was not a party to the contract and, unlike the non-party defendant in *Babcock v. Oman-sky*,¹³⁰ was not alleged to have been a party. Had the plaintiff prevailed, the court concluded, plaintiff could not have recovered attorney's fees from the lease assignee (defendant).¹³¹ The result probably would be different if the assignee had formally assumed the lease, expressly promising to fulfill all of the covenants of the original tenant. When a lease has been assumed, a suit to recover rent is an action on a contract, actually two contracts, and Section 1717 would apply. Apparently, the result in *Canal-Randolph* rests on the lack of an assumption of the lease.

B. Agency

A second way persons other than signatories may be held liable on contract obligations is based on agency law. In *Babcock v. Oman-sky*,¹³² the plaintiff, in addition to his tort causes of action, alleged that Bertha and Leon Omansky were each other's agents, and that they were partners and joint venturers.¹³³ Bertha won an order of nonsuit on the *contract* allegations with an award of attorney's fees. The court stated that Section 1717 "expressly indicates" that non-signatories to

125. CAL. CIV. PROC. CODE §726.

126. *Saucedo v. Mercury Savings and Loan Assoc.*, 111 Cal. App. 3d 309, 315, 168 Cal. Rptr. 552, 555-56 (1980).

127. 78 Cal. App. 3d 477, 143 Cal. Rptr. 789 (1978).

128. *Id.* at 483, 143 Cal. Rptr. at 791.

129. See notes 69-79 and accompanying text *supra*.

130. 31 Cal. App. 3d 625, 107 Cal. Rptr. 512 (1973).

131. 78 Cal. App. 3d at 486, 143 Cal. Rptr. at 793.

132. 31 Cal. App. 3d 625, 107 Cal. Rptr. 512 (1973).

133. *Id.* at 633, 107 Cal. Rptr. at 518.

the contract can recover attorney's fees.¹³⁴ It is difficult to argue with the result of these facts, but Section 1717 is not so clear. The history of the statute gives no indication that the legislature ever contemplated a non-party defendant might be sued as if he or she were a party.¹³⁵ The language relied on by the court is at best ambiguous when applied to non-parties to the contract.

Another aspect of agency law which has not yet produced any Section 1717 cases, but seems ripe for one, is in the area of franchising and licensing. A single defendant, Arthur Murray, Inc., may be credited with a large part of the law of franchisor liability on contracts in California. So notorious were Arthur Murray's operations nationwide that the New York legislature dispensed with the requirement of privity of contract altogether for consumer suits against dance studio franchisors.¹³⁶

In California, three separate suits were brought by students of defunct franchises for breach of contract and violations of the Dance Act.¹³⁷ In *Nichols v. Arthur Murray, Inc.*,¹³⁸ plaintiff established actual agency by showing that the franchisor retained the right to control the daily operation of the franchise. In *Beck v. Arthur Murray, Inc.*,¹³⁹ recovery was based on ostensible agency. As a result of advertising for the school, the repeated and prominent use of the Arthur Murray name, and the lack of effective notice of independent ownership, plaintiff reasonably believed that the school was owned by Arthur Murray and that the operators of the school were merely agents. The case predated Section 1717, but plaintiff recovered attorney's fees under the Dance Act.¹⁴⁰ Both cases were followed in *Kuchta v. Allied Builders Corp.*¹⁴¹ in which a construction franchisor was held liable for breach of contract and fraud. The holding was based on both the "control/actual agency" theory of *Nichols*¹⁴² and the "representation/ostensible agency" theory of *Beck*.¹⁴³

Considering the present size of the franchising industry, these cases open up a substantial possibility for recovery by consumers who lose their money after relying on a trade name. Consumer contracts with

134. *Id.*

135. See Enrolled Bill Memorandum, *supra* note 28.

136. N.Y. GEN. BUS. LAW §394-d.

137. CAL. CIV. CODE §§1812.50-1812.68.

138. 248 Cal. App. 2d 610, 56 Cal. Rptr. 728 (1967). *Accord*, Porter v. Arthur Murray, Inc., 249 Cal. App. 2d 410, 57 Cal. Rptr. 554 (1967).

139. 245 Cal. App. 2d 976, 54 Cal. Rptr. 328 (1966).

140. CAL. CIV. CODE §1812.62.

141. 21 Cal. App. 3d 541, 98 Cal. Rptr. 588 (1973).

142. *Id.* at 547, 98 Cal. Rptr. at 590.

143. *Id.* at 547, 98 Cal. Rptr. at 591.

franchise operations often include attorney's fee provisions, and the consumer, if successful, can recover the fees under Section 1717. There is also the danger, as yet not addressed in the cases, that an unsuccessful consumer might have to pay the defendant franchisor's attorney's fees if the agency is not established. While at least one writer has simply assumed that this would be the case,¹⁴⁴ this is by no means certain.

C. Corporations

Under some circumstances, the shareholders of a corporation may be held liable for its debts under the corporate "alter ego" theory.¹⁴⁵ In such a case, the plaintiff asserts that the corporation did not have a real, separate existence at all, but was merely a vehicle for the personal business of its owners.¹⁴⁶ In *Arnold v. Browne*¹⁴⁷ the corporation was admittedly in default, but plaintiffs attempted to hold the shareholders liable as well. In denying fees to the prevailing shareholder defendants, the First District Court of Appeal, like the Second District in *Babcock*,¹⁴⁸ found the meaning of Section 1717 "specific." However, while the *Babcock* court construed the section as specifically *providing* for attorney's fees for the defendant in this situation, the court in *Arnold* came to the opposite conclusion.¹⁴⁹

The debate between the *Arnold* and *Babcock* views regarding the ability of non-parties to recover attorney's fees under Section 1717 continued until the California Supreme Court settled the question for the most common fact pattern in *Reynolds Metals Co. v. Alperson*.¹⁵⁰ The facts were similar to *Arnold*: a creditor benefitted by a unilateral attorney's fee clause, an insolvent debtor corporation, and an unsuccessful attempt to hold the shareholders personally liable. The court recognized the ambiguity in language of the section. "[T]he terms 'parties' and 'party' are ambiguous. It is unclear whether the Legislature used the terms to refer to signatories or litigants."¹⁵¹ California has rejected the idea that words have a "plain meaning" independent of the context in which they are used.¹⁵² No clearer example can be found than the opposite conclusions reached by the Courts of Appeal regarding the

144. Saxon, *Recovery of Attorney's Fees by the Non-contracting Defendant*, 55 CAL. STATE B. J. 150, 153 (1980).

145. See generally N. LATTIN, *THE LAW OF CORPORATIONS* §18 (2d ed. 1971).

146. *Id.* at 86.

147. 27 Cal. App. 3d 386, 103 Cal. Rptr. 775 (1972).

148. *Babcock v. Omansky*, 31 Cal. App. 3d 625, 107 Cal. Rptr. 512 (1973).

149. 27 Cal. App. 3d at 398, 103 Cal. Rptr. at 789.

150. 25 Cal. 3d 124, 599 P.2d 83, 158 Cal. Rptr. 1 (1979).

151. *Id.* at 128, 599 P.2d at 85, 158 Cal. Rptr. at 3.

152. *Estate of Russell*, 69 Cal. 2d 200, 209, 444 P.2d 353, 359, 70 Cal. Rptr. 561, 567 (1968). See generally *Stillwell v. State Bar*, 29 Cal. 2d 119, 173 P.2d 313 (1946).

“obvious” meaning of the word “party” in Section 1717.¹⁵³ To resolve the ambiguity, the Supreme Court examined the intent and purpose of the statute.¹⁵⁴

Section 1717 was enacted to establish mutuality of remedy where contractual provision makes recovery of attorney’s fees available for only one party . . . and to prevent oppressive use of one-sided attorney’s fee provisions Its purposes require Section 1717 be interpreted to further provide a reciprocal remedy for a non-signatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney’s fees should he prevail in enforcing the contractual obligation Since [defendants] would have been liable for attorney’s fees pursuant to the fees provision had plaintiff prevailed, they may recover attorney’s fees pursuant to Section 1717 now that they have prevailed.¹⁵⁵

Significantly, the holding in *Reynolds Metals* was based on an interpretation derived from the legislative intent to “prevent the oppressive use of one-sided attorney’s fee provisions” and not on the questionable interpretation in *Babcock* that the language of the statute required its application to a non-party defendant. A clause may be unilateral or reciprocal, and it may be drafted by the plaintiff or the defendant.¹⁵⁶ These two variables yield four possible combinations and *Reynolds Metals* addressed only one: a unilateral clause drafted by the plaintiff.

THE NON-PARTY DEFENDANT AND CIVIL CODE SECTION 1717

This section will examine the four possibilities identified above and the applicability of Section 1717 to each one. For this discussion, a basic set of facts is assumed: plaintiff claims that defendant is a party to and liable on the contract; defendant claims that he or she is not; the contract contains an attorney’s fee provision covering the entire contract,¹⁵⁷ and there is no other applicable statute authorizing attorney’s fees. The outcome of any non-contract claim will not affect the result and will therefore not be considered. For this discussion it is assumed that liability of the original promisor is not in dispute, the only real question being whether the defendant is a party.

153. Compare *Arnold v. Browne*, 27 Cal. App. 3d at 398, 103 Cal. Rptr. at 784, with *Babcock v. Omansky*, 31 Cal. App. 3d at 633, 107 Cal. Rptr. at 518.

154. See generally R. DICKERSON, *THE INTERPRETATION AND APPLICATION OF STATUTES* 242-43 (1975).

155. 25 Cal. 3d at 128, 599 P.2d at 85-86, 158 Cal. Rptr. at 3-4 (emphasis added).

156. “Drafting party” in this section means the party responsible for the inclusion of the clause in the contract, and is usually the party presenting the other with a preprinted form. In a three-cornered transaction, it may be that neither plaintiff nor defendant is responsible for the clause. See generally *Wilson v. Lewis*, 106 Cal. App. 3d 803, 165 Cal. Rptr. 396 (1980) (reciprocal clause, drafted by real estate broker).

157. See text accompanying notes 80-99 *supra*.

In all four cases, if the plaintiff wins on the contract claim, a non-party problem does not exist. Plaintiff has proven that defendant is a party and can recover under the contract or under the statute,¹⁵⁸ but only to the contract limit, if any.¹⁵⁹

A. Case 1: Unilateral Clause, Drafted by Plaintiff

This is the most common case, as illustrated by *Arnold, Babcock, and Reynolds Metals*. The plaintiff has drafted the contract and has included a provision requiring the other party to pay the plaintiff's attorney's fees in the event of litigation. The other party defaults and is insolvent; plaintiff seeks to hold defendant liable. If defendant wins, *Reynolds Metals* is directly on point. The plaintiff used a superior bargaining position to extract a unilateral attorney's fee provision for his or her own benefit, and, if the statute is not applied, can coerce the defendant into an unfavorable settlement due to the unequal attorney's fee position. This was precisely the evil that the legislature sought to prevent.¹⁶⁰

B. Case 2: Reciprocal Clause, Drafted by Plaintiff

A different case arises when the plaintiff has made the clause reciprocal. Despite the contrary holdings in *Beneficial Standard* and *Sain v. Silvestre*, the California Supreme Court has indicated that Section 1717 does not apply to reciprocal clauses.¹⁶¹ Depending on the specific language of the attorney's fee provision, defendant may be able to recover by the same logic used to deny attorney's fees to a losing party in *Ecco-Phoenix*.¹⁶² Defendant may be able to argue that the clause covers non-parties who could be sued as third-party beneficiaries of the contract. The court may bend over backwards, as it did in *Ecco-Phoenix*, to find such a construction to avoid an inequitable result.¹⁶³

C. Case 3: Reciprocal Clause, Drafted by Defendant

The third case arises when the defendant is the drafter of the provision. This situation may arise when a franchisee or closely-held corporation has become insolvent, as illustrated in the Arthur Murray cases,

158. T.E.D. Bearing Co. v. Walter E. Heller & Co., 38 Cal. App. 3d 59, 63-64, 112 Cal. Rptr. 910, 914 (1974).

159. See notes 43-48 and accompanying text *supra*.

160. Coast Bank v. Holmes, 19 Cal. App. 3d 581, 597, 97 Cal. Rptr. 30, 39 (1971).

161. See note 77 and accompanying text *supra*.

162. See text accompanying notes 18-22 *supra*.

163. See *Ecco-Phoenix Electric Corp. v. Howard J. White, Inc.*, 1 Cal. 3d 266, 272, 461 P.2d 33, 36, 81 Cal. Rptr. 849, 852. *Cf.*, *Canal-Randolph Anaheim, Inc., v. Wilkoski*, 78 Cal. App. 3d 477, 144 Cal. Rptr. 789 (1978) (court refused to construe lease fee provision as protecting assignee sued on privity of estate only).

and the consumers who signed the contracts provided by the franchisor or corporate shareholder/officer seek to hold the defendant personally liable.¹⁶⁴

This defendant does not have the advantage of the principle that ambiguities are construed against the drafter. This principle was important in *Ecco-Phoenix* and would bolster the third-party beneficiary argument of the defendant in Case 2. The "equitable estoppel" argument suggested in *Pas v. Hill*¹⁶⁵ is inapplicable because an essential element of estoppel, reliance, is missing. Defendant has not acted in reliance on plaintiff's claim of agency or alter ego. Quite the contrary, defendant is fighting it. Defendant's inability to recover attorney's fees in this case is especially unjust since the defendant has complied with what the legislature has indicated is the public policy by making the clause reciprocal. To provide attorney's fees in this situation by judicial decision would require either an expansion of Section 1717 far beyond its intent or a complete disregard of the Code of Civil Procedure Section 1021.¹⁶⁶ Legislative action is in order to correct this anomaly.

D. Case 4: Unilateral Clause, Drafted by Defendant

The final case is similar to Case 3 and will arise out of the same situation, except that the drafter has made the clause unilateral. It would be a curious result indeed if the person who imposed a unilateral clause on a weaker party in an Arthur Murray-type case could recover attorney's fees while the drafter of a reciprocal clause in the same situation could not. Yet that would be the result if *Reynolds Metals* were blindly applied to this case without regard to the basis for its holding.

The policy considerations underlying the holding in *Reynolds Metals* do not support the awarding of attorney's fees in this situation. Section 1717 was intended to remove the advantage of unilateral attorney's fee provisions. Nevertheless, they continue to be a common feature of adhesion contracts.¹⁶⁷ Apparently attorneys continue to draft them in unilateral terms to intimidate parties who are unaware of Section 1717.¹⁶⁸ The judicial process remains a greater mystery to the bulk of consumers, and it is doubtful that more than a few have ever heard of Section 1717. A unilateral clause provides an additional weapon to threaten the consumer into settlement when he or she is unaware of the reciprocal right. To provide an additional incentive for unilateral

164. See notes 136-144 and accompanying text *supra*.

165. 87 Cal. App. 3d 521, 535-36, 151 Cal. Rptr. 98, 108 (1978).

166. See text accompanying notes 67-79 *supra*.

167. *Coast Bank v. Holmes*, 19 Cal. App. 3d 581, 596-97, 97 Cal. Rptr. 30, 39 (1971).

168. See, e.g., CAL. FORMS §22:280 (1975) (form book rental agreement fee provision).

clauses by giving the people responsible for them greater rights than they would have had under the contract or would have had under a reciprocal clause would be contrary to the purpose of the statute, not supportive of it.

The broad construction in *Reynolds Metals* was built on the equitable foundation laid in *International Industries* and *Ecco-Phoenix*. The general rules of equity therefore apply. One of these principles is that one must come to the court of equity with "clean hands."¹⁶⁹ The doctrine is not limited to fraud, crime, or even conduct which would form the basis for a cause of action. Any unconscionable conduct on the part of the person seeking the aid of equity is sufficient to deny relief.¹⁷⁰ The defendant seeking attorney's fees in this situation comes before the court claiming that it would be unfair and inequitable if the plaintiff should be able to recover attorney's fees while the defendant cannot. Yet that is precisely the way he or she wrote the contract. But for Section 1717, the defendant's corporation or franchisee would be able to recover attorney's fees from the plaintiff while the plaintiff would have no such right.

The section does not necessarily apply, by its own terms, to non-party defendants.¹⁷¹ When the court finds that the defendant was responsible for the inclusion of the unilateral attorney's fee clause, there is no equitable reason for rescuing the defendant from the exact predicament he or she sought to impose on the plaintiff.

RECOMMENDATIONS TO THE LEGISLATURE

California law on attorney's fees in contract cases has made great strides in the past two decades, providing a system based far more on the equities of the situation and far less on the bargaining power of the parties. Revision is required, however, to make the law consistent and to clarify remaining uncertainties.

A. Code of Civil Procedure Section 1021

Section 1021 of the Code of Civil Procedure is the basic provision for recovery of attorney's fees. This section should be amended to provide uniform rules for recovery as costs rather than as damages and a uniform definition of prevailing party. The legislature should also consider reversing the present rule that a party appearing *in propria persona* cannot recover the reasonable value of his or her own services.

169. *Katz v. Karlsson*, 84 Cal. App. 2d 469, 474, 191 P.2d 541, 544 (1948).

170. *Id.*

171. *Reynolds Metals, Co. v. Alperson*, 25 Cal. 3d 124, 128, 599 P.2d 83, 85, 158 Cal. Rptr. 1, 3 (1979).

This rule creates a unilateral attorney's fee situation in spite of Section 1717.

To correct the inequities and problems discussed, the present section should be redesignated subsection a) and be followed by these subsections:

b) When a party is entitled to attorney's fees by statute or contract, the fees shall be recovered as costs. Fees shall not be recovered when an action is voluntarily dismissed.

c) When different parties prevail on different issues in a case, the court shall apportion attorney's fees among the issues and award them accordingly. The fees so apportioned need not be in proportion to the monetary value of the issues, but shall represent the actual costs of the litigation.

d) When an otherwise prevailing party is denied costs or required to pay costs under Sections 998 or 1025 of this code¹⁷² that party shall not recover attorney's fees. When a party may be denied costs under sections 1031(b) or 1032(d) of this code, the court shall award only so much in attorney's fees as would have been reasonable had the case been tried in the appropriate lower court.¹⁷³

e) A party otherwise entitled to attorney's fees appearing *in propria persona* shall recover the value of his or her own services.

The allocation of fees among issues is the only practical way to handle cases like *National Computer* where an award of attorney's fees for the entire case might turn on an otherwise insignificant issue.¹⁷⁴ This is not to be confused with the allocation of fees between different causes of action sharing a common issue that was rejected in *Reynolds Metals*.¹⁷⁵

B. Civil Code Section 1717

The first paragraph of the present section should be redesignated subsection a). The phrase "enforce the provisions of such contract"

172. California Code of Civil Procedure Sections 998 and 1025 provide a method of shifting liability for costs by making an offer or depositing an amount not in dispute in court.

173. California Code of Civil Procedure Sections 1031(b) and 1032(d) provide for discretionary denial of costs when plaintiff recovers a judgment for an amount within the jurisdiction of a lower court. "Reasonable" fees in small claims may well be zero.

174. See text accompanying notes 103-113 *supra*.

175. Attorney's fees were incurred in defending three causes of action, only one of which involved a contract with an attorney's fee provision. The "alter ego" issue was common to all three claims and was the major issue of the case.

Attorney's fees need not be apportioned when incurred for representation on an issue common to both a cause of action in which fees are proper and one in which they are not allowed. All expenses incurred with respect to the alter ego issue . . . qualify for the award.

Reynolds Metals, Co. v. Alperson, 25 Cal. 3d 124, 129, 599 P.2d 83, 86, 158 Cal. Rptr. 1, 4 (1979).

should be followed by "or any portion thereof."¹⁷⁶ "[A]warded to one of the parties" should be expanded by adding "or more" after "one." This extension of Section 1717 to reciprocal clauses is necessary to cover non-party defendants sued on contracts with such clauses.¹⁷⁷ The second paragraph should be redesignated b), but not changed. The definition of "prevailing party" can be deleted, along with those in Sections 1811.1 and 2983.4, having been dealt with in Section 1021, *supra*. The following subsections can then be added:

c) "Reasonable attorney's fees," for the purpose of this section, are limited to the maximum either party could recover under the contract.

d) Any person who

1) is sued on a contract as if a party to that contract; or

2) owns property subject to or alleged to be subject to an encumbrance and such encumbrance includes a provision for attorney's fees incurred to enforce the encumbrance may recover attorney's fees under subsection a) of this section as if a party to the original agreement.

e) Unilateral attorney's fees provisions are against the public policy of this state. Recovery of attorney's fees by a person responsible for the inclusion of such a provision in a contract shall be limited to the terms of the contract, strictly construed, and shall not include any right under this section or Sections 1811.1 or 2983.4 of this code. "Unilateral attorney's fee provisions" include, but are not limited to,

1) provisions which create a right to attorney's fees for one party but not the other, and

2) provisions which create a right to attorney's fees incurred in actions to enforce the rights of one party but do not so provide for actions to enforce the rights of the other party or only for an insubstantial portion of the rights of the other party.

CONCLUSION

Civil Code Section 1717 was a significant step forward in relieving the oppression of the consumer via adhesion form contracts. The courts have generally implemented it consistently with its intent, but questions remain in the applicability of the statute to reciprocal clauses, successors to interests in land, clauses applicable to only part of the contract, and non-party defendants responsible for unilateral clauses. The above recommendations, if enacted, will clear up these uncertainties. In addi-

176. This addition would reverse *Sciarrotta v. Teaford Constr. Co.*, 110 Cal. App. 3d 444, 167 Cal. Rptr. 889 (1980). See text accompanying notes 80-99 *supra*.

177. See text accompanying notes 161-166 *supra*.

tion, they will provide greater uniformity in the area of attorney's fee recovery and prevent the drafters of adhesion contracts from evading the intent of Section 1717 by limiting the scope of the attorney's fee clause. Finally, the recommendations would withdraw the protection of Section 1717 from the very people whose unconscionable practices made the section necessary to begin with: those who would misuse liberty of contract to deny others an equal opportunity to present their case in a court of law.

Kent S. Scheidegger