

## **Contract Litigation Insurance: The Lawsuit Safety Net**

*One of the most worrisome elements of commercial litigation is the risk of paying the other side's attorneys' fees pursuant to a contract clause if you lose. Insurers have recently developed a new form of insurance to guard against this risk.*

One of the primary risks in contract litigation is the prospect of being ordered to pay significant attorneys' fees to the adversary party under contractual attorneys' fees clauses if the litigation is unsuccessful. The prospect of exposure to runaway attorneys' fees claims frequently impacts a party's strategy and decisions during litigation.

The recent arrival of a new form of insurance coverage tips the scales in the other direction. Contract litigation insurance ("CLI"), provides insurance coverage for an adverse attorneys' fee award, thereby providing a safety net against the enhanced risk of increased losses.

### **The Status Quo**

In the United States, the general rule (known as the "American Rule") is that each party pays its own attorneys' fees, win or lose. In this country, the American Rule is the law of the land except where recovery of actual attorneys' fees is enabled by statute, by court rule (usually for abusive litigation), by contract, or by a few rarely applied common law exceptions.

The costs associated with the potential recovery of attorneys' fees have skyrocketed in recent years, to the point where that recovery can exceed the primary exposure under the contract. Many parties thus include clauses in their contracts and leases imposing the attorneys' fees and litigation costs of the prevailing party upon the non-prevailing party. Such clauses are usually mutual, meaning either party may take advantage of this recovery. Many parties regard such clauses as routine, non-negotiable, and even beneficial, so they stay in the contract.

Subject to a few exceptions, contract cases are excluded from coverage under most liability policies. For this reason, until recently, businesses and individuals were unable to insure against this increasing risk.

### **CLI Coverage**

CLI was first introduced in the United States in California in 2010, and is now available in all fifty states. CLI may be purchased by individuals or business entities. Plaintiffs or Defendants in an ongoing lawsuit may purchase CLI for that case, as long as the purchase is made within the set number of days specified in the policy. Some states also enable CLI to cover statutory awards of attorneys' fees above and beyond the contractual award. The one-time premium is generally between six and ten percent of the amount of the coverage limits and customary levels of coverage range from \$200,000 to \$400,000. The policy remains in effect for the life of the lawsuit.

CLI policies typically have four significant exclusions: 1) attorneys fees for any suit determined by a court to have been brought by the insured in bad faith or prosecuted in a frivolous or malicious manner; 2) portions of attorney fee awards that arise from punitive or exemplary damages; 3) attorneys' fees incurred after the insured rejected a statutory offer in

compromise; and 4) an exclusion for suits terminated by settlement and by any other type of termination except trial on the merits or summary judgment.

Under most CLI policies, the insurer may require the insured to oppose an attorneys' fee motion, hire its own counsel to oppose the award, and require the insured to appeal the award. In such cases, the insurer will generally pay all reasonable expenses incurred in such efforts without reduction in the overall coverage amount.

### **Strategic Considerations**

CLI alters the strategy for litigants whose cases include a contract clause imposing attorneys' fees awards. A party who is about to sue or has just been sued must quickly determine whether to purchase CLI. Once CLI is acquired, the other party will probably learn of the policy issuance and limits through discovery. That discovery will greatly impact the behavior of both sides in any settlement discussions, and in their prosecution of the case.

A party who gains the benefits of CLI enjoys a wider range of options in his or her handling of the case. Once freed from the concern of paying attorneys' fees, the party can more fully focus on the merits of the case and undertake discovery and other procedures it may have earlier avoided due to the additional cost that could be imposed at the end of the case.

The party whose adversary carries CLI on the case must also revise its strategy. For example, if the insured party appears too comfortable with its position in the lawsuit, the opposing party might make an offer in compromise to trigger that particular exception (see #3 above) and reduce the insured party's comfort level.

One of the most intriguing considerations arises at the earliest stages when drafting the contract. The well advised contracting party will consider its options at this stage; our firm can offer some intriguing options which can pay significant dividends down the road.

### **Our Firm**

Our firm has the knowledge and strategies to enable contracting parties to take full advantage of the benefits available from Contract Litigation Insurance, right from the formation of the contractual relationship. We are skilled and experienced in drafting contracts, contract litigation, litigating attorneys' fees claims, and contesting and analyzing insurance coverage issues. Our expertise will prove most beneficial to you on all aspects of a contract case where acquiring CLI might be advisable.