



Is the Attorney's Fees Clause Moot in an Illegal Contract? - Depends on Your Involvement, Explains First Appellate District Court

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The Court of Appeal recently clarified when a party can recover attorney's fees under a real estate purchase contract that is ruled to be illegal. California courts have previously enforced attorney's fees provisions in a real estate purchase contract even though the underlying contract was illegal for failure to comply with the Subdivision Map Act (SMA) or the Subdivided Lands Act (SLA). (See *Yuba Cypress Housing Partners, Ltd. v. Area Developers*, 98 Cal.App.4th 1077 (2002) (home purchaser entitled to enforce fee provision of sales agreement void under statute intended to protect home buyers); *Black Hills Investments v. Albertson's*, 146 Cal.App.4th 883 (2007), and *Sixells v. Cannery Business Park* 170 Cal.App.4th 648 (2008).)

In those cases, the purchaser was allowed to recover attorney's fees even though the purchaser successfully argued that the contract was void, illegal and/or unenforceable. The rationale was that the SMA and the SLA were enacted to protect purchasers from unscrupulous land sellers who sold lots that were not yet legally created (and often could never be). Courts reasoned that denying legal fees to a successful purchaser would frustrate the purpose of the SMA and the SLA.

However, recently, in *Mountain Air Enterprises v. Sundowner Towers* (2014) 231 Cal.App.4th 805, the Court of Appeals for the First Appellate District distinguished prior decisions and delivered a blow to a successful defendant's request for attorney's fees after the contract was held to violate the SMA. The Court held that the enforceability of the attorney's fees provision in such an illegal contract turns on: (i) the type of illegality involved; and (ii) whether the parties to the action were *in pari delicto*, meaning that they were "equally wrong under the illegal contract". The fee clause will not be enforced if the parties were *in pari delicto* by

jointly preparing the illegal contract, or would both profit from the underlying illegality.

In *Mountain Air*, plaintiff Mountain Air Enterprises, LLC and defendant Sundowner Towers, LLC entered into a "repurchase agreement" for real estate that was not comprised of legal parcels under the SMA when the contract was signed, and the sale was not contingent on recording a final map. Both parties were sophisticated developers who had transacted business together for many years. When the market crashed, the parties found themselves holding an overvalued asset.

The plaintiff wanted to enforce the repurchase agreement and require the defendant to buy back the overvalued asset. The trial court agreed with the defendant that the repurchase agreement was illegal because the property was not a legal parcel under the SMA when the parties signed the contract. However, the court denied legal fees to the prevailing defendant.

The First District Court of Appeal agreed with the trial court. The Court affirmed the general rule that if the entire contract is void for illegality (e.g., neither party may enforce it), then an attorney's fees provision in such agreement is unenforceable. A different rule applies when the contract is merely *voidable*, meaning that it can either be enforced or rejected at the election of a party. A party who rejects a voidable contract may still recover fees. To further the public policy goal in deterring illegal conduct, an otherwise innocent (or relatively less wrong) party will be allowed to enforce the attorney's fees provision even if the underlying contract is void.

The Court of Appeal held that this general rule will not be followed if the parties were *in pari delicto* by jointly creating the illegality. In *Mountain Air*, the Court determined that both parties were sophisticated developers, shared in drafting the repurchase agreement and both helped create the illegality. Furthermore, the parties profited from the transactions consummated from the various agreements executed in connection with the repurchase agreement. Finally, if the Court were to grant the defendant the attorney's fees requested, it would permit it to benefit from the illegality that the defendant itself participated in creating, which is against public policy.

Following this decision, how can parties ensure that the attorney's fees provision stands the test of time? Obviously, the first step is to consult competent counsel to ensure that the contract passes muster under current applicable law. Other approaches include:

- As to potential changes in the law, a common provision is a severability clause that will sever the offending/illegal clause and give effect to the balance of the contract. A severability clause may be ineffectual, however, if the illegality goes to the very object of the contract containing the attorney's fees clause (e.g., the repurchase agreement in *Mountain Air*).
- One might also consider expanding the attorney's fees clause to include a right to fees in actions "to determine the enforceability or legality of this Agreement."
- Where there are multiple documents addressing different aspects of a transaction (e.g., the sale of a business with different types of assets), one might consider a robust attorney's fees clause in each document that could stand alone even if other contemporaneously signed agreements are found unenforceable. The fee clauses in each of the documents could apply to any dispute "relating to or arising from" the agreement or any related transactions, disputes or agreements.

On the other hand, if you represent a party more likely to be sued and who wants to negate the fee clause for either side if the contract is held illegal, you might consider a recital or other provision stating that both parties are sophisticated, represented by counsel and jointly contribute to the drafting of the document.

Other options will depend on the specific nature of the transaction. For example, some illegality problems can be cured by amendment. (See *Corrie v. Soloway* (2013) 216 Cal.App.4th 436.) If you learn that there is potentially an illegal provision in your contract, consult a specialist in that area before a dispute arises.