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Attorneys Fees, Offsets and Priorities

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by Roger Bernhardt*

In *Behniwal v. Mix*, 147 Cal App 4th 621, a 2007 California decision, purchasers prevailed in their action for specific performance of a contract to purchase the vendors' residence. Since there had been three trials and appeals of this matter, and since there was an attorneys' fees clause in the contract, the trial court awarded the purchasers $250,000 attorneys' fees and offset it against the $540,000 purchase price that they owed. The court of appeal held that this offset was error, for reasons that might cause surprise to most attorneys, although lenders' counsel might be glad to learn of them.

Offsets v. Priorities

First, the court held that the right of offset is subject to the law of priorities, meaning that a party to a lawsuit cannot automatically assert a right of offset – even if he otherwise entitled to one – if that would be inconsistent with the rules of lien priorities. Normally, if A owes B $100 and B owes A another $100, the two debts offset each other so that A does not have to pay B the $100 that she owes him. But, Behniwal held that if B has other claimants to that money whose interests in it are determined to be superior to A's claim, then A may have to pay B – despite the fact that she is at the same time owed money by B, in order to be fair to C, B's superior claimant. In this case, the sellers only asset was their house, on which three liens (two of them mortgages) had recently materialized, which made A's having to pay B so that C could collect would lead to A being unable to enforce her offsetting debt from B.

I think most attorneys would have predicted the opposite result, i.e. they would have assumed that the law of offsets prevailed over the law of priorities, because many cases often treat an offsetting debt as having already been paid, pro tanto (as if the purchasers in Behniwal had already actually paid $250,000 of the $540,000 price to the sellers). But this decision said no, at least as far as California goes. Compare that with *Chapman v. Olbrich*, 217 SW3d 482, a Texas case also decided just this year, that seems to be minded to go the other way. Can you predict what the outcome would be in your state?

Priority Against Other Claims

Second, the court held that the plaintiffs' attorneys' fee claim came in fourth – behind a $238,000 deed of trust given by the sellers to World Savings Bank, two other deeds of trust totaling $70,000 given to their attorneys, and a homestead exemption (equal to $150,000) recorded by the sellers on their residence. Since all three of those interests arose *after* the plaintiffs had filed their specific performance action, how did they achieve higher priority than the plaintiffs' attorneys' fees claim?

The court held that the reason the attorneys' fees claim came in last was because it constituted only tn ordinary money judgment that did not take effect until it was awarded, entered, and then recorded. Since none of that could happen until the end of the trial, the three rival claims against the sellers had priority of it because they had all been recorded prior to that date.

I think most attorneys would have again predicted the opposite result, i.e. they would have assumed that since the decree of specific performance related back to the inception of the lawsuit, the award of attorneys fees would therefore do the same, as an incident of that decree, instead of being characterized as a separate money judgment with an independent and later priority, as this case held. Relation back priority is often true for an attorney's lien on an award to her client for fees the client owed to her (see, for instance, *Mahesh v. Mills*, 607 NW2d 618, Mich., 1999), but that is different from the claim of contractual attorney's fees sought by the client against the other party.

If the fees do not themselves relate back, then neither 1) the fact that the first deed of trust was taken with constructive notice of the lawsuit (because of a recorded lis pendens, discussed next), nor 2) the fact that the deeds

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of trust given to the sellers' attorneys were undoubtedly taken with actual knowledge of the litigation (after all, the attorneys were defending it), and was probably for services to be rendered in the case, like a future advance arrangement, nor 3) the fact that the homestead declaration was recorded by the sellers after the filing of the lawsuit against them which was based upon a sales contract which included an agreed on attorneys' fees clause in it, mattered, since the ordinary money judgment for attorneys fees was not (and could not be) recorded until after all of that happened. Notice or knowledge of what is held to come beneath you does not put it in front of you. So all of the rival creditors prevailed.

This was a California decision. Do you know what your state would say on this priorities question? What do you tell a litigation minded client about the risk that his adversary may subject the property that he is trying to acquire to liens which can destroy the value of the attorneys' fee clause in the contract? How do you describe the risk to a potential lender who sees a lis pendens on property that he is being asked to finance?

The Lis Pendens and Relation Back

Third, the court held that the lis pendens – recorded at the very outset of the litigation – did not give the purchasers any superpriority over the three competing liens. It gave notice only of their attempt to pursue specific performance and thereby have to pay the price to the vendors; it did not give notice of a further claim for attorneys fees, because that has no relationship to the issues of title or possession of the property in issue, which is what a California lis pendens is all about. Title ordered by the decree of specific performance would relate back to the date of filing the lis pendens, but not the money awarded to pay the victorious plaintiff's attorneys fees.

I think, for the third time, that many attorneys would have again predicted the opposite result – we would have assumed that the title and the price were sufficiently related as to be tied together in the lis pendens. See *Scott v. Majors*, 980 P2d 214, Utah, 1999. But Behniwal held that the only response of a potential lender who saw notice of a specific performance action would be that the price paid by a victorious buyer would be a good substitute for the title held by the defeated seller if that happened, and would give that lender no reason to regard the security as impaired.

Who Cares?

The winners and losers in this case are not quite what they might appear to be. The purchasers prevailed, but they had to pay the sellers the full $540,000 purchase price, rather than the net $290,000 the trial court would have imposed on them. Of that $540,000, $238,000 will go first to World Savings Bank, $70,000 will go to the seller's attorneys, and $150,000 will be protected by the homestead exemption. Since those claims total $458,000, that leaves only $82,000 remaining for offset, as against the purchasers' entitlement of $250,000 for their attorneys fees, or a shortfall of $168,000. The defeated defendants' attorneys may have charged less, but seems much more likely to recover what they were owed than are the attorneys for the victorious plaintiffs. Let's hope that they did not also have the case on a contingent fee basis! ♦