

REAL ESTATE

When Partners Fight, They Might Not Recover Their Legal Fees

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Litigation between disgruntled partners or disgruntled members of a limited liability company often turns very nasty—and very expensive—very fast. Once the litigation is resolved, the victor has probably spent far more on legal fees than it ever expected to. Regardless, it will typically want to recover those fees from the loser.

That's not always so easy, as demonstrated in [a recent case decided by the New York Court of Appeals](#), the highest court in New York State.

As a starting point, American courts have traditionally denied the victor in litigation any right to recover legal fees, unless an underlying contract or a statute provides for that recovery. Thus, in most cases, the victor often isn't much of a victor at all after taking into account the legal fees incurred to achieve the victory. Many contracts do, however, allow the winner in litigation to recover its legal fees from the loser with a simple statement to that effect.

In the New York case mentioned above, though, the partnership agreement wasn't that simple. It handled the legal fees issue in a way

that is, actually, quite common in partnership agreements and limited liability company agreements. The agreement required each partner to “indemnify” the other against any “costs” and “expenses” incurred because a partner does something in “bad faith.”

One partner sued to dissolve the partnership. The other partner won. The winner then argued that the dissolution action was undertaken in “bad faith,” so the loser had to reimburse the winner’s legal fees. The trial court agreed. The loser appealed, and the appellate court agreed with the trial court.

When the loser appealed once again, to the Court of Appeals, the loser won this time. The Court of Appeals declared that the indemnity language in the partnership agreement wasn’t strong enough to make it “unmistakably clear” that unsuccessful two-party litigation between the partners triggered an obligation for the loser to reimburse the winner’s legal fees. Instead, the Court of Appeals viewed the indemnification language more narrowly. According to the Court of Appeals, that language covered only the case where a partner’s bad faith activities led a third party to sue the other partner or the partnership. That was the only circumstance where, under the parties’ agreement, a loser in litigation had an obligation to reimburse the other partner’s legal fees.



The Court of Appeals made it clear that the courts start from a presumption that a loser in litigation doesn’t have to reimburse the

winner's legal fees unless an exception clearly applies. Here, the language in the partnership agreement didn't create an exception, even though two lower courts thought it did.

The case presents another example of how "indemnification" can sometimes be a tricky concept that is misinterpreted and misunderstood. The case also teaches that if the parties to any partnership agreement, limited liability agreement, or other contract want the loser in litigation to pay the winner's legal fees, they should say exactly that. It's rather easy to do.

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I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**