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**A commentary article
reprinted from the
April 7, 2011 issue of
Mealey's Emerging
Insurance Disputes**



Commentary

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I. Introduction

In the world of litigation, recovery of attorney fees is often a driving factor in whether an attorney will represent a plaintiff. Insurance carriers, which have limited exposure for covered damages under the duty to indemnify, may nonetheless face very significant exposure if their policy provides for reimbursement of all costs taxed against their insured and if attorney fees are allowable as costs. Traditionally, if the carrier had a duty to defend and the policy had a supplemental payments provision, the carrier often had to pay all of the attorney fees recoverable as costs despite significant coverage defense on the duty to indemnify. More recent case law has clarified this duty and limited the obligation of the carrier. Although the carrier's cost to defend a claim and a carrier's potential obligation to reimburse its insured for fees awarded remain driving factors in litigation, recent California decisions have clarified and linked this obligation to pay attorney fees to claims actually covered under the policy.

II. *Mintarsih* Clarified Whether Attorneys' Fees Are Covered Under A Supplementary Payments Provision

Under *California Code of Civ. Proc.*, § 1032, the prevailing party is entitled, as a matter of right, to recover

"costs" in any action or proceeding. Attorneys' fees are allowable as costs, when authorized by contract, statute or law. (*CCP* § 1033.5.)

The recent case of *State Farm General Ins. Co. v. Mintarsih* (2009) 175 Cal.App. 4th 274 clarified the application of this statute where an insurance policy contained a supplementary payments provision, which promised to pay "costs" awarded against the insured. In the underlying action, Mintarsih, a domestic servant to the Lams (State Farm's insureds) sued the insureds for false imprisonment and other counts arising from her employment with them and obtained a judgment against them for among other things, attorney fees' as the prevailing party.

The court of appeal ruled that State Farm's obligation under the policies' supplemental payments provisions extended only to costs arising from claims that were at least potentially covered under one or both of the policies. An insurer's implied-in-law duty to defend an entire mixed action, including claims that are not even potentially covered, does not give rise to an obligation under a supplemental payments provision to pay costs awarded against the insured that can be attributed solely to claims that were not potentially covered. (*Id.* at p. 286.) Mintarsih's statutory right to recover attorney fees was based solely on the Labor Code violations. Absent a showing of a potential for coverage of those claims, the court concluded that Mintarsih established no basis to hold State Farm liable for her attorney fees awarded as costs against the Lams.

III. Evaluating Coverage Where No Supplementary Payments Provision

Since the ruling in *Mintarsih*, we have been asked to evaluate coverage for a significant number of habitability claims tendered by insured homeowners' associations or landlords under policies that have no supplementary payments provision and where the bulk of the recovery sought is for attorneys' fees. For example, many of the causes of action, such as the breach of warranty of habitability, seek attorneys' fees under California's *Civil Code*, § 1940.2 or for violation of the *Health & Safety Code*. The question, therefore, has arisen how to treat coverage for such fees awarded to a prevailing party in the absence of a supplementary payments provision.

IV. Legally Obligated To Pay Requirement

Unless the policy expressly excludes payment of attorneys' fees, the answer appears to lie in the policy's insuring agreement. A typical homeowner's policy or CGL will state that the insurer agrees to pay "all damages" that an insured becomes *legally obligated* to pay because of bodily injury, property damage or personal injury. Cases have held that an insurer does not become *legally liable* to pay anything until a court orders the losing party to do so, and only then, does the losing party become legally liable for whatever relief the court orders. (*AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 824-825; *Powerine Oil Co., Inc. v. Superior Court* (2005) 37 Cal. 4th 377, 397.) Thus, the first requirement to consider is whether the court has ordered attorneys' fees be paid.

V. The "All Damages" Requirement

What constitutes "all damages" in the context of the policy at issue is the next step in the coverage analysis. In California, the plain and ordinary meaning of the term "damages," as used in commercial general liability policies, is monetary compensation recovered by a party for detriment, loss, or injury it has suffered through the acts of another. (*Golden Eagle Ins. Co. v. Insurance Co. of the West* (2002) 99 Cal. App. 4th 837; *Civ. Code*, § 3281.) What constitutes "damages," has been interpreted and applied in several notable cases.

In *AIU*, the court was called upon to determine whether reimbursement of government response costs constitutes "damages" under various CGL policies. The court stated that "damages" refers to "compensation in money recovered by a party for loss or detriment it

suffered through the acts of another." (*AIU, supra*, 51 Cal.3d at p. 826.) The court concluded that the first element of the statutory and dictionary definitions of "damages" was fulfilled in that the agencies suffered a loss or detriment when they incurred response costs under CERCLA. (*AIU, supra*, 51 Cal. at p. 828.) The release of hazardous waste into groundwater and surface water constituted actual harm to property in which the state and federal governments had an ownership interest. Second, the agencies' out-of-pocket expenses of investigating and removing the waste as required by statute was 'loss' incurred as a direct result of harm allegedly created through the unlawful act or omission of FMC." It also concluded that the second element of statutory and dictionary definitions of "damages" was fulfilled. "FMC's reimbursement of government response costs is monetary compensation for the loss suffered by the agencies when they proceed with environmental cleanups." (*AIU, supra*, 51 Cal. 3d at p. 829.)

The court also noted that while reimbursement of response costs was essentially a form of restitution, both restitution and compensatory damages fell within the meaning of "damages" in the policies. (*AIU, supra*, 51 Cal. 3d at p. 836.) The court added: "the relief sought in the underlying suits at issue was *not punitive*, and distinguished it from those forms of restitution that, as a matter of public policy, cannot be covered by insurance. (*AIU, supra*, 51 Cal. 3d at p. 836-837.)

AIU teaches that we must look at the underlying damages alleged as well as the statute itself. If the statute provides for attorneys' fees in the form of a *penalty*, then this would not appear to constitute compensation for the loss, and therefore, such attorneys' fees could not be characterized as "damages."

Perhaps more on point with respect to attorneys' fees is *Cutler-Orosi Unified School District v. Tulare County School Etc. Authority* (1994) 31 Cal.App.4th 617. The court decided that the attorney fees for which the school districts were liable did not qualify as damages under the districts' liability policy. *Cutler-Orosi* involved a CGL policy that covered sums that the insured was obligated to pay "as damages." The underlying lawsuit sought declaratory and injunctive relief for violations of the Voting Rights Act, 42 U.S.C. § 1973. The carrier contended that no "damages" were sought, while the insured argued that

the plaintiffs' request for attorneys' fees constituted a claim for "damages." The court rejected the insured's argument, holding that the carrier had no duty to defend. It explained: "[t]he only remedies available in an action to enforce the Voting Rights Act are declaratory and injunctive relief; an award of compensatory damages is not sanctioned." (*Id.* at pp. 630 – 631.)

The court further stated:

an award of attorney fees does not compensate the plaintiff for the injury that first brought him into court; instead, the award reimburses him for a portion of the expenses he incurred in seeking relief, and fees which are inconsistent with the concept of 'damages' as the term is used in its ordinary and popular sense, that is, compensation paid to a party for the loss or detriment suffered because of the wrongful act of another. (*Id.* at p. 632.)

Thus, not surprisingly, the court concluded that when the statute unambiguously treated attorneys' fees as "costs" and the policy obligated the insurer to defend only against claims in which damages were sought, there was no duty to defend. *Cutler-Orosi* makes it clear that damages must compensate the plaintiff for his or her loss.

VI. Determine The Purpose Of The Attorney Fee Award

Additionally, *Combs v. State Farm Fire & Cas. Co.* (2006) 143 Cal.App.4th 1338, 1344-1346 states that *public policy* requires that the insurer be precluded from indemnifying an attorney fee award based on a non-covered claim that was uninsurable because of willful conduct excluded pursuant to *Ins. Code*, § 533.. Allowing the wrongdoer to be insured for an award of attorney fees would undercut the purpose of *Ins. Code*, § 533 and permit the wrongdoer to avoid what may be a significant consequence of the wrongdoing. *Coombs* also stated:

Attorney fee awards may not normally be considered as 'damages' in that they do not compensate claimants for the injury for which they brought suit (citing *San Diego Housing Com. V. Industrial Indemnity Co.* (2002) 95 Cal. App.4th 669,

689), nor may they ordinarily be awarded for the purpose of punishing the defendant (citing *Simpson v. Sheahan* (7th Cir. 1997) 104 F.3d 998, 1003; *Corder v. Gates* (9th Cir. 1991) 947 F.2d 374, 383) (*Coombs, supra*, 143 Cal.App. 4th at p. 1345.) (bold added.)

Therefore, based on the above authority, it would appear that, despite the broad "all damages" or "all sums" language in some insurance policies, attorneys' fees do not appear to be covered because attorneys' fees attorneys' fees do not constitute "damages."

VII. At Least One State Supreme Court Has Ruled: A Policy That Does Not Define "Damages" Includes Coverage For Attorneys' Fees Unless Expressly Excluded

In California and in most states, public policy prohibits insurance companies from covering punitive damage awards. Until now, this prohibition presumably included attorney fees awarded solely as a result of a punitive damage award. Recently, the Ohio Supreme Court addressed whether an insurance policy provided coverage for attorneys' fees awarded due to a punitive damage award. In *Neal-Pettit v. Lahman* (May 4, 2010), the Ohio Supreme Court refuted that presumption of non-coverage of attorney fees. The majority held that: "Attorney fees are distinct from punitive damages, and public policy does not prevent an insurance company from covering attorney fees on behalf of an insured when they are awarded solely as a result of an award for punitive damages."

This issue arose from a personal injury automobile lawsuit. The accident involved an intoxicated driver who fled the scene of an earlier collision. The jury awarded compensatory and punitive damages. The jury also awarded the plaintiff attorneys' fees because the jury found that the driver acted with malice. The insurer denied payment of both punitive damages and attorneys' fees.

The insurance policy did not mention coverage for attorney fees. The policy's insuring agreement contained language concerning coverage for "damages" and for "bodily injury." Although "bodily injury" was defined, "damages" was not. The policy also excluded

coverage of “punitive or exemplary damages, fines or penalties.”

The insurer contended that: (1) attorney fees did not constitute “damages because of ‘bodily injury’; and (2) the policy’s exclusion of ‘punitive or exemplary damages, fines or penalties’ excluded coverage of attorney fees. The court rejected the arguments.

On the issue of inclusion, the court phrased the controlling question as “whether the attorney fees awarded are damages that the defendant is legally obligated to pay because of the bodily injury sustained by the plaintiff.” The court held that: “although an award of attorney fees may stem from an award of punitive damages, the attorney-fee award itself is not an element of the punitive-damages award.” The court added that: “The language of the policy does not limit coverage solely because of bodily injury.” Thus, “insofar as the parties have offered their own separate interpretations of the language of the policy, both of them plausible, we must resolve any uncertainty in favor of the insured.

On the issue of exclusion, the court held that the exclusion of punitive or exemplary damages does not clearly and unambiguously encompass an award of attorney fees. The court also noted that the insurer never argued that attorney fees are a “fine” or “penalty.” Thus, whether attorney fees constitute such, the exclusion remained unresolved.

Although not binding in California, this Ohio case demonstrates that some courts are ready to rule that an insurance policy that does not define the term “damages” will cover attorneys’ fees unless it expressly excludes them. It is our opinion, however, that the position taken by the Ohio Supreme Court would not be followed in California because there are a plethora of cases in California that have ruled that

attorney fee awards are generally not considered as “damages.” However, for those involved in writing insurance policies and analyzing coverage in other states, this decision is certainly something to take into consideration.

VIII. Conclusion

Policy holder’s need to review the supplemental payments provisions in their policies. They need to make sure that the phrase “costs taxed against the insured” exist in the forms they are purchasing. Many carriers have revised forms which do not provide for reimbursement of costs taxed against the insured. Plaintiffs need to determine in early stages of litigation whether or not potential fee awards will be covered under the policies issued to the defendants. Plaintiff’s counsel needs to make sure they are pleading their case in such a manner as to maximize recovery under covered causes of action for which attorney fees are recoverable. To recover attorney fees under a non covered statutory cause of action from an insured without assets will do a plaintiff no good when it comes to collecting the judgment under the policy issued by the insurance company.

Finally, insurance companies need to apply recent case law judiciously, analyzing the potential theories of recovery. Even in the case of a general verdict, where attorney fees can only be recoverable under a statute which operates as a fine or penalty, the carrier can appropriate deny reimbursement for those fees when awarded against their insured. Vigilant analysis of the plaintiff’s legal theories, the discovery produced in the case, and the evidence presented at trial will be necessary if an insurance company can apply these new Court of Appeal decisions to assist in a determination of whether or not attorney fees are an obligation that the insurance company must reimburse to satisfy a judgment. ■

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The Report is produced twice monthly by



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ISSN 1087-139X