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EXPERT ANALYSIS

Attorney Fees and Liability Insurance: Recovering Fees Paid to Plaintiffs and Fees Incurred by Policyholders

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When confronted with a loss, many policyholders find themselves in a two-front battle. First, they face the plaintiff's attorneys, who in addition to wanting to recover as much as possible for their clients, also often seek an enormous fee. Second, if the insurance company reserves its rights to deny coverage, a second front of a dispute with the insurance company materializes. This raises two crucial bottom-line questions: Who pays the plaintiff's attorney fees when a loss affects your organization? And who pays the attorney fees related to contesting a dispute with your insurance company?

Below we answer each of these questions.

WHO PICKS UP THE PLAINTIFF'S TAB?

Courts around the country routinely recognize that the attorney fees awarded to plaintiffs in suits against defendant-policyholders are losses covered by liability insurance policies. Whether you seek coverage under a directors and officers liability insurance policy, a professional liability policy or a commercial general liability policy, there is a good chance that the plain language of your policy provides coverage for plaintiff's attorney fees that are awarded as part of a settlement or judgment.

It's no secret that plaintiff's attorney fees compose a hefty part of any settlement or judgment, whether in a derivative suit, securities class action or product liability class action. The average policyholder would consider a multimillion-dollar obligation to pay plaintiff's attorney fees to be a loss or damage arising from the lawsuit. Fortunately, to address the issue, most courts have adopted this commonsense approach and recognize that plaintiff's attorney fees are covered "loss," "damages" or "sums" that arise out of the claim or that the policyholder is "legally obligated to pay."

Your policy probably covers fees

Liability insurance policies generally cover plaintiff's attorney fees. The coverage for such fees is often shown by the policy's insuring agreement, in which the insurance company promises to pay "loss," "damages" or "sums" that arise out of a claim or that the insured legally becomes obligated to pay. The definition of those quoted terms further supports coverage. The absence of any language that expressly excludes coverage for plaintiff's attorney fees is further powerful evidence of the intent to provide coverage. The following cases are examples of instances when courts have interpreted the plain language of a liability policy to cover plaintiff's attorney fees.

In *APL Co. Pte. Ltd. v. Valley Forge Insurance Co.*, 754 F. Supp. 2d 1084, 1094 (N.D. Cal. 2010), *rev'd on other grounds*, 541 F. App'x 770 (9th Cir. 2013), the court found that the plaintiff's attorney fees were covered by the policy provision that the insurance company would "pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury,' 'property damage,' 'personal injury,' or 'advertising injury.'"

Courts around the country routinely recognize that the attorney fees awarded to plaintiffs in suits against defendant-policyholders are losses covered by liability insurance policies.

Though "damages" was undefined, the court, applying California law, found that the "ordinary definition" of damages encompassed plaintiff's attorney fees. *See also Ypsilanti v. Appalachian Ins. Co.*, 547 F. Supp. 823, 828 (E.D. Mich. 1982), *aff'd*, 725 F.2d 682 (6th Cir. 1983) ("The court finds that a reasonable person in the position of the insured would believe that the words 'all sums which the insured shall become legally obligated to pay as damages' would provide coverage for all forms of civil liability, including attorney fees."); *Sokolowski ex rel. M.M.&P. Pension Plan v. Aetna Life & Cas. Co.*, 670 F. Supp. 1199, 1210 (S.D.N.Y. 1987) ("it does not exceed a fair reading of the policy to construe attorneys fees as a form of damages covered by the policy").

Plaintiff's attorney fees are covered by policies in which "damages" are defined to include "compensatory, exemplary, statutorily mandated, and punitive damages; settlements; and claim expenses, awarded against, or agreed to as part of a settlement," and to exclude "fines, penalties, or taxes." *UnitedHealth Group Inc. v. Hiscox Dedicated Corporate Member Ltd.*, No. 09-CV-0210, 2010 WL 550991 (D. Minn. Feb. 9, 2010). The *Hiscox* court determined that that "[n]othing in the definition of 'damages' excludes a claim for attorney fees from being part of a judgment or settlement" and denied the insurance company's motion to dismiss the policyholder's claim for coverage of underlying plaintiff's attorney fees. *See also St. Paul Fire & Marine Ins. Co. v. Hebert Constr.*, 450 F. Supp. 2d 1214, 1235 (W.D. Wash. 2006) ("the plain, ordinary meaning of the 'costs taxed' clause in the St. Paul policies includes attorneys' fees").

Plaintiff's attorney fees are also a covered "loss," as in *XL Specialty Insurance Co. v. Loral Space & Communication,* 918 N.Y.S.2d 57, 61, 108 (N.Y. App. Div., 1st Dep't 2011), in which a New York appellate court held that the policyholder's obligation "to pay the amount of the fee award out of its own pocket . . . fits squarely within the definition of 'loss' as an 'other amount' Loral is 'legally obligated to pay.'"

The language of your insurance policy covers plaintiff's attorney fees, but you can expect that insurance companies will argue that it does not. Below we discuss three oft-raised challenges to coverage of plaintiff's attorney fees, and we provide examples of how courts have addressed those challenges.

Are plaintiff's attorney fees covered when there is no other covered claim?

A number of courts have found that plaintiff's attorney fees are covered even if no other parts of the policyholder's claim are covered. For instance, in *Hiscox*, the court, applying New York law, found that the demand for plaintiff's attorney fees in a settlement agreement was a covered claim even though the underlying lawsuit "was made up entirely of uncovered claims." Likewise, in *PNC Financial Services Group v. Houston Casualty Co.*, No. 13-331, 2014 WL 2862611 (W.D. Pa. June 24, 2014), the court found that although individual payments to class plaintiffs were excluded by the policy's fee exclusion, the policy's "broad definition of damages does not exclude coverage of the portions of the settlements allocated to such attorneys' fees and costs, simply because some of the damages resulting from the claim are excluded under the fee exception."

Not all courts have agreed with all policyholders, though, as illustrated by *Big 5 Corp. v. Gulf Underwriters Insurance Co.*, No. 02 Civ. 3320, 2003 WL 22127883 (C.D. Cal. Aug. 20, 2003), in which the court declined to grant coverage for plaintiff's attorney fees on the ground that none of the policyholder's other claims were covered by the policy.

The *Big 5* court suggested that the only reason attorney fees were not covered was because there were no other covered claims. It acknowledged that the definition of "damages" — "the total amount which [Big 5] become[s] legally obligated to pay" — would encompass plaintiff's attorney fees, but holding "as the Gulf policy does not cover the payments of unpaid overtime wages, the court is inclined to deny indemnification for attorney fees on a claim for unpaid overtime wages."

Are any terms ambiguous?

Some courts have found that the term "damages" is ambiguous with respect to whether plaintiff's attorney fees are included or excluded damages, and they have concluded that the ambiguity ought to be resolved in favor of coverage. *See, e.g., Ypsilanti,* 547 F. Supp. at 828;

Kirtland v. Western World Ins. Co., 540 N.E.2d 282, 285 (Ohio Ct. App. 1988) (finding the term "money damages" to be ambiguous and construing ambiguity in favor of the policyholder).

Since the majority of states have a similar rule regarding the construction of ambiguous terms, policyholders can argue that, at the very least, their policy's definition of "loss," "damages" or "sums" is ambiguous and that the ambiguity ought to be resolved in their favor. Indeed, as the *Ypsilanti* court put it, "[it] would have been simple enough to exclude attorney fee awards had the parties so intended." In the absence of such an exclusion, policyholders should argue that the relevant term encompasses plaintiff's attorney fees.

Is recovery of plaintiff's attorney fees against public policy?

Courts have rejected a variety of public policy-type challenges to recovery of plaintiff's attorney fees. For instance, the *Ypsilanti* court rejected the notion that whether or not liability insurance policies cover plaintiff's attorney fees was a matter of public policy, stating that "the issue is simply one of contract interpretation, as there is no law or public policy which would prevent the defendant from agreeing to be liable for awards of attorney fees assessed against its Insured."

Nor is strict adherence to the "American rule," which provides that each side pays its own attorney fees, enough of a policy justification to relieve an insurance company of its contractual obligation to cover plaintiff's attorney fees. Missouri's Court of Appeals dismissed such a challenge, in *Hyatt Corp. v. Occidental Fire & Casualty Co.*, 801 S.W.2d 382, 394 (Mo. Ct. App. 1990):

> Seeking to avoid the consequences of the inevitable holding that its policy does cover court-awarded attorneys' fees, [the insurance company] mounts a collateral attack on the award of attorneys' fees as violating the "American Rule." As the trial court held, this attack is without foundation.

Perhaps the most well-known public policy-based argument regarding coverage of plaintiff's attorney fees is found in *XL Specialty v. Loral*. In *Loral*, a New York's appellate court held that insurance coverage of plaintiff's attorney fees incurred in a derivative action was a covered "loss," even though the derivative action arguably was beneficial to the policyholder.

The insurance company argued that the derivative action resulted in a court-ordered restructuring of the policyholder company that "actually provided a benefit, albeit nonmonetary" to the policyholder. Because the policyholder supposedly benefited from the derivative action, the insurance company asserted, it did not suffer a loss, and the amount of plaintiff's attorney fees ought to be offset against the amount of nonmonetary benefits the policyholder received.

The Appellate Division disagreed and found that the fact that plaintiff's attorney fees were an amount that the policyholder was "legally obligated to pay" rendered the fee award a covered loss, regardless of any supposed "benefit" to the policyholder that the derivative action ultimately provided.

Now that the first question regarding plaintiff's attorney fees has been answered, we now move to the question of who pays the attorney fees in contesting a dispute with an insurance company.

WHO PAYS FOR THE INSURANCE RECOVERY FIGHT?

A majority of states may force the insurance company to pay your legal fees in order to force the company to honor the policy it sold. If informal efforts to resolve the dispute with your insurance company have been unsuccessful, litigation may be the next step. It is frustrating — indeed, infuriating — to be forced into court to obtain insurance coverage for which you've already paid. Indeed, insurance companies realize that it may be *profitable* for them to breach their duties under the insurance policy.[1]

By using this "opportunistic breach," the insurance company may deny coverage wrongfully and continue to collect and invest premiums during its well-financed coverage litigation. The only penalty it risks is paying the policyholder the same coverage it owed all along. As the Colorado Supreme Court stated:

The language of your insurance policy covers plaintiff's attorney fees, but you can expect that insurance companies will argue that it does not.

> Contract damages "offer no motivation whatsoever for the insurer not to breach. If the only damages an insurer will have to pay upon a judgment of breach are the amounts that it would have owed under the policy plus interest, it has every interest in retaining the money, earning the higher rates of interest on the outside market, and hoping eventually to force the insured into a settlement for less than the policy amount."

Cary v. United of Omaha Life Ins. Co., 68 P.3d 462, 468 (Colo. 2003) (quoting *Dodge v. Fid. & Deposit Co. of Md.*, 778 P.2d 1240, 1242-43 (Ariz. 1989)).

That is why policyholders and insurance companies alike should be aware that a majority of states may permit the recovery of attorney fees by a prevailing policyholder in a coverage dispute. Such a rule increases the risk associated with an adverse outcome for the insurance company and should be used by policyholders to help, at least in part, to level the playing field.

There is an understanding that *insurance is different*.[2] Courts have frequently noted that the "disparity of bargaining power between an insurance company and its policyholder makes the insurance contract substantially different from other commercial contracts." *See Olympic S.S. Co. v. Centennial Ins. Co.*, 811 P.2d 673, 681 (Wash. 1991). Moreover, when buying insurance, policyholders intend to purchase peace of mind, not litigation, with their insurance company when a claim is made.

Some courts have found that the term "damages" is ambiguous with respect to whether plaintiff's attorney fees are included or excluded damages, and they have concluded that the ambiguity ought to be resolved in favor of coverage.

Policyholders may also be permitted to recover fees for in-house counsel as costs of pursuing insurance coverage. The cost of using the policyholder's in-house legal staff should be recoverable just as outside counsel fees may be recovered in a successful insurance coverage case. Some courts considering this issue have permitted policyholders to recover corporate-counsel costs incurred both in the underlying action and the insurance coverage action.

Even after the insurance company has sought to avoid its duty to defend under the policy, it nevertheless may contest the amount of fees the policyholder expended in its own defense. After the insurance company is found to have wrongfully denied its duty to defend, any attorney fees the policyholder has paid, without knowing whether or not they will be reimbursed, should be held reasonable as a matter of law.

This section discusses the approaches of a number of states in awarding policyholders their attorney fees in coverage disputes, as supported by statutes, common law and commentators.[3] The second part of this section discusses the potential for recovery of in-house counsel costs. The third part discusses the reasonableness of the policyholder's defense fees when the insurance company has breached its duty to defend and then seeks to avoid reimbursement.

Finally, a state-by-state survey of authority that may be helpful to policyholders who are seeking a recovery of attorney fees for an insurance coverage action is included at the end of this commentary.[4]

Recovery of policyholder's attorney fees

There are a number of rationales for an award of attorney fees to policyholders in insurance coverage disputes. These rationales generally are founded upon:

- The nature of the insurance promise (for example, the nature of an insurance company's duty to defend its policyholder).
- The theory of consequential damages.
- Rhe language of particular insurance policy provisions.
- Public policy considerations.
- Specific statutory provisions.

Included is an insurance company's argument that policyholders should be permitted to recover attorney fees in a successful insurance coverage action.

Rationales supporting the award of fees

An insurance company's improper refusal to defend the policyholder should entitle the policyholder to recover attorney fees and costs.[5] This is particularly true in the context of third-party liability insurance.

In a case in which the policyholder establishes the insurance company's duty to defend in a subsequent declaratory judgment action, the insurance company should bear the consequences of its wrongful action and reimburse the policyholder for its attorney fees and costs in the declaratory judgment action. For example, the court in *Legacy Partners v. Travelers Insurance Co.*, No. C 00 3413 SI, 2002 WL 500771 (N.D. Cal. Mar. 29, 2002), *aff'd*, 79 F. App'x 295 (9th Cir. 2003), found that, under Texas law, "an insurer who has breached the duty to defend is liable for damages including the attorneys' fees incurred in pursuing an insurance coverage action." *See also Montgomery Ward & Co. v. Pac. Indem Co.,* 557 F.2d 51 (3d Cir. 1977) (upheld award of attorney fees because of public policy considerations under Pennsylvania law).

In the liability insurance context, a breach of the duty to defend is one event supporting an award of policyholder's attorney fees. The nature of the insurance promise as "peace of mind" and "liability insurance" is such that the award of attorney fees to a policyholder in a coverage action protects the value of the "duty to defend" provision.

Courts have described an insurance company's duty to provide a timely defense as "litigation insurance." In *City of Johnstown v. Bankers Standard Insurance Co.,* 877 F.2d 1146, 1148 (2d Cir. 1989) (applying New York law), it is stated, "The insurer's duty to defend works, in essence, as a form of 'litigation insurance' for the insured." *See also Rubenstein v. Royal Ins. Co. of Am.*, 708 N.E.2d 639, 642 (Mass. 1999) (internal citations omitted) ("[T]he promise to defend the insured, as well as the promise to indemnify, is the consideration received by the insured for payment of the policy premiums. Although the type of policy here considered is most often referred to as liability insurance, it is 'litigation insurance' as well, protecting the insured from the expense of defending suits brought against him."). Litigation insurance that functions only after the underlying litigation is a sham.

In *Montrose Chemical Corp. v. American Motorists Insurance Co.,* 16 Cal. Rptr. 2d 516, 531 (Cal. Ct. App., 2d Dist. 1993) (emphasis added), *superseded by*, 849 P.2d 1329 (Cal. 1993), which upholds an order requiring immediate payment of the policyholder's defense costs in the underlying action and reimbursement for past defense costs with interest, the court affirms that the insurance company must undertake the duty-to-defend obligation *promptly*:

> By requiring the prompt resolution of a carrier's duty to defend prior to the resolution of the underlying liability actions, *the courts protect the insured's right to peace of mind and security*, a right which "would ring resoundingly hollow were the holder compelled to simultaneously enforce rights under the policy and defend a costly and potentially devastating claim."

An insurance company is required to assume defense costs in a timely manner so that "policyholders thus are assured that they need not expend their own funds in order to receive protection for liability." *See Okada v. MGIC Indem. Corp.,* 823 F.2d 276, 280 (9th Cir. 1986) (applying Hawaii law); *Lamar Homes Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 19 (Tex. 2007) (stating that the prompt payment statute in Texas specifies that insurance companies have 15 days after receiving notice to acknowledge the claim, commence investigation and request all necessary materials from the claimant).

Courts have emphasized the unique importance of the time element of the duty to defend awards. They have rejected the assertion that a later damage award sufficiently compensates a breach. In *Avondale Industries v. Travelers Indemnity Co.,* 123 F.R.D. 80, 83 (S.D.N.Y. 1988), *aff'd*, 887 F.2d 1200 (2d Cir. 1989), the trial court granted the policyholder's motion for entry of final judgment, rejecting the insurance company's argument that the policyholder possessed the financial resources to permit the policyholder to continue to wait for coverage:

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> [T]his court does not see any reason why Avondale [the policyholder] should have to wait until some indefinite future date to receive the defense to which it is entitled. ... To suggest that the passage of time matters not to the plaintiffs in such circumstances, and that enforcement of the duty to defend can await another day, denigrates the professional obligation here found to have been undertaken.

See also McGinniss v. Employers Reinsurance Corp., 648 F. Supp. 1263, 1271 (S.D.N.Y. 1986) ("Without contemporaneous payment of defense costs, the insurance 'would not truly protect the insureds from financial harm caused by suits against them.'").

For the defense obligation to be effective, costs must be paid "as they were and are incurred," per *Village Management Inc. v. Hartford Accident & Indemnity Co.,* 662 F. Supp. 1366, 1374 (N.D. Ill. 1987). When ordering immediate payment of defense costs, the court in *Village Management* rejected the suggestion that an insurance company could delay payment until the conclusion of coverage disputes, commenting, "[T]hat notion is hard to reconcile with the concept that the duty to defend is not at all coextensive with policy coverage."

Some courts have adopted the rationale that the insurance company implicitly has authorized, by failing to defend, the expenditure of attorney fees by the insured. In *Occidental Fire & Casualty Co. v. Cook*, 435 P.2d 364, 368 (Idaho 1967), the court ruled that the award of "reasonable expenses" as promised in the policy includes attorney fees expended in a declaratory judgment action because the effect on the policyholder is as burdensome as any other type of legal action. *See also Cohen v. American Home Assurance Co.,* 258 A.2d 225, 239 (Md. 1969) (attorney fees may be awarded under either the implied authorization or consequential-damage theory).

A number of courts have awarded attorney fees in cases in which the carrier has engaged in bad faith, fraud, stubborn litigiousness or vexatious conduct.

Rationales for awarding attorney fees to policyholders from insurance companies sometimes have a broad reach beyond the context of third-party liability insurance policies. Some courts, quite properly, have awarded attorney fees as consequential damages for breach of contract in the declaratory judgment action.

A number of cases provide support for this action. In *Hayseeds Inc. v. State Farm Fire & Casualty,* 352 S.E.2d 73, 80 (W. Va. 1986), the court stated that "we hold today that when a policyholder substantially prevails in a property damage suit against an insurer, the policyholder is entitled to damages for net economic loss caused by the delay in settlement, as well as an award for aggravation and inconvenience."

The 5th Circuit in *Federated Mutual Insurance Co. v. Grapevine Excavation Inc.,* 241 F.3d 396, 398 (5th Cir. 2001), stated, "in a policyholder's successful suit for breach of contract against an insurer that is subject to the provisions listed in Section 38.006, the insurer is liable for reasonable attorney fees incurred in pursuing the breach-of-contract action under Section 38.001 unless the insurer is liable for attorney's fees under another statutory scheme."

In addition, even New York courts, which previously have allowed recovery of attorney fees only when the policyholder is on the defensive, have recognized that the fees may be recoverable as consequential damages when the policyholder brings a breach of contract action against the insurance company. *See Chernish v. Mass. Mut. Life Ins. Co.*, No. 08 Civ. 0957, 2009 WL 385418 (N.D.N.Y. Feb. 10, 2009) (stating "consequential damages ... may be asserted in an insurance contract context, so long as the damages were 'within the contemplation of the parties as a probable result of a breach at the time of or prior to contracting'") (*citing Panasia Estates Inc. v. Hudson Ins. Co.*, 886 N.E.2d 135 (N.Y. 2008); *Bi-Economy Mkt. v. Harleysville Ins. Co. of N.Y.*, 886 N.E.2d 127 (N.Y. 2008)).

Other courts have found that attorney fees constitute an element of the policyholder's damages for the insurance company's bad-faith refusal to pay a claim. For example, in *Taylor v. State Farm Fire & Casualty Co*., 981 P.2d 1253, 1258 (Okla. 1999) (emphasis in original), the Supreme Court of Oklahoma held that:

> [W]hen an action is pressed for *bad-faith refusal to settle* — first recognized as a distinct tort in *Christian v. American Assur. Co*. — the plaintiff may seek damages (a) for the

> *loss payable under the policy* together with (b) those *other items of recovery* that are consistent with harm flowing from insurer's bad-faith breach of its implied-in-law duty to settle.

Courts in a number of jurisdictions can look to statutory law in order to justify an award of attorney fees. The legislatures in a majority of states have passed laws that provide for attorney fees. Some statutes are drafted broadly, such as in New Hampshire, where N.H. Rev. Stat. Ann. § 491:22-b (2014), states:

> In any action to determine coverage of an insurance policy pursuant to [Section] 491:22, if the insured prevails in such action, he shall receive court costs and reasonable attorneys' fees from the insurer.

Other statutes are drafted differently, such as Virginia's Va. Code Ann. § 38.2-209 (2014), which permits recovery in cases in which an insurance company, not acting in good faith, failed to make payment to the policyholder. Likewise, in Louisiana, under La. Rev. Stat. Ann. § 22:1220 (2014), a policyholder will be entitled to attorney fees if his or her insurance company has acted in bad faith, for example, by "[m]isrepresenting pertinent facts or insurance policy provisions relating to any coverages at issue."

Some states permit policyholders to obtain attorney fees under general statutes, In Arizona, Ariz. Rev. Stat. Ann. § 12-341.01 (2014), which potentially provides for attorney fees in all contract actions. Even states that typically do not permit attorney fees allow policyholders to recover attorney fees in specific circumstances. For example, Delaware law, at Del. Code Ann. tit. 18, § 4102 (2014), provides for reasonable attorney fees for "property insurance" coverage actions. *Galiotti v. Travelers Indem. Co.*, 333 A.2d 176, 178 (Del. Super. Ct. 1975) (awarding fees under Section 4102 because the policyholder was seeking coverage under the "property insurance" component of the policy, *i.e.*, damage to the vehicle).

An increasing number of jurisdictions are allowing recovery of attorney fees in insurance coverage actions.

Finally, some courts have held that if a statute is drafted narrowly, a policyholder will not be denied attorney fees because of a rigid interpretation of the language of the said statute. For example, Oklahoma law, at Okla. Stat. Ann. tit. 36, §3629(B) (2013), provides, in relevant part: "It shall be the duty of the insurer, receiving a proof of loss, to submit a written offer of settlement or rejection of the claim to the insured party within ninety (90) days of receipt of that proof of loss. Upon a judgment rendered to either party, costs and attorney fees shall be allowable to the prevailing party."

Thus, in *Stauth v. National Union Fire Insurance Co.,* 236 F.3d 1260, 1263 (10th Cir. 2001), one insurance company tried to argue that its policyholder, who had prevailed in a coverage action, was not entitled to attorney fees because he had not submitted a formal proof of loss. The court held, however, that the terms of the policy at issue required only that the policyholder provide written notice of loss, and not a conventional proof-of-loss statement. Thus, the policyholder satisfied the "proof of loss" requirement when he notified his insurance company of his loss.

A number of courts have awarded attorney fees in cases in which the carrier has engaged in bad faith, fraud, stubborn litigiousness or vexatious conduct. *See, e.g., Mobil Oil Corp. v. Maryland Casualty Co.*, 681 N.E.2d 552 (Ill. App. Ct. 1997) (attorney fees authorized upon showing of vexatious and unreasonable conduct by the insurance company in refusing the claim); *see also Brandt v. Superior Court*, 693 P.2d 796, 797 (Cal. 1985) (attorney fees recoverable if the insurance company tortiously withholds benefits).

This approach, however, has been particularly criticized in the context of liability insurance policies. In *Hayseeds*, 352 S.E.2d at 79-80, the court stated:

> [W]e consider it of little importance whether an insurer contests an insured's claim in good or bad faith. In either case, the insured is out his consequential damages and attorney fees. To impose upon the insured the cost of compelling his insurer to honor its contractual obligation is effectively to deny him the benefit of his bargain.

Likewise, John A. Appleman in "Insurance Law & Practice" has criticized the approach of courts that refuse to award attorney fees in declaratory judgment actions absent bad conduct on the part of the insurance company as being fundamentally unfair to the policyholder:

> After all, the insurer had contracted to defend the insured, and it failed to do so. It guessed wrong as to its duty, and should be compelled to bear the consequences thereof. If the rule laid down by these courts should be followed by other authorities, it would actually amount to permitting the insurer to do by indirection that which it could not do directly. That is, the insured has a contract right to have actions against him defended by the insurer, at its expense. If the insurer can force him into a declaratory judgment proceeding and, even though it loses in such action, compel him to bear the expense of such litigation, the insured is actually no better off financially than if he had never had the contract right mentioned above. Other courts have refused to impose such a burden upon the insured.[6]

An increasing number of jurisdictions are allowing recovery of attorney fees in insurance coverage actions. Policyholders and their counsel should always consider the possibility of recovering attorney fees. Furthermore, the bedrock reasons underlying many of these decisions support an argument for the expansion of attorney fees in jurisdictions that inappropriately prohibit or limit attorney fees in insurance coverage actions.

Under Ohio law, a policyholder may recover the costs it has incurred in a successful declaratory judgment action to force an insurance company to honor its policy obligations.

SELECTED REVIEW OF RECOVERY OF POLICYHOLDER'S ATTORNEY FEES

Set forth below is a review of the laws of Maryland, Kansas, New Jersey, New York, Ohio and Washington. Also below is an insurance company's own argument that supports an award of policyholder's attorney fees.

Maryland permits recovery of fees

Maryland courts have stated, unwaveringly, that "[t]he rule in this state is firmly established that when an insured must resort to litigation to enforce its liability insurer's contractual duty to provide coverage for its potential liability to injured third persons, the insured is entitled to a recovery of the attorneys' fees and expenses incurred in that litigation." *Nolt v. U.S. Fid. & Guar. Co.*, 617 A.2d 578, 584 (Md. 1993) (reversing the lower court's decision and remanding, in part, to determine the policyholder's attorney fees in connection with a coverage dispute).

Indeed, under Maryland law, policyholders are entitled to recover attorney fees incurred in seeking coverage from an insurance company that has wrongfully breached its duty to defend under a third-party liability policy. In *Cohen*, 258 A.2d 225, the Maryland Court of Appeals awarded attorney fees to the prevailing policyholder, stating:

> American Home produced the current situation when it refused to defend its assured. Accordingly, whether one speaks in terms of its having authorized the expenditure by its failure to defend or whether one speaks in terms of the attorney's fees for the declaratory judgment action being a part of the damages sustained by the insured by American Home's wrongful breach of the contract, we hold American Home bound to pay the fees incurred by Mrs. Brown in bringing the declaratory judgment action to establish that American Home had not done that which it had agreed with her to do.

Similarly, in *Bankers and Shippers Insurance Co. of New York v. Electro Enterprises*, 415 A.2d 278, 282 (Md. 1980), the court again awarded the policyholder its attorney fees in its coverage dispute with the insurance company, stating:

> [A]n insurer is liable for the damages, including attorneys' fees incurred by an insured as a result of the insurer's breach of its contractual obligation to defend the insured against a claim potentially within the policy's coverage, and this is so whether the attorneys' fees are incurred in defending against the underlying damage claim or in a declaratory judgment action to determine coverage and a duty to defend.

Moreover, the *Bankers and Shippers* court continued:

> Furthermore, the right of an insured to recover attorneys' fees in such a situation applies not only to the named insured of the policy but also to any person who is within the policy definition of an insured and against whom a claim alleging a loss within the policy coverage has been filed.

Bankers and Shippers, 415 A.2d at 283; *see also Litz v. State Farm Fire & Cas. Co.*, 695 A.2d 566, 573 (Md. 1997) (finding an insurance company liable for a policyholder's attorney fees incurred "as a result of the insurer's breach of its contractual obligation to defend the insured against a claim potentially within the policy's coverage").

Kansas permits recovery of fees

Under Kansas law, a policyholder is entitled to its reasonable attorney fees when it is forced to sue an insurance company for refusing "without just cause or excuse" to defend or indemnify the policyholder. Specifically, Kan. Stat. Ann. § 40-256 (2013) provides:

> That in all actions hereafter commenced, in which judgment is rendered against any insurance company as defined in K.S.A. 40-201, ... on any policy or certificate of any type or kind of insurance, if it appears from the evidence that such company, ... has refused without just cause or excuse to pay the full amount of such loss, the court in rendering such judgment shall allow the plaintiff a reasonable sum as an attorney fee for services in such action, including proceedings upon appeal, to be recovered and collected as a part of the costs.

The Kansas Supreme Court has held that the determination of whether the insurance company's actions were "without just cause or excuse" depends on the facts and the circumstances of each case.

In *Wheeler v. Employer's Mutual Casualty Co.*, 505 P.2d 768, 773 (Kan. 1973), the Kansas Supreme Court rejected the insurance company's argument that it properly denied coverage under an automobile policy on grounds that the named insured was not occupying an automobile at the time of the accident. The court held that, even though the interpretation of the policy provision in question presented an issue of first impression, this did not justify the insurance company's denial of the claim. In a case in which the great weight of authority is contrary to the insurance company's position, the Supreme Court held that an award of attorney fees is proper. *See also Spruill Motors v. Universal Underwriters Ins. Co.*, 512 P.2d 403, 409 (Kan. 1973).

Kansas courts consistently have held that an insurance company's failure to investigate a claim thoroughly before denying coverage is grounds for awarding attorney fees under Section 40-256. *See Evans v. Provident Life & Accident Ins. Co.*, 815 P.2d 550 (Kan. 1991); *State Farm Fire & Cas. Co. v. Liggett*, 689 P.2d 1187 (Kan. 1984); *Smith v. Blackwell*, 791 P.2d 1343, 1349 (Kan. Ct. App. 1989); *Weathers v. Am. Family Mut. Ins. Co.*, 777 F. Supp. 879 (D. Kan. 1991).

In *Lord v. State Automobile & Casualty Underwriters*, 491 P.2d 917 (Kan. 1971), the Kansas Supreme Court upheld an award of attorney fees based on the insurance company's failure to investigate a claim brought by a policyholder to recover the value of his truck. In affirming an award of attorney fees under Section 40-256, the court held that the insurance company acted "without just cause or excuse" in refusing the claim because the insurance company did not conduct a thorough investigation of the policyholder's claim:

> [W]e recognize that the company has a duty to make a good faith investigation of the facts before finally refusing to pay. ... [T]he insurance company put the entire burden on its insured, taking the somewhat lofty position that investigation, evaluation, and determination of the claim was not its responsibility. That the ... claim might be based on erroneous facts, or be a "nuisance" claim, or be wholly frivolous was none of its concern; it would not deign even to inquire. In short, it did not know and did not care whether its "cause or excuse" for refusing to pay was "just."

Moreover, the Kansas Supreme Court has held that Section 40-256 entitles a prevailing policyholder, who already has recovered attorney fees from the coverage dispute, to also seek

subsequent attorney fees incurred defending the reasonableness of the coverage dispute fees. *Moore v. St. Paul Fire Mercury Ins. Co.*, 3 P.3d 81, 86 (Kan. 2000). In awarding the fees, the court reasoned:

> The primary purpose of the Kansas fee-shifting statute is to benefit the insured. Fees incurred litigating the amount of attorney's fees to be awarded are recoverable under K.S.A. 40-256. The fact that the award of such fee ultimately results in the insured's attorney being paid to litigate the fee is collateral and incidental to the primary purpose of indemnifying an insured for the cost of counsel in an action against the insurer.

New Jersey permits recovery of fees

The New Jersey Rules of Court explicitly provide for the recovery by the policyholder of the attorney fees and costs incurred in successfully enforcing its rights under an insurance policy. New Jersey Rule 4:42-9 provides:

> (a) Actions in Which Fee Is Allowable. No fee for legal services shall be allowed in the taxed costs or otherwise, except:
>
> * * *
>
> (6) In an action upon a liability or indemnity policy of insurance, in favor of a successful claimant.

A successful policyholder may recover its attorney fees under New Jersey Rule of Court 1969 R. 4:42-9(a)(6) (2014), even if the insurance company's refusal to honor its obligations under its policy was made in good faith. *See Universal-Rundle Corp. v. Commercial Union Ins. Co.,* 725 A.2d 76 (N.J. Super. Ct. App. Div. 1999); *Corcoran v. Hartford Fire Ins. Co.,* 333 A.2d 293, 299 (N.J. Super. Ct. App. Div. 1975); *N.J. Mfrs. Ins. Co. v. Consol. Mut. Ins. Co.*, 308 A.2d 76 (N.J. Super. Ct. Law Div. 1973).

New York permits recovery of fees

In *Mighty Midgets Inc. v. Centennial Insurance Co.,* 389 N.E.2d 1080, 1085 (N.Y. 1979), New York's highest court held that in an insurance coverage action, a policyholder is entitled to recover its litigation expenses "when [the policyholder] has been cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy."

New York courts have not hesitated to award attorney fees and costs to policyholders for having successfully defended actions brought about because their insurance companies have sought to walk away from insurance policies. In *GRE Insurance Group v. GMA Accessories, Inc.*, 691 N.Y.S.2d 244, 248 (N.Y. Sup. Ct., N.Y. County 1998), the court held that "[s]ince plaintiff brought this declaratory judgment action seeking to free itself from its policy obligations, defendant is therefore also entitled to recover its reasonable costs and attorney fees incurred in successfully defending this action thus far." *See also Mount Vernon Fire Ins. Co. v. Unjar*, 575 N.Y.S.2d 694 (N.Y. App. Div., 2d Dep't 1991); *U.S. Liab. Ins. Co. v. Staten Island Hosp.*, 556 N.Y.S.2d 153 (N.Y. App. Div., 2d Dep't 1990); *State Farm Fire & Cas. Co. v. Irene S.*, 526 N.Y.S.2d 171 (N.Y. App. Div., 2d Dep't 1988); *Gen. Accident Ins. Co. of Am. v. Hyatt Legal Servs.,* 516 N.Y.S.2d 560 (N.Y. App. Div., 4th Dep't 1987).

Furthermore, recovery of attorney fees by a policyholder that has been sued by its insurance company does not depend on a breach of a duty to defend. In *U.S. Underwriters Insurance Co. v. City Club Hotel*, 822 N.E.2d 777 (N.Y. 2004), the insurance company disclaimed coverage under an employee exclusion in the policy and brought a declaratory judgment action, but nevertheless defended the policyholder in the underlying action. The policyholder prevailed in the coverage action and sought its attorney fees even though the insurance company had not breached the policy.

The New York Court of Appeals, on certification from the 2nd Circuit, reaffirmed the *Mighty Midgets* rule and held that:

> an insured who prevails in an action brought by an insurance company seeking a declaratory judgment that it has no duty to defend or indemnify the insured may recover attorneys' fees regardless of whether the insurer provided a defense to the insured.

City Club Hotel, 822 N.E.2d at 780 *see also Pub. Serv. Mut. Ins. Co. v. Jefferson Towers Inc.*, 586 N.Y.S.2d 799 (N.Y. App. Div., 1st Dep't 1992) (awarding attorney fees in a coverage action in which the insurance company provided a complete defense in the underlying action); *Allegany Co-Op Ins. Co. v. Williams*, 628 N.Y.S.2d 900 (N.Y. App. Div., 4th Dep't 1995) (affirming the trial court's award of attorney fees for a coverage action after the insurance company originally undertook defense and then filed a motion to withdraw).

Indeed, New York courts have been resolute in awarding attorney fees in coverage actions because "an insurer's duty to defend an insured extends to the defense of any action arising out of the occurrence, including a defense against an insurer's declaratory judgment action." *City Club Hotel*, 822 N.E.2d at 780.

Ohio permits recovery of fees

Under Ohio law, a policyholder may recover the costs it has incurred in a successful declaratory judgment action to force an insurance company to honor its policy obligations. In declaratory judgment actions involving insurance coverage, the Ohio Supreme Court has carved out an exception to the general rule that costs and attorney fees are usually not recoverable in breach-of-contract actions. The reason for this, according to *Motorists Mutual Insurance Co. v. Trainor,* 294 N.E.2d 874, 878 (Ohio 1973), is that the policyholder "must be put in a position as good as that which he would have occupied if the insurer had performed its duty." *See also Westfield Cos. v. O.K.L. Can Line*, 804 N.E.2d 45, 56 (Ohio Ct. App. 2003) (awarding fees in a case in which the insurance company acted obdurately "with a stubborn propensity for needless litigation").

Washington permits recovery of fees

In Washington, it is well established that courts may award attorney fees to a prevailing policy holder. According to *Olympic Steamship,* 811 P.2d at 681 (citations omitted):

> We also extend the right of an insured to recoup attorney's fees that it incurs because an insurer refuses to defend or pay the justified action or claim of the insured, regardless of whether a lawsuit is filed against the insured. Other courts have recognized that disparity of bargaining power between an insurance company and its policyholder makes the insurance contract substantially different from other commercial contracts. When an insured purchases a contract of insurance, it seeks protection from expenses arising from litigation, not "vexatious, time-consuming, expensive litigation with his insurer." Whether the insured must defend a suit filed by third parties, appear in a declaratory action or, as in this case, file a suit for damages to obtain the benefit of its insurance contract is irrelevant. In every case, the conduct of the insurer imposes upon the insured the cost of compelling the insurer to honor its commitment and, thus, is equally burdensome to the insured. Further, allowing an award of attorney fees will encourage the prompt payment of claims.

In *Olympic Steamship,* the purpose of awarding attorney fees to a prevailing policyholder was to make the policyholder whole. The court upheld that principle in *McGreevy v. Oregon Mutual Insurance Co.,* 904 P.2d 731, 738 (Wash. 1995):

> [W]hen an insurer unsuccessfully contests coverage, it has placed its interests above the insured. Our decision in Olympic Steamship remedies this inequity by requiring that the insured be made whole.

The rationale underlying the decision in *Olympic Steamship,* as stated in *McGreevy*, is the enhanced fiduciary obligation that an insurance company owes its policyholder not to engage in any action or conduct "which would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk." *See also Am. Nat'l Fire Ins. Co. v. B&L Trucking & Constr. Co.*, 951 P.2d 250 (Wash. 1998).

Insurer argues for awarding fees

At least one insurance company, Liberty Mutual, argued in support of the policyholder view in a brief filed March 1, 1985, in *Liberty Mutual Insurance Co. v. Continental Casualty Co.*, 771 F.2d 579 (1st Cir. 1985), stating:

> On the crucial issue of providing a defense, both Superior Court and Supreme Court concluded that Continental was obligated to defend [policyholder H.H.] Robertson [Co.]. To the detriment of Robertson, Continental, which had drafted the insurance contract, refused to recognize its duty to defend. As a result of Continental's mistake, Robertson was left in a position where it incurred substantial attorneys' fees for asserting what it was entitled to all along, a defense. Where the sum and substance of an insurance policy is to provide for leaving the insured free of financial losses in those instances where coverage does exist, the attorneys' fees incurred in litigating an action to establish coverage are a proper element of damages where the insurer is the party who has breached the contract.
>
> A number of jurisdictions, which, like Massachusetts, follow the general rule that attorney fees are not recoverable by prevailing party, provide for an exception where fees are incurred by a successful insured in a declaratory judgment action where coverage was denied by the insurer. *Hegler v. Gulf Ins. Co.*, 243 S.E.2d 443 (S.C. 1978); *Brown v. U.S. Fid. & Guar.*, 361 N.Y.S.2d 232 (N.Y. App. Div., 3d Dep't 1974); *Landie v. Century Indem. Co.*, 390 S.W.2d 558 (Mo. Ct. App. 1965); *see Utils. Constr. Corp. v. Peerless Ins. Co.*, 233 F. Supp. 64 (D. Vt. 1964); *Motorists Mut. Ins. Co. v. Trainor*, 294 N.E.2d 874 (Ohio 1973) (the rationale being, to put the insured in as good a position as that which he would have occupied had the insurer performed its duty); accord *Allstate Insurer v. Robins*, 597 P.2d 1052 (Colo. Ct. App. 1979). Attorney's fees, such as those incurred by Robertson in the course of litigating the Continental declaratory judgment action, have also been ruled recoverable as a loss resulting directly from the breach of the insurer's promise to defend. *Morrison v. Swenson*, 142 N.W.2d 640 (Minn. 1966), *Cohen v. Am. Home Assur. Co.*, 258 A.2d 225 (Md. 1969). There is nothing extraordinary about permitting recovery of the attorney fees incurred by Robertson.

Insurance companies are fully aware that the majority of courts across the nation are awarding attorney fees in connection with an insurance coverage action, and insurance companies will argue for fees if it suits their interests. Policyholders should not allow insurance companies to argue against fees if those same insurance companies wrongfully refuse to pay the policyholder's claim.

Recovery of corporate-counsel fees

The cost of using the policyholder's in-house legal staff should be recoverable at least to the same extent that the costs of outside counsel may be recovered in a successful insurance coverage case.[7] A number of courts considering the issue have permitted policyholders to recover corporate-counsel fees incurred in the underlying action. In *Stichman v. Michigan Mutual Liability Co.,* 220 F. Supp. 848, 854 (S.D.N.Y. 1963), which held that the insurance company was liable for expenses reasonably incurred by the policyholder, including time devoted to defense of the underlying action by three attorneys in the policyholder's employ.

Some courts have extended recovery of corporate-counsel fees to the insurance coverage action itself. In *Dale Electronics Inc. v. Federal Insurance Co.,* 286 N.W.2d 437, 443 (Neb. 1979), the court held that the statute providing for attorney fees in coverage actions "entitled [the policyholder] to the allowance of an attorney's fee even for in-house counsel."

A landmark case awarding corporate-counsel fees to a policyholder is *Pittsburgh Plate Glass Co. v. Fidelity & Casualty Co.*, 281 F.2d 538 (3d Cir. 1960) (applying Pennsylvania law). In *Pittsburgh Plate*, the policyholder, a paint manufacturer, was sued by one of its customers, a company that made venetian blinds. Evidently, the paint used and purchased from the policyholder flaked off of the venetian blinds onto the hands of customers. The manufacturer of the venetian

blinds sought to recover the expense of repairing the blinds and other damage caused by the policyholder's product. The policyholder settled the action against it after its insurance company refused to defend it against the manufacturer of the venetian blinds or indemnify it for the cost of funding the settlement.

In *Pittsburgh Plate*, the policyholder used two of its corporate lawyers to defend an underlying action against it after its insurance company refused to honor its defense obligation under certain insurance policies. In the ensuing insurance coverage case, the 3rd U.S. Circuit Court of Appeals held that the insurance company wrongfully refused to defend its policyholder in the underlying action and awarded attorney fees to the policyholder. The insurance company did not question the award of outside counsel fees, but it did argue that it should not be responsible for the policyholder's corporate-counsel fees. In awarding the policyholder's corporate-counsel costs, the court ruled that "[t]here is no reason in law or in equity why the insurer should benefit from [the policyholder's] choice to proceed with some of the work through its own legal department."

Several courts have adopted the reasoning and the doctrine of *Pittsburgh Plate* in rendering their decisions. For example, in *United States v. State Farm Mutual Automobile Insurance Co.*, 245 F. Supp. 58 (D. Or. 1965), the U.S. District Court for the District of Oregon followed the court in *Pittsburgh Plate* and awarded the policyholder, the United States, attorney fees for work performed by government attorneys. The court found that the United States was an "insured" under one of its employee's insurance policies and ruled that government attorneys are analogous to corporate counsel.

The United States was able to recover the value of legal costs associated with the defense of two underlying actions and the costs of its insurance coverage suit. The court further held that corporate-counsel fees are recoverable to the same extent that outside counsel fees are recoverable. *See also Goldblatt Brothers v. Home Indem. Co.*, No. 82 C 5021, 1985 WL 2114 (N.D. Ill. July 25, 1985) (awarding to the policyholder attorney fees of in-house counsel); *Bailey v. United States*, 260 F. Supp. 48, 54 (E.D. Va. 1966) (allowing attorney fees to the government-insured policyholder even though the policyholder did not incur out-of-pocket expenses).

In *United States v. Myers,* 363 F.2d 615, 621 (5th Cir. 1966), the 5th Circuit cited the Oregon federal court's decision in *State Farm* as support for awarding corporate-counsel fees. The court awarded the policyholder, again the United States, attorney fees for the use of government lawyers in the underlying action that the insurance company refused to defend. The 5th Circuit disagreed with the insurance company's argument that the use of salaried lawyers by the United States precludes recovery for their fees. The court held that "where an insured must conduct its own defense due to an unwarranted refusal to defend by the insurer, the insured is entitled to recover the expenses of litigation, including attorney's fees."

In *Travelers Insurance Co. v. State Insurance Fund*, 588 N.Y.S.2d 973 (N.Y. Ct. Cl. 1992), a case in which corporate-counsel fees were awarded, Travelers Insurance Co. argued in favor of an award of in-house attorney fees. Travelers sued another insurance company for contribution for costs incurred by reason of defending the policyholder in an underlying litigation and funding its settlement. Although insurance companies typically argue against a recovery of corporate-counsel fees, Travelers was in the interesting position of advocating for an award of these fees to the policyholder-subrogated insurance company. The New York Court of Claims held that "where an insurer wrongfully refuses to defend, the insured may recover its defense costs, including those attributable to in-house counsel." The court noted that all the cases that have addressed this issue have concluded that the policyholder, if victorious in its coverage case, is entitled to the costs of using its corporate counsel.

Reasonableness of attorney fees

Even when the insurance company forces its policyholder into coverage litigation by denying its duty to defend the underlying litigation, it may nevertheless attempt to appoint its policyholder's defense counsel. However, although it is in the policyholder's best interest to vigorously and efficiently defend the underlying action, the insurance company's interest may be to expend as little time and money as possible and instead vigorously pursue the coverage action.

It is well settled that in a case in which a conflict of interest is probable, the policyholder is entitled to choose its own independent defense counsel for the underlying action. *Pub. Serv. Mut. Ins. Co. v. Goldfarb*, 425 N.E.2d 810 (N.Y. 1981). Courts of New York and other states have consistently held that:

> the law is clear that where a conflict of interest is probable [between the insurance company and insured], selection of attorneys to represent the insured should be made by the insured rather than by the insurance company, which should remain liable for reasonable fees.

See 69th St. and 2nd Ave. Garage Assocs. v. Ticor Title Guar. Co., 622 N.Y.S.2d 13, 14 (N.Y. App. Div., 1st Dep't 1995); *Union Ins. Co. v. Knife Co.,* 902 F. Supp. 877, 881 (W.D. Ark. 1995) ("the conflict situation cannot be eliminated so long as the insurance company selects the counsel ... [i]t is simply a matter of human nature."). The insurance company's obligation to defend its policyholder "extends to paying the *reasonable value of the legal services and costs* performed by independent counsel selected by insured." *San Gabriel Valley Water Co. v. Hartford Accident & Indem. Co.*, 98 Cal. Rptr. 2d 807, 810 (Cal. Ct. App., 2d Dist. 2000) (emphasis added).

However, after the insurance company is found to have breached its duty to defend its policyholder and thus is obligated to pay the underlying defense costs, the insurance company sometimes asserts arguments concerning the *reasonableness* of those fees. In determining whether a fee is reasonable, often courts will look at the entirety of the representation, considering factors such as the nature of the case and the issues presented; the time and labor required; the amount of damages involved; the result obtained; the experience, reputation and ability of the attorney; and the usual price charged for similar services by other attorneys in the same area. *Global Investors Agent Corp. v. Nat'l Fire Ins. Co. of Hartford*, 927 N.E.2d 480 (Mass. App. Ct. 2010); *Curtis v. Nutmeg Ins. Co.*, 681 N.Y.S.2d 620 (N.Y. App. Div., 3d Dep't 1998).

However, increasingly courts have considered the position that the policyholder is in when the insurance company refuses to pay for its defense, and they have held that the fees actually paid by the policyholder in its own defense are reasonable as a matter of law. In *Taco Bell Corp. v. Continental Casualty Co.*, 388 F.3d 1069 (7th Cir. 2004), the policyholder was accused of misappropriating the plaintiff's marketing gimmick, and it sought defense costs for "advertising injury" coverage under its insurance policy with Zurich American Insurance Co. Zurich refused to pay its policyholder's defense costs, forcing Taco Bell to incur and pay its own attorney fees of $2.8 million, roughly $800,000 of which Zurich was responsible for after a $2 million self-insured retention.

Nevertheless, Zurich still argued that its policyholder overpaid for legal services, and it sought to introduce detailed records and affidavits to prove that assertion. The court logically refuted Zurich's "excessive fees" argument by stating:

> When Taco Bell hired its lawyers, and indeed at all times since, Zurich was vigorously denying that it had any duty to defend — any duty, therefore, to reimburse Taco Bell. Because of the resulting uncertainty about reimbursement, Taco Bell had an incentive to minimize its legal expenses (for it might not be able to shift them); and where there are market incentives to economize, there is no occasion to a painstaking judicial review.

The court reiterated that had Zurich truly mistrusted its policyholder's ability to minimize its own legal fees, it could have selected, supervised and paid for Taco Bell's lawyers, all while still reserving its right that it had no duty to defend and seek reimbursement later. Instead, Zurich put its policyholder in a position in which it had to assume its own defense costs, with no assurance of reimbursement.

In such cases, the fact that the policyholder has paid the underlying legal fees, without knowing if it will ever be reimbursed, is *prima facie* evidence that the fees are reasonable. *See e.g., Am. Serv. Ins. Co. v. China Ocean Shipping Co.*, No. 1–08 1821, 402 Ill. App. 3d 513 (Ill. App. Ct., 1st Dist. June 16, 2010); *Knoll Pharm. Co. v. Auto. Ins. Co. of Hartford*, 210 F. Supp. 2d 1017, 1025 (N.D. Ill. 2002) (that the policyholder paid all the defense costs "strongly implies commercial reasonableness of

the fees, especially in light of the fact that ultimate recovery of the fees was uncertain because [the insurance company] refused to pay"); *Stryker Corp. v. XL Ins. Am.*, No. 4:01-CV-157, 2008 WL 68958 (W.D. Mich. Jan. 4, 2008) ("Plaintiffs are correct that as a consequence of defendant's decision not to defend plaintiffs in the underlying lawsuits the settlements and defense costs for the underlying lawsuits are presumed reasonable.").

Therefore, the insurance company can no longer undermine its duty to reimburse fees by hiring an audit firm and obtaining an evidentiary hearing to pick apart a law firm's billing. *Taco Bell*, 388 F.3d at 1077. Instead, courts recognize that the fact that the insurance company forced its policyholder to pay for its own defense, with no guarantee of reimbursement, is powerful proof to show that fees are inherently reasonable.

CONCLUSION

First, policyholders with third-party liability policies should know that the award of attorney fees to plaintiffs in an underlying action very likely is supported by the plain language of the policy. Further, the absence of an exclusion for plaintiff's attorney fees is strong evidence of the intent to cover those commonplace damages. If necessary, policyholders also can rely on the rule of construction that ambiguous terms in an insurance policy are construed in favor of the policyholder. There also is support for coverage of attorney fees even when no other part of the claim is covered, and courts have rejected a number of public policy-based challenges to insurance coverage for plaintiff's attorney fees.

Second, when your insurance company denies a significant claim, be aware that a majority of states have useful precedent that may support an argument to require the insurance company to pay for the insurance coverage fight. The rationales and precise functioning of these rules differ according to jurisdiction.[8] Some jurisdictions currently have rules that are not particularly policyholder-friendly, and other jurisdictions currently are silent on the issue.

Some courts have ruled that policyholders should be permitted to recover for in-house counsel expenses at least as broadly as outside counsel fees in a successful insurance coverage action. Moreover, an increasing number of courts are finding that when the insurance company wrongfully refuses to defend and then contests the amount of defense costs, the fact that the policyholder has paid its own legal fees in the underlying litigation is *prima facie* evidence of their reasonableness.

NOTES

[1] *See* EUGENE R. ANDERSON ET AL., INSURANCE COVERAGE LITIGATION § 2.00 (2d ed. 2009); E. Allen Farnsworth, *Legal Remedies for Breach of Contract,* 70 COLUM. L. REV. 1145 (November 1970).

[2] *See* Jane Massey Draper, *Insured's Right to Recover Attorney's Fees Incurred In Declaratory Judgment Action to Determine Existence of Coverage Under Liability Policy,* A.L.R. 3d, 87 (1996); Floyd A. Wisner, *Insurer's Liability for Insured's Attorney's Fees In Declaratory Judgment Actions,* THE BRIEF (Fall 1998).

[3] Under what is often called the "American rule," each side is generally responsible for its own attorney fees in civil cases. *See Alyeska Pipeline Serv. Co. v. Wilderness Soc'y,* 421 U.S. 240, 257 (1975). Many courts and state govern-ments, however, have found "property damage cases between policyholders and insurers to be one of the prominent instances where the American rule concerning attorneys' fees works badly." *Hayseeds Inc. v. State Farm Fire & Cas.,* 352 S.E.2d 73, 78 (W. Va. 1986).

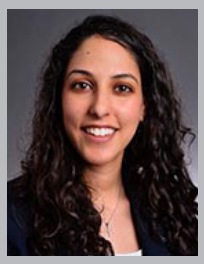
[4] Courts in some jurisdictions have held in the past that policyholders may not be able to recover attorney fees in coverage disputes. *See, e.g., Green v. Standard Fire Ins. Co.,* 477 So. 2d 333, 335 (Ala. 1985) (holding that attorney fees from insurance coverage declaratory action not recoverable but refusing to decide whether such a claim is absolutely precluded because insurance company's claim was not frivolous). Even in these states — and others without precedent on the issue — the arguments set forth in support of a policyholder fee award may be valuable. *See, e.g., Greer v. Burkhardt,* 58 F.3d 1070, 1075 (5th Cir. 1995) (observing that although Mississippi law permits recovery of attorney fees only if punitive damages have been awarded, "some [Mississippi] cases indicate that attorney's fees can be awarded as extra-contractual or consequential damages even where punitive damages are not warranted, if the insurer denied a claim without any arguable basis.").

[5] Although the majority of jurisdictions permit attorney fees in coverage actions to some degree, courts in several jurisdictions have limited the scope and applicability of awards of fees.

[6] JOHN A. APPLEMAN, INSURANCE LAW & PRACTICE § 4691 (Walter F. Berdal ed., 1979).

[7] Eugene R. Anderson & Joshua Gold, *Recoverability of Corporate Counsel Fees in Insurance Coverage Disputes,* 1 AM J TRIAL ADVOC. 20 (Fall 1996). Gold is a partner in the firm of Anderson Kill.

[8] This commentary follows our earlier articles on related topics and updates and expands upon them. *Forcing an Insurance Company to Pay Legal Fees for the Coverage Fight: A Study of State Laws,* ADVISEN FPN (April 2011) and THE JOHN LINER REVIEW (Winter 2011); (with Diana Shafter Gliedman), *Paying by the Rules — Recovery of Attorney Fees,* THE JOHN LINER REVIEW, Vol. 16, No. 3 (Fall 2002).



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Helpful authority for policyholders seeking attorney fees	
STATE	**CITATION**
Alabama	No helpful authority on recovery of attorney's fees generally, but see dissenting opinion in *Life Insurance Co. v. Johnson*, 684 So. 2d 685, 711-13 (Ala. 1996). Note that bringing and prevailing on a declaratory judgment action is not sufficient for an attorney fee award, absent statutory authorization. *Alliance Ins. Co. v. Reynolds*, 504 So. 2d 1215 (Ala. Ct. Civ. App. 1987).
Alaska	Alaska R. Civ. P. 82 (2014); *Puritan Life Insurance Co. v. Guess,* 598 P.2d 900 (Alaska 1979).
Arizona	Ariz. Rev. Stat. § 12-341.01 (2014); *Sparks v. Republic National Life Insurance Co.,* 647 P.2d 1127 (Ariz. 1982).
Arkansas	Ark. Code Ann. § 23-79-208 (2014); *State Farm Automobile Insurance Co. v. Stamps,* 292 S.W. 3d 833 (Ark. Ct. App. 2009); *Newcourt Financial v. Canal Insurance Co.,* 15 S.W. 3d 328 (Ark. 2000); *Parker v. Southern Farm Bureau Casualty Insurance Co.,* 935 S.W.2d 556 (Ark. 1996); *Blevins v. Commercial Standard Insurance Cos.,* 544 F.2d 967 (8th Cir. 1976).
California	*Essex Insurance Co. v. Five Star Dye House, Inc.,* 137 P. 3d 192 (Cal. 2006); *Brandt v. Superior Court,* 693 P.2d 796 (Cal. 1985); *Campbell v. Cal-Gard Surety Services,* 73 Cal. Rptr. 2d 64 (Cal. Ct. App., 4th Dist. 1998).
Colorado	Colo. Rev. Stat. Ann. § 13-17-101 (2013)
Connecticut	Conn. Gen. Stat. § 38a-274 (2014); *ACMAT Corp. v. Greater New York Mutual Insurance Co.,* 923 A.2d 697 (Conn. 2007) (allowing for attorney's fees where insurance company acts in bad faith).
Delaware	Del. Code Ann. tit. 18, § 4102 (2014); *Galiotti v. Travelers Indemnity Co.,* 333 A.2d 176 (Del. Super. Ct. 1975)
Florida	Fla. Stat. Ann. § 627.428 (2013); *O'Malley v. Nationwide Mutual Fire Insurance Co.,* 890 So. 2d 1163 (Fla. 4th Dist. Ct. App. 2004); *Danis Industries Corp. v. Ground Improvement Techniques,* 645 So. 2d 420 (Fla. 1994); *Government Employees Insurance Co. v. Gonzalez,* 512 So. 2d 269 (Fla. 3d Dist. Ct. App. 1987).
Georgia	Ga. Code Ann. § 33-4-6 (2014); *State Farm Mutual Automobile Insurance Co. v. Drury,* 474 S.E.2d 64 (Ga. Ct. App. 1996); *Reserve Life Insurance Co. v. Ayers,* 121 S.E.2d 649 (Ga. 1961); *LaRoche Industries v. AIG Risk Management,* 959 F.2d 189 (11th Cir. 1992).
Hawaii	Haw. Rev. Stat. § 431:10-242 (2014); *Commerce & Industry Insurance Co. v. Bank of Hawaii,* 832 P.2d 733 (Haw. 1992).
Idaho	Idaho Code Ann. § 41-1839 (2014); *Empire Fire & Marine Insurance Co. v. North Pacific Insurance Co.,* 905 P.2d 1025 (Idaho 1995); *Occidental Fire & Casualty Co. v. Cook,* 435 P.2d 364 (Idaho 1967); *Continental Re-Insurance Co. v. Spanton,* 667 F.2d 1289 (9th Cir. 1982).
Illinois	215 Ill. Comp. Stat. 5/155 (2014); *Estate of Price v. Universal Casualty Co.,* 779 N.E.2d 384 (Ill. App. Ct., 1st Dist. 2002); *Mobil Oil Corp. v. Maryland Casualty Co.,* 681 N.E.2d 552 (Ill. App. Ct., 1st Dist. 1997); *Smith v. Equitable Life Assurance Society of the United States,* 67 F.3d 611 (7th Cir. 1995).
Indiana	Ind. Code § 34-52-1-1 (2014); *Phaedra Partners Ltd. v. Travelers Property Casualty Corp.,* No. 1:99-CV-29 (N.D. Ind. Apr. 26, 1999).
Iowa	*Dairyland Insurance Co. v. Hawkins,* 292 F. Supp. 947 (S.D. Iowa 1968).
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Louisiana	La. Rev. Stat. § 22:1892 (2014); *Hart v. Allstate Insurance Co.,* 437 So. 2d 823 (La. 1983); *Parker v. Western Fidelity Insurance Co.,* 560 So. 2d 953 (La. Ct. App., 3d Cir. 1990), *cert. denied,* 565 So. 2d 448 (La. 1990); *Real Asset Management v. Lloyd's of London,* 61 F.3d 1223 (5th Cir. 1995).
Maine	Me. Rev. Stat. tit. 24-A, § 2436-A (2014); *Foremost Insurance Co. v. Levesque,* 926 A.2d 1185 (Me. 2007); *Maine Mutual Fire Insurance Co. v. Gervais,* 745 A.2d 360 (Me. 1999); *Gibson v. Farm Family Mutual Insurance Co.,* 673 A.2d 1350 (Me. 1996).
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Massachusetts	Mass. Ann. Laws ch. 93A, § 11 (2014); *Hopkins v. Liberty Mutual Insurance Co.,* 750 N.E.2d 943 (Mass. 2001); *Rubenstein v. Royal Insurance Company of America,* 708 N.E.2d 639 (Mass. 1999); *Preferred Mutual Insurance Co. v. Gamache,* 686 N.E.2d 989 (Mass. 1997); *Jet Line Services v. American Employers Insurance Co.,* 537 N.E.2d 107 (Mass. 1989); *Vickers v. Boston Mutual Life Insurance Co.,* 135 F.3d 179 (1st Cir. 1998).
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North Carolina	N.C. Gen. Stat. § 6-21.1 (2014); *PHC Inc. v. N.C. Farm Bureau Mutual Insurance Co.,* 501 S.E.2d 701 (N.C. Ct. App. 1998); *Whitfield v. Nationwide Mutual Insurance Co.,* 358 S.E.2d 92 (N.C. Ct. App. 1987).
North Dakota	*Western National Mutual Insurance Co. v. University of North Dakota*, 643 N.W.2d 4 (N.D. 2002); *Johnson v. Center Mutual Insurance Co.,* 529 N.W.2d 568 (N.D. 1995); *State Farm Fire & Casualty Co. v. Sigman,* 508 N.W.2d 323 (N.D. 1993).
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Pennsylvania	42 Pa. Cons. Stat. Ann. § 8371 (2014); *Carpenter v. Federal Insurance Co.,* 637 A.2d 1008 (Pa. Super. Ct. 1994); *Kelmo Enterprises v. Commercial Union Insurance Co.,* 426 A.2d 680 (Pa. Super. Ct. 1981); *Polselli v. Nationwide Mutual Fire Insurance Co.,* 126 F.3d 524 (3d Cir. 1997); *Montgomery Ward & Co. v. Pacific Indemnity Co.,* 557 F.2d 51 (3d Cir. 1977).
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South Carolina	*Security Insurance Company of Hartford v. Campbell Schneider & Associates,* 481 F. Supp. 2d 496 (D.S.C. 2007); *First Financial Insurance Co. v. Sea Island Sport Fishing Society,* 490 S.E.2d 257 (S.C. 1997); *Hegler v. Gulf Insurance Co.,* 243 S.E.2d 443 (S.C. 1978).
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