Wording and Interpretation

# Attorneys' Fees as

By Thomas R. Newman

**To help preclude obligations to defend or indemnify insureds for suits seeking awards of attorneys' fees, insurers and their counsel need to understand the effect of policy language and courts' interpretation of it.**

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# Covered Costs, Damages, or Loss

In the United States, under the so-called "American rule," the prevailing party in a litigation is ordinarily not entitled to reimbursement for its reasonable attorneys' fees and expenses from the loser in the absence of a statutory or contractual provision allowing such an award to be made. When such an award is made and the losing party is insured under a liability policy—e.g., a commercial general liability policy (CGL) or a directors' and officers' (D&O) liability policy—it usually will seek to pass the burden of payment of those fees and expenses to its insurer as covered "costs" or "damages." Whether the insured will succeed depends on the exact policy wording and the court's interpretation of those terms in the context of the rest of the policy wording, as well as considerations of public policy.

## Attorneys' Fees Covered as "Supplementary Payments" Even Without a Covered Claim for Indemnity

In *Employers Mutual Casualty Co. v. Donnelly,* 300 P.3d 31 (Ida. 2013)(*EMC*), a divided Idaho Supreme Court recently affirmed a judgment ordering a contractor's CGL insurer that had defended its insured under a reservation of rights in a homeowners' underlying action for breach of contract, breach of warranties and negligence to pay $296,933.89 in costs and attorneys' fees. This was despite a finding that the insurer had no duty to indemnify the contractor for the contract damages awarded against it because the policy contained an express exclusion for contractual damages.

The *EMC* case arose out of a dispute between the Donnellys and Rimar Construction, Inc. (RCI), a contractor that the Donnellys had engaged to do repairs and further remodeling on their home after a fire. RCI was insured by Employers Mutual Casualty Company (EMC) under a CGL policy. The Donnellys brought the underlying action against RCI, alleging, among other things, negligent and intentionally faulty workmanship, breach of contract, and breach of warranties.

EMC filed a declaratory judgment action against the Donnellys and RCI to establish that it had no duty to pay any damages claimed or awarded to Donnelly in the underlying action. RCI counterclaimed against EMC, alleging bad faith and a breach of contract. A jury in the underlying action rendered a special verdict, finding that RCI had breached the implied warranty of workmanship resulting in $126,611.55 in damages. A settlement was then reached between EMC and RCI regarding the declaratory action and the underlying action under which RCI dropped its counterclaims and agreed not to contest EMC in the declaratory action.

The district court ruled that, as to the contract-based damages, there was no insurance coverage for the underlying $128,611.55 in compensatory damages that the Donnellys incurred, but there was coverage for the award of $296,933.89 in costs and attorneys' fees. The Idaho Supreme Court affirmed the decision of the district court.

EMC's policy contained a "Supplementary Payments" provision that stated:

> 1. We will pay, with respect to any claim we investigate or settle, or any "suit" against an insured we defend:
>
> a. All expenses we incur.
>
> …
>
> e. All costs taxed against the insured in the "suit."

The CGL policy defined "suit" as "a civil proceeding in which damages because of 'bodily injury', 'property damage' or 'personal and advertising injury' to which this insurance applies are alleged." 300 P.3d at 34.

The majority in *EMC*, quoting from that court's earlier decision in *Mutual of Enumclaw v. Harvey*, 115 Idaho 1009, 1013, 772 P.2d 216, 220 (1989) ("*Harvey*"), stated: "The fact the company reserved its contractual rights before undertaking the defense in no way dissipates its obligation to pay such costs." 300 P.3d at 35. The court explained that a reservation of rights can only preserve existing rights. "It is not a destruction of the insured's rights nor a creation of new rights for the Company. It preserves that to which the parties had originally agreed." *Id*. And the insurer had agreed to pay "all costs taxed against the insured in any suit defended by the Company." There is nothing in this policy wording to "indicate that payment of costs is conditioned upon a final determination that the policy covers the insured's conduct." *Harvey, supra,* 115 Idaho at 1012, 772 P.2d at 219.

> The Idaho Supreme Court also followed its earlier decision in *Harvey* for the proposition that [t]hough the word 'costs' as a legal term of art may be ambiguous, it is not so from the perspective of the ordinary person unfamiliar with the jargon of the legal and insurance professions standing in the position of the insured. An insurance policy must be interpreted from that perspective.

115 Ida. at 1013, 772 P.2d at 220. The court looked to Webster's Third New International Dictionary, which defines the term "costs," in relevant part, as

> 4. costs pl.: expenses incurred in litigation; as a: those payable to the attorney or counsel by his clients esp. when fixed by law b: those given by the law or the court to the prevailing against the losing party in equity and frequently by statute—called also bill of costs

The court found that this definition "represents the common understanding

of the term 'costs.' The plain, ordinary and popular meaning of 'costs' is the expense of litigation which includes attorney fees." 115 Ida. at 1013, 772 P.2d at 220.

In *EMC*, the court pointed out that in *Harvey*

> the duty to pay emanated from the supplemental coverages… [while] EMC's obligations emanate from the insurer's duty to defend as provided in the supplementary payments section of the policy. Although EMC's obligation arises from a different source, the outcome is the same as in Harvey. Under the plain language of the contract, RCI's policy states that damages only need to be "alleged" to trigger coverage, they do not need to be proven.

That lesser standard was met. 300 P.3d at 35.

The dissenting justice believed that where the complaint alleges both covered and uncovered claims, the majority's opinion places the insurer "between a rock and a hard place, because

> On the one hand, if it denied coverage while the complaint continued to *allege* potentially covered damages, if it were eventually determined there were such damages, EMC would subject itself to claims of breach of contract, bad faith, and punitive damages…. By continuing with the defense, however, it ended up subjecting itself to claims for costs and attorney's fees by reason of the supplemental payments provision of its insurance policy, or so at least the majority holds.

300 P.3d at 33–34 [citation omitted]

The majority opinion did not address the dissenter's point, but one justice wrote a concurring opinion "to address arguments made by the dissent." 300 P.3d at 39. In his view, the policy wording was clear and unambiguous, the underlying lawsuit was a "suit" under the policy definition and "because EMC defended that suit it is contractually obligated to pay all costs assessed against RCI, its insured, in that suit." 300 P.3d at 40. He disagreed that whenever covered and uncovered claims are alleged in the complaint, the insurer is "squarely between a rock and a hard place," stating

> If EMC does not want to be obligated to pay all costs assessed against its insured in lawsuits that EMC defends, then it simply has to change the wording of its policy… . It is not up to us to rewrite EMC's policy to say what it now wishes it would have said.

300 P.3d at 40.

**The *EMC* decision** can have far-ranging effects if followed elsewhere since the policy wording construed by the Idaho Supreme Court is taken from ISO's standard form CGL policy that is in widespread use throughout the United States.

The *EMC* decision can have far-ranging effects if followed elsewhere since the policy wording construed by the Idaho Supreme Court is taken from ISO's standard form CGL policy [CG 00 01 (Ed. 10/01)] that is in widespread use throughout the United States. ISO only recently changed that wording to exclude attorneys' fees and expenses expressly from supplementary payments. Thus, ISO's current commercial general liability form [CG 00 01 (Ed. 04/13)] provides coverage for

> e. All court costs taxed against the insured in the "suit." However, these payments do not include attorney's fees or attorney's expenses taxed against the insured.

A similar result had been reached in *Prichard v. Liberty Mutual Ins. Co.*, 84 Cal. App. 4th 890, 101 Cal. Rptr. 2d 298 (Ct. App. 4th Dist. 2000), a "mixed action" that the insurer defended under a reservation of rights because of a potentially covered defamation claim, and it turned out that there was no coverage because no defamatory statements were made during the policy period. The underlying plaintiff was awarded $253,000 in costs, which included attorneys' fees that he was able to collect "pursuant to prevailing party clauses." 84 Cal. App. 4th at 911, 101 Cal. Rptr.2d at 312.

The California Court of Appeal found that

> the supplementary payments provision providing all 'costs taxed' is a function of the insurer's defense obligation, not its indemnity obligation. Liberty's contention that its insurance policy would not 'apply' to a defended mixed action where there is no actual coverage is belied by the direct references to the defense obligation and the allegation of damages.

84 Cal. App. 4th at 911–12, 101 Cal. Rptr.2d at 312–13. The court recognized that in the absence of even the possibility of coverage, the result may be "somehow unfair because the insured is getting a benefit he never paid for." "The problem, however, is in the insurance contract, not the law. If the ISO (Insurance Services Office) forms are written so that attorney fees awarded as part of prevailing party clauses can be considered costs associated with the insurer's defense obligation, there is nothing we can do about it." 84 Cal. App. 4th at 912 n.22, 101 Cal. Rptr.2d at 313 n.22.

## Attorneys' Fees as Covered "Damages"

In *Ypsilanti v. Appalachian Ins. Co.*, 547 F. Supp. 823 (E.D. Mich. 1982), *aff'd mem.* 725 F.2d 862 (6th Cir. 1983), the court stated that "the American Rule applies only to the situation where a prevailing litigant is seeking to recover its own attorney fees" and not where the issue is whether an insurer agreed to pay, on behalf of its insured, the award of attorney fees assessed against the insured in the underlying litigation. "Thus, 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." 547 F. Supp. at 827.

The court found 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.… It is reasonable to say that an attorney fee award in a civil rights suit is a form

of "damage" which the defendant contracted to cover. It would have been simple enough to exclude attorney fee awards had the parties so intended. Since they did not, and since an ambiguity remains, the ambiguity will be resolved against the Insurer.

547 F. Supp. at 827.

The *Ypsilanti* decision was followed in *Hyatt Corp. v. Occidental Fire & Cas. Co. of N.C.*, 801 S.W2d 382 (Mo. Ct. App. 1990), where the court found an award of attorneys' fees made as part of the settlement of a class action "indistinguishable from a damages award for coverage purposes." *Ypsilanti* was also cited with approval in *Sokolowski v. Aetna Life & Cas. Co.*, 670 F.Supp. 1199, 1210 (S.D.N.Y. 1987), an ERISA action against a pension plan and its trustees and administrator, where the court found "it does not exceed a fair reading of the Policy to construe attorney's fees as a form of damages covered by the Policy," which defined "damages," *inter alia*, as "sums of money payable as compensation for loss."

The district court's analysis in *Sokolowski* was followed by the Eighth Circuit in *Pacific Ins. Co. v. Burnet Title, Inc.*, 380 F.3d 1061, 1066 (8th Cir. 2004), a declaratory judgment action arising out of an underlying class action in which the insured defendant allegedly violated the Real Estate Settlement Procedures Act, 12 U.S.C. §§2601–2617. The underlying plaintiffs sought "actual damages, along with prejudgment interest, penalties, treble damages, attorneys' fees, costs, expenses and any other remedy available." 380 F.3d at 1065–66.

> Since the actual damages sought were the return or reimbursement of the overcharged fees (and thus do not count as damages under the policy) and the district court found the treble damages were a "penalty" (and Burnet did not cross-appeal that determination), the fighting issue between the parties is whether the prayer for attorney fees constitutes "damages" within the meaning of the policy.

380 F.3d at 1066. The Eighth Circuit agreed with the district court's analysis that " in the context of a claim for attorney fees under RESPA, the award of attorney fees is not a 'cost' and therefore falls within the meaning of 'damages.' This is because RESPA distinguishes between 'attorney fees' and 'costs.'" 380 F.3d at 1066. Thus, the complaint alleges damages covered by the policy for purposes of triggering the duty to defend. *Ibid.*

In *Sullivan County v. Home Indem. Co.*, 925 F.2d 152 (6th Cir. 1991), a prisoner obtained injunctive and declaratory relief against the county and was awarded attorneys' fees as the prevailing party under 42 U.S.C. §1988. The county was insured by Home under a policy that provided coverage for "all sums which plaintiff might become legally obligated to pay as damages." However, a standard-form supplementary payments provision, which would have made the insurer also liable for "all costs taxed against the insured," was expressly made inapplicable by an endorsement to the policy. Home, therefore, denied the county's claim for the prisoner's attorneys' fee award on the ground that fees awarded under §1988 were "costs" rather than "damages," and "costs" were not covered by the policy.

The court found that "in providing for the allowance of attorney fees 'as part of the costs,' §1988 takes a distinctly different tack from statutes that have been construed as authorizing the inclusion of attorney fees in recoverable 'damages'" (925 F.2d at 153), as, for example, in *Oates v. Oates*, 866 F.2d 203, 206 (6th Cir.), *cert. denied*, 490 U.S. 1109 (1989). However, the drafters of insurance policies are not required to preserve that distinction between "costs" and "damages." As the court stated

> An insurance policy can obviously use the word "damages" to mean anything the policy says it means, including costs taxed by the court…. [T]he policy as originally published included a Supplementary Payments provision making "costs taxed against the insured" recoverable in addition to "damages." If "damages" had been used originally in a sense that already included costs, the quoted portion of the Supplementary Payments provision ["costs taxed against the insured"] would have been totally unnecessary—and nothing in the language of the endorsement making that provision inapplicable ("Supplementary Payments do not apply to insurance afforded by this coverage part") suggests an intent to change the meaning of "damages."

925 F.2d at 153. The court found that the endorsement limiting application of the supplementary payments provision distinguished the case from *Ypsilanti*, resulting in no coverage.

In *City of Kirtland v. Western World Ins. Co.*, 43 Ohio App. 3d 167, 168–69, 540 N.E.2d 282, 284–85 (Ohio App. 1988), the City was ordered to pay attorneys' fees to Holden Arboretum, the successful plaintiff in an underlying 42 U.S.C. §1983 action that sought only equitable relief. Western World's policy agreed to pay "all loss which the Public Entity becomes legally obligated to pay as damages…." "Loss" was defined to mean "any amount which the Insureds are legally obligated to pay, … for any claim or claims made against them, for Wrongful Acts and shall include but not be limited to damages, judgments, settlements, and costs…." The term "money damages" was not defined in the policy and the policy excluded any claim "based upon or arising out of… 4(b) For fees or expenses relating to claims, demands or actions seeking relief or redress, in any form other than money damages;…" *Id.*, 43 Ohio App. 3d at 169, 540 N.E.2d at 284–85.

**Since the term** "money damages" was not defined in the policy, the court found it was ambiguous and, in accordance with "basic contract law," construed it against Western World, the maker of the policy.

Western World argued that the award of attorneys' fees pursuant to 42 U.S.C.§1988 was a fee or expense relating to an equitable claim and therefore excludable by Section 4(b) of the insurance policy. The insurer also argued that "since money was not

asked for in the original action, the award of attorney fees must have been allowed as part of the costs," which the "the court, in its discretion, may allow… as part of the costs." *Id*., 43 Ohio App. 3d at 169, 540 N.E.2d at 285. The insurer relied in part on *Board of County Commrs., etc. v. Guarantee Ins. Co*., 90 F.R.D. 405 (D. Colo. 1981), where the court stated that attorneys' fees awarded in a case where money damages were not demanded were not damages as contemplated by the policy. "Rather, attorney fees under section 1988 are 'costs' of the litigation," citing 42 U.S.C. §1988 and *Battle v. Anderson*, 614 F.2d 251, 258–59 (10th Cir. 1980). That case is distinguishable, however, because the policy defined "damages" as "only those damages which are payable because of personal injury arising out of an offense to which this insurance applies."

**Some courts** have disagreed and disallowed coverage, finding an award of attorneys' fees "is a type of penalty imposed not to make the injured party whole, but rather to discourage a particular activity on the part of the opposing party."

The City maintained that the claim for attorneys' fees is in the form of "money damages" and, therefore, is covered by the insurance policy, even though the original claim was equitable. The City also argued that "the award of attorney fees is a cost, but that costs, as interpreted by the insurance policy, are a form of money damages," relying on the Ohio Supreme Court's decision in *Symons v. Eichelberger,* 110 Ohio St. 224, 144 N.E. 279 (1924), that "[costs] are in the nature of incidental damages allowed to indemnify a party against the expense of successfully asserting his rights in court. *Id.,* 110 Ohio St. at 238, 144 N.E. at 283.

The Court of Appeals of Ohio affirmed the trial court's finding in favor of the City. Since the term "money damages" was not defined in the policy, the court found it was ambiguous and, in accordance with "basic contract law," construed it against Western World, the maker of the policy. *Id*., 43 Ohio App. 3d at 170, 540 N.E.2d at 285.

In *City of Sandusky, Ohio v. Coregis Ins. Co*., 192 Fed. Appx. 355 (6th Cir. 2006), the Sixth Circuit found the term "damages," which was defined as "monetary sums and excludes all forms of injunctive relief and declaratory judgments," was unambiguous and, "[b]ecause of the lack of ambiguity," distinguished *City of Kirtland* and other Ohio cases holding that "damages" was ambiguous and could include a §1988 award of attorneys' fees. 192 Fed. Appx. at 360 n.2. In the Sixth Circuit's view,

> A prayer for §1988 relief is not its own independent claim; rather, it is parasitic to the success of other claims for relief. See 42 U.S.C. §1988(b)(awarding attorney fees to a "prevailing party" on certain claims). The award of attorney fees as part of the costs under §1988 in the underlying suit here was due to the success of the class plaintiffs on equitable claims that were plainly not covered by the Coregis insurance contract. We find no specific language in the insurance contract providing that a §1988 award under such circumstances is to be itself a claim for "damages" covered by the contract, and we therefore hold that the contract plainly did not contemplate such coverage. Because the attorney fees awarded to the class plaintiffs in the underlying suit were not "damages" as contemplated by the insurance contract, Coregis had no duty to indemnify Sandusky for their payment.

The court expressed no opinion as to whether a §1988 award that depended, at least in part, on the success of claims that were affirmatively covered by the insurance policy, could be considered a claim for "damages." 192 Fed. Appx. at 360 n.3.

*Continental Casualty Co. v. Pittsburgh Corning Corp.*, 917 F.2d 297 (7th Cir. 1990), was a declaratory judgment action by Continental against its insured, a manufacturer of asbestos products, for a declaration that the policies do not make it liable for costs the manufacturer incurred in defending against thousands of product liability suits. The court found Continental was not liable for the defense costs. 917 F.2d at 300.

> The key word is "loss," which the policy goes on to define as "the sums paid in settlements of losses for which the insured is liable… and shall exclude all expense and costs." "Costs" in turn are defined as "interest on judgments, investigations, adjustment and legal expenses (excluding, however, all expense for salaried employees and retained counsel of and all office expense of the insured)."… The indemnification is limited to loss, loss excludes costs, costs include legal expenses, so legal expenses are excluded from coverage.

917 F.2d at 298.

## Attorneys' Fees Are Not Excluded as Punitive Damages

In *Neal-Pettit v. Allstate Ins. Co*., 125 Ohio St.3d 327, 928 N.E.2d 421, 422 (2010), a divided Supreme Court of Ohio held that an automobile liability insurer must cover attorneys' fees awarded solely as a result of a concomitant punitive damage award, and that public policy does not prevent such coverage.

Kimberly Neal-Pettit sued Linda Lahman for compensatory and punitive damages due to personal injuries sustained in an automobile accident. As alleged in the complaint, when Lahman struck Neal-Pettit's vehicle, she was intoxicated and fleeing the scene of an earlier collision. A jury returned a verdict against Lahman for compensatory damages and $75,000 punitive damages. In addition, the jury awarded attorneys' fees to Neal-Pettit based on a finding that Lahman had acted with malice. The trial court set the amount of attorneys' fees at $46,825 and also awarded Neal-Pettit $10,084.96 in expenses.

Lahman's insurer, Allstate, paid the amounts awarded as compensatory damages, interest, and expenses, but denied payment of the punitive damages and attorneys' fees. Neal-Pettit filed a supplemental complaint against Allstate for payment of the attorneys' fees. The trial court entered summary judgment in favor of Neal-Pettit and Allstate appealed, arguing

that it had not contracted to pay attorneys' fees and that an attorneys' fee award is an element of punitive damages, which public policy prevents an insurer from covering. The Ohio intermediate appellate court affirmed the trial court's decision, holding that attorneys' fees are "conceptually distinct" from punitive damages and that attorneys' fees are not expressly excluded from coverage by the language of the policy. The Ohio Supreme Court accepted jurisdiction over Allstate's further appeal and affirmed.

The policy's coverage grant provides that "Allstate will pay damages which an insured person is legally obligated to pay because of: 1. bodily injury sustained by any person, …." The policy does not define the word "damages," and the first question for the Ohio Supreme Court was whether the attorneys' fees awarded are "damages" that Lahman is legally obligated to pay because of the bodily injury sustained by Neal-Pettit.

Allstate argued that the award is not covered under its policy because attorneys' fees are not damages themselves, but are derivative of punitive damages and thus are not awarded "because of… bodily injury." The majority found "the fact that the awards have similar bases is irrelevant. We have recognized that attorney-fee awards and punitive-damages awards are distinct.… [A]lthough 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." 125 Ohio St.3d at 329, 928 N.E.2d at 424.

The dissent agreed that "an award of attorney fees is not an element of punitive damages," but found "an award of attorney fees is inextricably intertwined with an award of punitive damages" and "if a court reverses a punitive-damages award, the attorney-fee award must likewise be reversed." 125 Ohio St.3d at 332, 928 N.E.2d at 426.

The next question for the court was whether the attorneys' fees are damages "because of bodily injury," as required by the policy. Allstate argued they were not, but rather are awarded because of the award of punitive damages. The court disagreed, stating

> Although, in this case, attorney fees were awarded as a result of an award of punitive damages, they also stem from the underlying bodily injury. The language of the policy does not limit coverage to damages *solely* because of bodily injury. In addition, 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.

125 Ohio St.3d at 330, 928 N.E.2d at 424. Thus, the court held that "Attorney fees may therefore fall under the insurance policy's general coverage of 'damages which an insured person is legally obligated to pay' because of 'bodily injury.'" 125 Ohio St.3d at 330, 928 N.E.2d at 424.

The court then considered whether attorneys' fees come within Allstate's exclusion for "punitive or exemplary damages, fines or penalties," and it found they do not.

> [The] exclusion does not refer in any way to attorney fees or litigation expenses. It specifically mentions only punitive or exemplary damages, which… are conceptually distinct from attorney fees. Therefore, the term "punitive or exemplary damages" does not clearly and unambiguously encompass an award of attorney fees. We decline to read such language into the contract. We instead construe the policy strictly against the insurer.… Allstate, as the drafter, is responsible for ensuring that the policy states clearly what it does and does not cover.

125 Ohio St.3d at 330-331, 928 N.E.2d at 425.

While Allstate did not claim that the award of attorneys' fees was a fine or penalty, since the dissenters characterized the award of fees as a "penalty," the majority addressed and rejected that point, noting "Allstate failed to cite a case suggesting that attorney's fees are considered 'fines or penalties' independent of other awards." 125 Ohio St.3d at 330 n.1, 928 N.E.2d at 425 n.1.

Finally, the court rejected Allstate's public policy argument stating: "Our holding will not encourage wrongful behavior merely because it permits insurers to cover attorney fees for which tortfeasors become liable. The tortfeasors remain liable for punitive damages awarded for their malicious actions, and these punitive damages remain uninsurable." 125 Ohio St.3d at 331, 928 N.E.2d at 425.

Some courts have disagreed and disallowed coverage, finding an award of attorneys' fees "is a type of penalty imposed not to make the injured party whole, but rather to discourage a particular activity on the part of the opposing party." See, *e.g.*, *Langley v. Petro Star Corp.*, 792 So. 2d 721,723 (La. 2001).

*Devillier v. Fidelity & Deposit Co. of Maryland*, 709 So.2d 277, 282 (La. App. 3d Cir. 1998), was a sex discrimination suit brought against the employer company, its D&Os, and its D&O insurer. Plaintiffs sought compensatory and punitive damages, attorneys' fees and injunctive relief. The trial court dismissed plaintiffs' claims for attorneys' fees under the D&O policy and for punitive damages, and the Court of Appeal affirmed, stating:

> We note that F&D's policy makes no mention of attorney's fees and specifically excludes coverage for "fines or penalties imposed by law, punitive or exemplary damages." La.R.S. 51:2231, et. seq. allows for recovery of "actual damages," together with court costs and reasonable attorney's fees. Plaintiffs, if successful in their action under the statute, would be allowed to recover attorney's fees, but not under the F&D policy. Furthermore, attorney's fees are not recoverable unless authorized by statute or provided by contract. 709 So.2d at 282.

**Whether the corporation** can obtain indemnity from its liability insurer for an award of attorney's fees in a derivative suit will depend on the policy's definition of "loss."

## Attorneys' Fees Awards in Derivative Actions

In New York, if a shareholder derivative suit is "successful, in whole or in part… the court may award the plaintiff… rea-

sonable expenses, including reasonable attorney's fees, …" *N.Y. Business Corporation Law* §626(e). In the absence of such a statute, successful derivative plaintiffs may recover attorneys' fees under the "corporate benefit doctrine," which allows the court to award attorneys' fees to plaintiffs' counsel in successful derivative suits if the corporation has received a monetary or non-monetary benefit as a result of the litigation. If the litigation results in a money judgment benefitting the corporation, the attorneys' fees will ordinarily be paid from the "common fund" that counsel's efforts helped to create. *XL Specialty Ins. Co. v. Loral Space & Communication, Inc.*, 82 A.D.3d 108, 918 N.Y.S.2d 57 (1st Dept. 2011) ("*Loral*"). When there is no common fund, but it can be shown that the corporation has received a benefit, attorneys' fees will be based on quantum meruit and paid by the corporation.

**The only** guiding principle that might be derived from these decisions is that the relevant policy language will control the court's analysis and dictate its decision.

This exception to the American rule in awarding attorneys' fees in derivative litigation is based on the belief that "[t]o allow the others to obtain full benefit from the plaintiff's efforts without contributing equally to the litigation expenses would be to enrich the others unjustly at the plaintiff's expense." *See Mills v. Electric Auto-Lite Co.*, 396 US 375, 392, 90 S Ct 616, 625, 24 L Ed 2d 593, 606 (1970). "The expense of litigating what ultimately results in a benefit to the corporation should not rest entirely on the shoulders of a few plaintiff shareholders, but should be spread among all shareholders of the company for whose benefit the shareholder brought suit." *Loral, supra,* 82 A.D.3d at 122, 918 N.Y.S.2d at 67 (dissent).

Whether the corporation can obtain indemnity from its liability insurer for an award of attorney's fees in a derivative suit will depend on the policy's definition of "loss." A typical definition, taken from the ISO Management Protection form MP 00 01 04 03, reads

> "Loss" means "claim expenses," compensatory damages, settlement amounts, legal fees, and costs awarded pursuant to judgments. "Loss" does not include civil or criminal fines or penalties imposed by law, punitive or exemplary damages, the multiplied portion of multiplied damages, taxes or matters that are uninsurable pursuant to applicable law.
>
> "Claim expenses" means that part of a "loss" consisting of reasonable and necessary fees (including attorneys' and experts' fees) and expenses incurred in the defense or appeal of a "claim," excluding the wages, salaries, benefits or expenses of any director, officer or employee of the "company."

FC&S, D&O Volume, at A.4-1 (2011 National Underwriter Co.).

*XL Specialty Ins. Co. v. Loral Space & Communication, Inc.*, 82 A.D.3d 108, 918 N.Y.S.2d 57 (1st Dept 2011)("*Loral*"), dealt with D&O coverage for an attorneys' fee award in the context of a derivative suit. While the majority found that Loral had suffered a "Loss" within the meaning of the policy and that "the attorneys' fees Loral had to pay constitute damages" (82 A.D.3d at 114, 116, 918 N.Y.S.2d at 62, 63), the decision cannot fairly be said to have settled the law in this highly contentious area.

*Loral* was a 3–2 decision by New York's intermediate appellate court that turned on an atypically broad definition of "Loss" that covered "damages, judgments, settlements *or other amounts* (including punitive or exemplary damages where insurable by law) and Defense Expenses in excess of the retention that the Insured is legally obligated to pay." 82 A.D.3d at 110, 918 N.Y.S.2d at 59 (emphasis added). The majority stated that "The policy definition of "Loss" lists both "damages" and "other amounts… the insured is legally obligated to pay." If both items mean "damages," there would be no need to list "other amounts." 82 A.D.3d at 114, 918 N.Y.S.2d at 62. While the majority would not "equate 'other amounts' entirely with 'damages', it found that "the fee award is an amount that Loral has become legally obligated to pay" and that it "constitute[s] damages." 82 A.D.3d at 114, 116, 918 N.Y.S.2d at 62, 63.

The majority rejected the insurers' argument that "Loral cannot recover costs of, in effect, prosecuting a derivative action, and that Loral can only recover for these fees if the Delaware court found that Loral committed a 'Company Wrongful Act,'" finding that "the policy does not contain these limitations." Since the definition of "Company Wrongful Act" includes an "*alleged* act" (the court's emphasis), "the policy covers all losses resulting from a derivative action *alleging* a 'Company Wrongful Act.' The policy says nothing that requires a court to find that the company had committed a 'Company Wrongful Act' before coverage is available." 82 A.D.3d at 116, 918 N.Y.S.2d at 63.

The dissent focused mainly on whether Loral had suffered a loss since it was "undisputed that the Delaware court did not award monetary damages against any party; it found no wrongdoing by Loral, but ordered the remedy against a third party (MHR), and the resulting restructure provided a benefit to Loral." 82 A.D.3d at 120, 918 N.Y.S.2d at 66. It referred to the "well-established principle that a covered loss must be an actual loss, and not an expense or cost of doing business. (See *Safeway Stores, Inc. v. National Union Fire Ins. of Pittsburgh, Pa.*, 64 F3d 1282, 1286 n 8 [1995]["[t]he plain meaning of the term 'loss' requires that (a company) suffer a financial detriment"].)" 82 A.D.3d at 120, 918 N.Y.S.2d at 66.

Finally, the dissent noted that the rationale for the exception to the American rule in awarding attorneys' fees in derivative litigation is that the expense of obtaining a benefit to the corporation should be spread among all shareholders of the company for whose benefit the suit was brought. It concluded that "if not spreading the cost of attorney's fees sounds in unjust enrichment, the obvious corollary is that shifting the cost to shareholders as a group cannot be characterized as a loss" for which indemnity may be sought. 82 A.D.3d at 122, 918 N.Y.S.2d at 67–68.

The majority in *Loral* relied on *United-Health Group Inc. v. Hiscox Dedicated Cor-*

*porate Member Ltd.*, 2010 US Dist LEXIS 10983 (D. Minn. 2010)("*UnitedHealth*"), where the federal district court, applying New York law, denied a motion to dismiss United's claim for coverage for payment of the underlying plaintiffs' attorneys' fees in a class action settlement, even though none of the substantive claims was covered by United's D&O policy. The court held that a portion of a settlement constituting the Malchow plaintiff's attorneys' fee award "falls squarely within the Policy's definition of 'Damages' " where policy defined "Damages" as "*any monetary amount*… which an Insured is legally obligated to pay." 2010 US Dist LEXIS 10983 at *29–31 (emphasis added).

The court found United's argument that the claim for attorneys' fees is a claim for "Damages," "is, at first blush, a strange argument," and "the result sought by United is counterintuitive" because the insurers "would have to pay the attorney's fees incurred by the Malchow plaintiffs in pursuing uncovered claims against United, even though the insurers would not have to pay the attorney's fees incurred by United in defending those uncovered claims." 2010 US Dist LEXIS 10983 at *29, 33–34. Nevertheless, "the Policy says what the Policy says. Under the extremely broad language used by the policy, the claim for attorney's fees made against United by the Malchow plaintiffs was a "Claim" for "Damages." 2010 US Dist LEXIS 10983 at *34.

Since both *Loral* ("other amounts") and *UnitedHealth* ("any monetary amount") turn on the policies' atypically broad definitions of "Loss" and "Damages," those decisions will be readily distinguishable in other cases that involve narrower definitions of "loss" or "damages." Accordingly, the only guiding principle that might be derived from these decisions is that the relevant policy language will control the court's analysis and dictate its decision.

## When Attorneys' Fees Are Multiplied

In *Carolina Cas. Ins. Co. v. Merge Healthcare Solutions, Inc.*, 728 F.3d 615 (7th Cir. 2013), shareholders of Amicas obtained a preliminary injunction in a Massachusetts state court to stop a proposed merger with Thoma Bravo, LLC, in a transaction that valued each Amicas share at $5.35. The suit settled when Merge Healthcare, Inc., made a tender offer at $6.05 that Amicas's board recommended its investors accept. Amicas's shareholders gained $26 million and that lawyers who filed the suit sought attorneys' fees based on the difference between the two suitors' bids.

The state court awarded plaintiffs' counsel $3,150,000, derived from a lodestar of $630,000 (1,400 hours at $450 per hour) times five. The multiplier represented an adjustment for both the risk of nonpayment and what the judge called "an exceptionally favorable result for Amicas' shareholders." *Id*. at 616. Amicas appealed to the Massachusetts Appeals Court, contending that the award is excessive, and that appeal was settled.

Meanwhile, Carolina Casualty Insurance, which had issued a policy covering as part of the insured "loss" Amicas's own attorneys' fees as well as what it must pay to its adversaries' lawyers, sued in federal court contending that its coverage is limited to the $630,000 lodestar and that the remaining $2.52 million is the "multiplied portion of multiplied *damages,*" which are expressly excluded from "Loss" [emphasis added].

The district court and Seventh Circuit Court of Appeals disagreed. While the state court judge had used a multiplier, "an award of attorneys' fees differs from 'damages'" *Id*. at 617. and "nothing in Carolina Casualty's policy defines the word 'damages' broadly enough to include attorneys' fees." *Id*. The court of appeals said it

> looked for state decisions asking whether the phrase 'multiplied portion of multiplied damages' in insurance policies includes attorneys' fees. We could not find a single decision from a court of any state, or for that matter any federal court. The few decisions, state or federal, that do interpret this phrase arise from disputes about the coverage of treble damages under antitrust or antifraud legislation. Courts unsurprisingly say that the policies cover single damages but not the sum after trebling. See, e.g., *Foster v. D.B.S. Collection Agency,* 2008 U.S. Dist. LEXIS 22264 (S.D. Ohio Mar. 20, 2008).

*Id*.

The court found the "context of the phrase 'multiplied portion of multiplied damages' tells us that treble damages and the like are the target," and that "Adversaries' attorneys' fees in commercial litigation are not remotely like punitive damages, trebled damages, or criminal fines and penalties. A multiplier of hourly rates provides compensation for the attorney's risk. That does not entail moral hazard, which is risk-taking *by the insured*, induced by the insurance. A risk adjustment for legal fees, by contrast, makes up for the fact that in other suits defendants will prevail and lawyers will get nothing." *Id*. at 617–18.

Finally, the court also noted that the state court judge

> could have reached $3,150,000 by reckoning it as 12.11 percent of the shareholders' gain, and we assume that Carolina Casualty then would not be relying on the exclusion. Why should it matter that the judge got to the final award using the lodestar method rather than the percentage-of-benefit method? Carolina Casualty does not have a good answer.

*Id*. at 618.

## In Summary

If insurers do not want to be obligated to defend or indemnify their insureds for suits seeking awards of attorneys' fees, in the future they will have to adopt the wording of ISO's current CGL policy [CG 00 01 (Ed. 04/13)] that, while providing coverage for "All court costs taxed against the insured in the 'suit," clearly and unambiguously states, "these payments do not include attorney's fees or attorney's expenses taxed against the insured." In addition, the insurer would be well advised to adopt a "belt and suspenders" approach and make clear 1) in the Insuring Agreement's coverage grant that an award of attorneys' fees is not covered, and 2) in the definitions section that the terms "loss," "damages," and "money damages" do not include an award of attorneys' fees. E v e n these measures will not affect how courts may rule on claims of coverage for attorneys' fee awards under existing and prior "occurrence" forms or claims-made policies where notice of circumstances has been given and a future claim is found to relate back to the earlier policy period during which notice was given. FD