



Ambiguities in Policy Language Results in Coverage for Attorney’s Fees Awards Against Insureds

Published: *American Bar Association TIPS Insurance Coverage Litigation Committee Newsletter*

By Nathan B. Lee

A recent federal court ruling is another cautionary tale for insurers who write ambiguous provisions into their commercial general liability policy language. [*Wallace v. Nautilus Ins. Co.*, No. 18-CV-747-LM, 2019 WL 3302172, 2019 U.S. Dist. LEXIS 122219 (D.N.H. July 23, 2019)]

In *Wallace*, the homeowner plaintiffs hired a roofer (McPhail) to replace the roofs on their houses. After McPhail finished construction, plaintiffs noticed that their roofs were leaking, and they replaced the roofs. Thereafter, Plaintiffs commenced an arbitration proceeding against McPhail.

Nautilus Insurance Company (“Nautilus”), McPhail’s commercial general liability insurer, defended McPhail in the arbitration. During the arbitration hearing, the parties stipulated that the substantially prevailing party in this action must be awarded attorney’s fees in an amount to be determined by the arbitrator, together with expenses.

Following the arbitration hearing, the arbitrator issued an award, finding that McPhail had failed to properly install the roofs in accordance with the manufacturer’s instructions, and that the remedy of removing and replacing the roofs was reasonable. The arbitrator awarded plaintiffs the cost of replacing the roofs, compensation for the damage done to their property by the leaking, attorneys’ fees, and other expenses.

Nautilus paid plaintiffs on McPhail’s behalf roughly 10% of the arbitrator’s award, which included compensation for the damage to plaintiffs’ houses and property caused by the leaking, such as landscaping damages, repainting, and attic cleaning and reinsulation. In addition, Nautilus paid expenses and fees plaintiffs incurred in pursuing the arbitration, including expert witness fees and pre and post-judgment interest. Nautilus asserted, however, that its insurance policy with McPhail did not cover the cost of plaintiffs’ attorneys’ fees, and it refused to indemnify McPhail regarding same.

After McPhail declared bankruptcy, plaintiffs filed a declaratory action against Nautilus, seeking a declaration that the unpaid attorney’s fees portion of the arbitrator’s award is covered by

McPhail’s insurance policy with Nautilus. Nautilus bore the burden of proving that coverage does not exist.

First, Nautilus argued that its Policy’s Supplementary Payments provision, provides that Nautilus is obligated to pay all costs taxed against the insured in any suit that Nautilus defends, as well as any pre- and post-judgment interest. However, Nautilus contended that the Supplementary Payments provision was silent as to attorney’s fees, and as such, Nautilus is not obligated to pay such attorney’s fees on McPhail’s behalf.

Second, Nautilus argued that attorney’s fees cannot be considered damages because of property damage as interpreted under New Hampshire law.

The subject Policy’s Supplementary Payments provision provided in pertinent part:

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

Plaintiffs argued that the phrase costs taxed against the insured includes attorney’s fees. Plaintiffs noted that the Policy did not define costs taxed in the Supplementary Payments provision or elsewhere. Plaintiffs further contended that costs taxed as used in the Policy is ambiguous, and should be construed against Nautilus to include attorney’s fees.

Nautilus argued that its Policy expressly provides for payment of costs, prejudgment interest, and post-judgment interest, however, its omission of a similar provision for attorney’s fees demonstrated that attorney’s fees are not compensable under the Policy.

Ultimately, the Court held that because the phrase “costs taxed against the insured” was ambiguous, attorney’s fees that had been awarded by the arbitrator against the insured satisfied the supplementary payments definition and were covered by the subject Policy. The Court noted that any inference in Nautilus’ favor would be contrary to New Hampshire law, which construes ambiguities in the policy language against the insurer.

Courts’ Interpretation of Costs Taxed Varies Across the Country

Many courts have held that the phrase “costs taxed” includes an award of attorneys’ fees.

In *Ins. Co. of N. Am. v. Nat’l Am. Ins. Co.*, 37 Cal. App. 4th 195, 206–07, 43 Cal. Rptr. 2d 518 (1995), applying California law, the Court held that attorneys’ fees are costs taxed against an insured in the standard Supplementary Payments provision of an insurance contract. [Contractual agreement included a “prevailing party” clause entitling the prevailing party to its attorney fees,

attorney fees under such a contractual clause allowable as costs. (Cal. Civ. Proc. Code § 1032, 1033.5, subd. (a)(10)(A) (West)]. In California, attorneys' fees awards are made a part of the cost award. [Cal. Civ. Proc. Code § 1033.5 (West).] California Courts have held that these "costs" then fall within the Supplementary Payments provision.

In *Ferrell v. W. Bend Mut. Ins. Co.*, 393 F.3d 786, 796 (8th Cir. 2005), applying Arkansas law, the Court held that an attorneys' fee award in an underlying dispute "was part of the 'costs' taxed against the insured" (subject policy covered certain "supplementary payments" including "all costs taxed against the insured in the suit).

In *R.W. Beck & Assocs. v. City & Borough of Sitka*, 27 F.3d 1475, 1484 n.13 (9th Cir. 1994), applying Alaska law, court held that an "insurance policy provision providing for payment of 'costs taxed against the insured' covered attorneys' fees."

In *St. Paul Fire & Marine Ins. Co. v. Hebert Const., Inc.*, 450 F. Supp. 2d 1214, 1234– 35 (W.D. Wash. 2006), the Court held that the "costs taxed" provision included the attorneys' fees, and that the plain, ordinary meaning of the "costs taxed" clause in the insurance policies includes attorneys' fees.

In *Hunters Ridge Condo. Ass'n v. Sherwood Crossing, LLC*, 285 Or. App. 416, 395 P.3d 892, 905 (2017), the Court held that under Oregon law, the term "costs" as used in an insurance policy is ambiguous and should be construed against the drafter to include attorneys' fees.

However, a Hawaii federal district court held that interpreting the phrase "costs taxed against the insured" to exclude attorneys' fees is consistent with Hawaii law. [*CIM Ins. Corp. v. Masamitsu*, 74 F. Supp. 2d 975, 993 (D. Haw. 1999)]

ISO Changes in the Commercial General Liability Policy

However, as of the 2007 revision, the standard CGL Supplementary Payments provision does not include such attorneys' fee awards as costs. [Section 1.e. of the Supplementary Payments section reads that the insurer will pay with respect to any suit that it defends: All court costs taxed against the insured in any suit.' However, these payments do not include attorneys' fees or attorneys' expenses taxed against the insured. See, ISO Properties, CGL Form CG 00 01 12 07 at 8 (2007)]

If insurers do not intend to underwrite attorney's fees charged against their insureds, the insurers should consider adding exclusionary language to their policies, e.g., exclusive of attorney's fees. In the absence of such language, insurers run the risk of courts determining that their policies' coverage of costs will also include attorney's fees.

Nathan B. Lee is an Associate in the Encino office of Gray•Duffy, LLP. His practice focuses on civil litigation matters, including insurance coverage, personal injury and business-related disputes. He may be contacted at 818-907-4000 and nlee@grayduffylaw.com.

©2019. Published in Tort Trial & Insurance Practice Insurance Coverage Litigation Committee Newsletter, by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association or the copyright holder.