New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 257—NO. 6
TUESDAY, JANUARY 10, 2017

Outside Counsel

Expert Analysis

Are Contractually-Agreed Prevailing Party Attorney Fees Covered Under a CGL Policy?

By **Costantino P. Suriano**

And **Daniel Markewich**

Suppose you are advising a CGL insurer of an insured contractor that does renovation work on one floor of a New York City building. The job goes badly, causing damage to building property beyond the work area, and all tenants temporarily remove themselves from the building, resulting in the building owner's voluntary waiver of their rent and reimbursement of their moving costs.

Suppose further that the building owner sues the sloppy contractor for property damage for breach of contract and wins a substantial verdict that includes several hundred thousand dollars in attorney fees pursuant to their contractual provision that in the event of legal action to enforce any term of the contract, the party prevailing shall recover "reasonable attorney fees and costs."

This article discusses the circumstances under which such contractual legal fees might be covered under a CGL policy in New York. *First*, we analyze whether and when contractually granted prevailing party attorney fees may qualify either as damages for bodily injury or as property damage caused by an occurrence. *Second*, we consider when such attorney fees can be treated as equivalent to damages under a contract for what would have been common-law tort liability in the absence of contract. *Third*, we explain the result in the case of an "insured contract" when such legal fees form part of the building owner's damages for defending against a third-party claim arising from the insured contractor's breach of its contract with the owner. *Fourth*, we posit what might happen if the CGL policy includes an unusually broad definition of "damages" or "loss." *Fifth*, we explore whether such attorney fees might fit within the costs taxed against the insured in the underlying lawsuit. Finally, we track the more common result in New York, that the CGL policy will provide no insurance coverage for the prevailing party's contractual attorney fees.

> Under New York law, "costs taxed" in a GCL policy do not encompass contractual attorney fees.

Most CGL policies do not define "damages" or "loss," but covenant to "pay those sums that the Insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' … caused by an 'occurrence'." "No other obligation or liability to pay sums … is covered unless explicitly provided for under Supplementary Payments—Coverages A and B," which includes "[a]ll costs taxed against the Insured in the 'suit'."

"'Bodily injury' or 'property damage' for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement" is excluded from coverage, but the "exclusion does not apply to liability for damages (1) [t]hat the insured would have in the absence of the contract or agreement; or (2) [a]ssumed in a contract or agreement that is an 'insured contract.'"

COSTANTINO P. SURIANO *and* DANIEL MARKEWICH *are partners at Mound Cotton Wollan & Greengrass.*

An insured contract "means: … [t]hat part of any … contract or agreement pertaining to your business … under which you assume the tort liability of another party to pay for 'bodily injury' or 'property damage' to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement."

Solely with regard to an insured contract, "reasonable attorney fees … incurred by or for a party other than an insured are deemed to be damages because of 'bodily injury' or 'property damage'," if: "(a) [l]iability to such party for, or for the cost of, that party's defense has also been assumed in the same 'insured contract'; and (b) such attorney fees … are for defense of that party against a civil … proceeding in which damages to which this insurance applies are alleged."

The grant of coverage in this type of CGL policy is for "damages because of 'bodily injury' or 'property damage'" resulting from an accident or "occurrence." There is an exclusion from coverage for bodily injury and property damage for which the insured has assumed liability under a contract, but an exception to that exclusion for damages the insured would have had in the absence of the contract. As in the above definition of "insured contract," this exception should mean that common-law tort liability is covered. See *Commercial Union Ins. v. Basic Am. Medical*, 703 F. Supp. 629, 633 (E.D. Mich. 1989), even if assumed by contract as here.

But unless the building owner's contractual attorney fees are regarded as an offshoot of its property damage, this exclusion and exception do not appear to provide coverage for the attorney fees because the insured would have had no liability to the building owner for such fees under applicable New York law in the absence of the contractual provision. This is because to hold the loser liable for the winner's legal fees in the absence of a contract or statute so providing directly conflicts with the common-law "American rule," which New York follows. See, e.g., *Chicago Title Ins. v. LaPierre*, 140 A.D.3d 821, 822 (2d Dep't 2016) ("The 'American Rule,' which is followed in New York, is that 'an attorney's fee is merely an incident of litigation and is not recoverable absent a specific contractual provision or statutory authority.'");

> Most CGL policies do not define "damages" or "loss," but covenant to "pay those sums that the Insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' … caused by an 'occurrence.'"

A.G. Ship Maint. v. Lezak, 69 N.Y.2d 1, 5 (1986) (same).

Writing for Zurich online in Spring 2016, attorney J. Kent Howard opined in "Prevailing party attorneys' fees clause: Some challenges" that

> [b]y agreeing to pay the attorneys' fees of a client that prevails in a claim against the insured, the insured has created a contractual liability that is excluded from coverage because it is an obligation it would not otherwise have at common law, but which was created solely by virtue of the contractual promise.

There is no relevant explicit CGL coverage for the insured for legal fees relating to either bodily injury or property damage except, under another exception to the contractual liability exclusion, for "insured contracts" in connection with the building owner's defense of claims against it. But here no part of the building owner's claim for attorney fees derives from the "insured contract" exception, as the owner was not required to incur legal fees in defending any tort claims; rather, the owner voluntarily waived its tenants' rent and reimbursed their moving costs. The explicit inclusion of legal fees as within bodily injury and property damage under the "insured contracts" exception strongly suggests that, otherwise, attorney fees are not within bodily injury or property damage.

Of course, it is possible a court could find contractual attorney fees to be among the damages awardable to the insured for property damage under a breach of contract judgment. But a careful review of recent case law suggests that—absent a policy definition of "damages"—the CGL insurer has by far the better of that argument. Numerous New York appellate decisions, e.g., *Affiliated Credit Adjustors v. Carlucci & Legum*, 139 A.D.2d 611 (2d Dep't 1988); *Hinman, Straub, Pigors & Manning, P.C. v. Broder*, 89 A.D.2d 278 (3d Dep't 1982); and *Baker v. Dorfman*, 239 F.3d 415, 426 (2d Cir. 2000), hold that contractual attorney fees are not in the nature of "consequential damages." Further, a recent decision of the Texas Supreme Court, *In re Nalle Plastics Family Partnership*, 406 S.W.3d 168, 174 (Tex. 2013), holds

that they are not in the nature of "compensatory damages."

The New York Court of Appeals has declared, *Chapel v. Mitchell*, 84 N.Y.2d 345, 348-49 (1994), that attorney fees "for seeking legal redress are not recoverable as damages" although a prevailing party may collect them from the loser as "incidents of litigation" when, as here, "an award is authorized by agreement between the parties." As it appears in our hypothetical that the building owner's attorney fees qualify under New York law only as "incidents of litigation," but not as "damages," it is unlikely that coverage for those fees under the CGL insurer's policy with the insured will be found under the rubric of "damages."[1]

The only reported New York case law holding attorney fees covered in the absence of an explicit policy provision, *Sokolowski v. Aetna Life & Cas.*, 670 F. Supp. 1199 (S.D.N.Y. 1987), and *XL Specialty Ins. v. Loral Space & Communication*, 82 A.D.3d 108 (1st Dep't 2011), depended, respectively, on extremely broad definitions of "damages" and "loss" that are completely absent from our insurer's policy.[2] These decisions, which concern coverage for ERISA and derivative actions, provide no point of reference for a policy analysis here,[3] as no such definition pertains to our insurer's policy with its insured. Nevertheless, might the building owner's contractual legal fees be covered under this policy's Supplementary Payments provision not as akin to "damages" or "loss" but as "costs taxed against the Insured in the 'suit'"?

Three years ago, a divided Idaho Supreme Court held, *Employers Mut. Cas. v. Donnelly*, 300 P.3d 31 (Ida. 2013), that such attorney fees were covered as court costs taxed against the insured in the underlying lawsuit. Quoting from its earlier decision in *Mut. of Enumclaw v. Harvey*, 772 P.2d 216, 220 (Ida. 1989), the court opined at 35 that "[t]he plain, ordinary and popular meaning of 'costs' is the expense of litigation which includes attorney fees." Although the policy provision at issue was identical to ours, this decision under Idaho law is contrary to CPLR Article 81 and case law, which strictly confines court costs to the relatively small sums there fixed.[4] *Donnelly* has been followed by few if any courts outside Idaho, and never in New York.

But California law has long been similar to Idaho's, and it continues to be, at least for attorney fees for covered claims. See *Prichard v. Liberty Mut. Ins.*, 84 Cal. App. 4th 890, 912 (2000), as limited by *State Farm Gen. Ins. v. Mintarsih*, 175 Cal. App. 4th 274, 284-87 (2009). These decisions both derive from *Ins. of N. Am. v. Nat'l Am. Ins.*, 37 Cal. App. 4th 195, 206-07 (1995), which read the policy provision in tandem with §1033.5(a)(10) of the state's Code of Civil Procedure. That section expressly includes "[a]ttorney's fees, when authorized by … [c]ontract … [s]tatute … [or] [l]aw," as among "allowable … costs" in civil suits under §1032. To the contrary, New York's rules pertaining to taxable costs do not encompass attorney fees.

ISO has recently changed its forms, presumably in response to these decisions, so as specifically to exclude attorney fees from covered court costs, but many policies currently in force continue to employ the former language. Although there is no precedent including attorney fees as covered costs in New York, there is always the potential, however remote, for some future court to hold that their specific exclusion from new policy wording should be read as implying their inclusion until the wording was changed. Unless that day comes, however, under New York law, "costs taxed" in a GCL policy do not encompass contractual attorney fees.

1. *Hatfield v. 96-100 Prince St.*, 972 F. Supp. 246, 248 (S.D.N.Y. 1997), held that where punitive damages are awarded as part of the determination on the merits, a consequent award of attorney fees on the basis that "the miscreant party's tortious misconduct proximately caused his adversary to incur attorneys' fees" is not "so much punitive as compensatory" and, as a "classic form of compensatory, remedial damages," must be bonded by the insurer for appeal.

2. Several federal and state ERISA and shareholder derivative cases from outside New York have reached similar conclusions upon equally broad definitions.

3. Siegel, N.Y. Practice, sec. 414 (5th ed. with July 2016 supp.) observes that there are a few kinds of cases, such as class actions and claims against the state under the Equal Access to Justice Act, where "the legislature has varied the general rule and allowed an attorney's fee." Moreover, he notes, Congress has authorized attorney fees in federal civil rights litigation, even where the venue is in state court.

4. See, e.g., Siegel, loc. cit. (costs "are not … a substitute for an attorney's fee or even a theoretical equivalent"); *Harlan v. Weiner*, 80 Misc. 2d 723, 725 (N.Y.C. Civ. Ct. 1974) ("Nowhere … are costs referred to as reimbursement for attorney's fees … . [T]he weight of authority is that costs are distinct from attorney's fees.").