

No Coverage for Attorney's Fees Awarded Pursuant to Statute to Underlying Claimant

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The United States District Court for the Middle District of Pennsylvania, applying Pennsylvania law, has held that an insurer does not have to pay the underlying claimant's attorney's fees taxed against its insured pursuant to a federal statute where the policy excluded coverage for costs associated with injunctive relief or a declaratory judgment and the relief awarded to the claimant was solely injunctive. *Scottsdale Ins. Co. v. City of Hazleton*, 2009 WL 1507161 (M.D. Pa. May 28, 2009). The court also determined that the insurer did not have to pay the legal fees of defense counsel retained without the insurer's consent and that the insurer did not breach the policy or act in bad faith in connection with refusing to pay either the claimant's attorney's fees or the fees of the unapproved defense counsel.

The policyholder was a political subdivision organized under the laws of Pennsylvania that was sued for civil rights violations pursuant to a federal statute. The insurer provided a defense for the policyholder pursuant to a public entity insurance policy and otherwise reserved rights. At the time of trial, the operative complaint included only prayers for declaratory and injunctive relief and attorney's fees.

The insurer subsequently filed a declaratory judgment action seeking to establish (1) that it had no duty to defend or indemnify the underlying claim; (2) that it had no duty to pay the underlying claimant's legal fees; and (3) that it did not have to pay the legal fees of a second law firm retained by the insured in addition to the law firm provided by the insurer. The policyholder filed counterclaims for breach of contract, bad faith and declaratory relief. The insurer then moved for summary judgment as to its own claims and the policyholder's counterclaims.

The court first determined that the insurer's claim seeking a declaration that it had no duty to defend under the policy was moot because the defense was complete and "a declaration that there was no duty to defend [would not] entitle [the insurer] to recover any costs it has expended" under Pennsylvania law. It also noted that the indemnity issue was likewise moot, either because the insurer had not yet been required to indemnify the insured or because the court's subsequent determinations regarding attorney's fees would resolve the issue in the insurer's favor.

The court then considered the issue of the award of fees to the underlying claimant in light of the policy's exclusion "for claims, demands, or actions seeking relief or redress in any form other than monetary damages, or for any fees, costs or expenses which the insured may become obligated to pay as a result of any adverse judgment for declaratory relief or injunctive relief." The court found the undefined term "fees" in the exclusion was ambiguous and interpreted it in favor of the policyholder; however, the court then determined that the term "costs" was not ambiguous. According to the court, attorney's fees awarded pursuant to a federal statute "fall within the plain, ordinary meaning of 'costs.'" The court relied on the language of the civil rights statute, which stated that "the court, in its discretion, may allow the prevailing party . . . a reasonable attorney's fee as part of the costs" 42 U.S.C. § 1988(b). The court further supported its decision by noting that the relevant civil rights statute was explicitly cited in the policy, which meant that the potential for the policyholder to become liable for attorney's fees as part of costs was in the parties' contemplation when the policy inceptioned.

With respect to the attorney's fees incurred by the insured's unapproved counsel, the court stated that the insured's argument evidently was that the insured was entitled to select counsel that was free from a conflict of interest. The court first rejected the argument that, simply because the insurer had selected counsel for the insured, such counsel was conflicted. It also noted that the insured had not objected to the counsel selected by the insurer; rather, it has opted to retain additional counsel of its own choice. Citing the policy's language stating that the insured "will not, without [the insurer's] written consent, . . . assume any obligation, or incur any expense," the court determined that the insurer had no obligation to pay for the additional defense counsel.

The court then dismissed two of the policyholder's three counterclaims based on its arguments in support of granting the insurer's motion for summary judgment. With respect to the policyholder's allegation of bad faith, the court noted that it was "well-settled that, where a court finds no duty to defend or indemnify, a bad faith claim cannot survive 'because the court's determination that there was no potential coverage means that the insurer had good cause to refuse to defend [or indemnify]," citing *Frog, Switch & Mfg. Co. v. Travelers Ins. Co.*, 193 F.3d 742, 751 n.9 (3d Cir. 1999). Because of its prior coverage determinations, and because the insured had otherwise failed to identify clear and convincing evidence of bad faith, the court granted the insurer's motion for summary judgment on the bad faith claim.