

## OBTAINING ATTORNEY FEES IN ACTIONS AGAINST INSURERS

Under the American Rule, one who prevails in a civil action is not entitled to recover attorney fees absent a statute or contract provision that specifically provides for them.<sup>1</sup> Consequently, few victims of wrongdoing who seek recompense in the civil system are ever made whole. Plaintiffs' attorneys know well the irony of perpetually seeking to obtain for their clients compensation that is merely adequate while the corporate media have the public believing that plaintiffs in the civil system are winners of a liability jackpot.

Justice requires an award of attorney fees and costs in many insurance cases especially where the insurance consumer, be she the insured or the victim of the insured tortfeasor, must engage in civil litigation to obtain the benefit promised by the insurer. That benefit may be first-party medical coverage, a promise of defense, indemnity, fire insurance proceeds, uninsured motorist coverage, or a host of other benefits for which the insured bargained to assure security from risk. From the point of view of the injured plaintiff, the benefit may be the liability coverage of the wrongdoer.

The law governing attorney fees in actions against insurance companies is far from uniform in the United States. One state may deny attorney fees outright to an insured plaintiff who prevails in a coverage dispute, while another awards attorney fees outright in the same situation, and a third awards them only if the insurer initiated the action and not the insured. While I will, in this article, refer to the general common law rules as set forth in some of the insurance treatises, the main focus will be to review the law regarding awards of attorney fees in cases against insurance companies by insurance consumers or third-party claimants as developed by the Montana Supreme Court.

Fortunately, Montana common law recognizes equitable exceptions to the American Rule,<sup>2</sup> in cases involving insurance. As can be seen in the recent decisions of *Mt. West Farm Bureau Mut. Ins. Co. v. Brewer*,<sup>3</sup> and *Trustees of Indiana University v. Buxbaum*,<sup>4</sup> the Montana Supreme Court has developed a significant remedial body of law that can be used to obtain attorney fees and costs in cases where civil litigation has been necessary to secure the insurance benefit.

We might consider those cases in categories: First, there are the refusal to defend cases in which the insurance companies flatly deny coverage under liability policies and, therefore, refuse to defend their insureds from the civil claims for wrongdoing. In those cases, the insureds suffer damages in the form of attorney fees incurred in defending themselves.

Second, the insureds who are refused defense may suffer another distinct set of attorney fees, those incurred in bringing actions against the insurers for a declaration that the insurers must defend or had the duty to defend.

Third, there are the cases of the insurers' refusal to indemnify the insureds for the loss suffered in settlement or verdict. In such situations, the carriers may still undertake defense under reservation of rights, in effect warning the insureds that, because of the insurers' perceived lack of coverage or coverage disputes, they may have no duty to pay any resulting judgments or verdicts. In those situations, the insureds must assume the insurers intend to pay nothing and must analyze whether it is wise to let them continue in defense under reservation of right.<sup>5</sup> In such situations, the insured tort-feasors may suffer attorney fees in engaging in declaratory actions initiated by them or their insurers to determine coverage for indemnity. Or the insureds may negotiate their own settlements by assigning their rights to indemnity to the injured claimants who will bring third-party declaratory or bad faith actions. In either case, someone is going to suffer attorney fees and costs in securing the indemnity benefit from the insurers.

Fourth is the category of actions brought under the Uniform Declaratory Judgment Act<sup>6</sup> to enforce any promise of benefit made by the insurer, not just defense or indemnity. In each case, the insured or a third-party will likely hire an attorney and expend attorney fees and costs in forcing the carrier to pay the benefit. The question is whether the carrier can be made to pay in those circumstances.

Finally, there is the category of "bad faith" refusal of benefits in which the insurer's act of refusing benefits of any kind is deemed unreasonable or in some other way reflects bad faith in making the decision to refuse. This category has two sub-categories, first-party cases and third-party cases, which may be treated differently when attorney fee awards are at issue.

This article will briefly examine the way the Montana Supreme Court has treated these categories in determining whether insurance consumers have the remedy of an award of attorney fees and costs. The reader is forewarned that the task of categorizing the cases is not as simple as it seems. The decisions are not always clear on whether the proceeding to determine coverage or benefits was of the nature of a declaratory judgment action. Also unclear may be whether the attorney fees sought were for defending the underlying tort action or for bringing or defending the declaratory judgment action involving the insurer and the theory on which the court awarded the fees.

### **Attorney fees as compensatory damages for refusal to defend the first-party insured**

Generally, when an insurer wrongly refuses to defend, the insured can recover the attorney fees he expended in defending himself in the underlying action on the theory that such fees are direct damages caused by the insurer's breach of contract.<sup>7</sup> Later in this article I will discuss whether the insured can recover attorney fees and costs if he prevails in a declaratory action to secure the coverage and defense refused.

In Montana, the Supreme Court has approved awards of attorney fees suffered as a result of the insurer's refusal to defend. For instance, in 1967, the court awarded costs of defense to State Farm's insured, Thompson, in the case of *St. Paul Fire and Marine Ins. Co. v. Thompson*.<sup>8</sup> State Farm had refused to defend Thompson in an indemnity action brought against him by St. Paul, the insurer for a joint defendant. As a result of the refusal, the insured, Thompson, suffered damages in the form of attorney fees and costs in defending himself against the claim brought by his co-defendant. Thompson filed a third-party complaint against State Farm in the indemnity action brought by St. Paul, prevailed, and was awarded attorney fees and costs. We should note that Thompson's claim for attorney fees against State Farm involved those incurred in defending himself but apparently not those incurred in pleading and proving his third-party complaint.

In 1972, in *Home Insurance Company v. Pinski Brothers, Inc.*,<sup>9</sup> Home Insurance Company paid its insured, Montana Deaconess Hospital in Great Falls, \$135,000 for the loss resulting from a boiler explosion at the hospital. Home then brought a subrogation claim against the architects responsible for the hospital remodeling project involving the boiler. Ironically, those architects were also Home's insureds who demanded that Home defend them against the subrogation claim. Home refused defense. Ultimately, the Montana Supreme Court upheld the lower court's summary judgment for the architects on the ground that Home could not subrogate against its own insured in the first place and had wrongly refused coverage.

The architects sought attorney fees and costs for breach of Home's comprehensive liability policy for failing to defend. The court held that Home's refusal to defend "constituted a breach of contract even if based on an honest mistake, thereby rendering Home liable for defense costs resulting from such breach." This was so, even though there was no coverage on the second and third counts of the complaint. The court found it impossible to segregate the attorney fees involved in the covered as opposed to uncovered claims and noted that Home was the "moving party" in the litigation causing its insureds to expend fees in the subrogation action and resulting counterclaim for breach of contract. Accordingly, the court remanded for trial court determination of damages that presumably could include all of the insured's attorney fees.

Clearly this case stands for the proposition that one can obtain attorney fees suffered as compensatory damages for the insurer's failure to defend and the insured's resultant necessity of defending himself. Interestingly, it is also a case in which the insurer initiated an action in which the parties litigated the legal issue of whether the insured could subrogate against its own insured. In that respect, it is a declaratory action in which the insured likely was awarded attorney fees involved in seeking coverage.

In the 1984 decision of *Truck Insurance Exchange v. Wolstad*,<sup>10</sup> the insured, Action Sales, was sued by the personal representative of Wolstad who was burned and died in the explosion of a propane furnace in a pickup-camper sold by Action Sales. Truck Insurance Exchange refused Action Sales any defense on the ground that the explosion occurred after the policy expired. Action asserted that the "Completed Operations Hazard" and "Products Hazard" portions of the policy provided occurrence type coverage, because those portions of the policy were in effect when the product was sold.

Action Sales retained its own counsel to defend the wrongful death action. That counsel subsequently advised TIE of a settlement offer from Wolstad and demanded that TIE either settle the case or unconditionally assume the defense. TIE refused to respond or defend. The company also refused to respond to Action Sale's later warning that it planned to enter into a consent judgment and covenant not to sue with Wolstad for \$225,000. TIE then filed the declaratory judgment action to determine coverage, and the injured Wolstad, as assignee of the rights of Action Sales against TIE, successfully established coverage via summary judgment. Wolstad and Action Sales then moved to compel payment of the judgment by TIE, and Action Sales sought attorney fees and costs.

The court cited the fact that Action made repeated unsuccessful requests of Truck Insurance Exchange to assume the defense and said, "In light of Truck's breach, we find Truck liable for Action's attorney fees and costs in defense of this matter." The order simply states: "Affirmed and remanded to the District Court for determination of attorney fees and costs." It isn't clear whether this was a case in which the court awarded both the attorney fees suffered as a contract damage for the insurer's refusal to defend as well as those for handling the declaratory judgment action. The legal ground for awarding attorney fees on the declaratory judgment are not stated, nor are the awarding of the fees the subject of the dissents of Justices Weber, Gulbrandson and Shea.

### **Attorney fees incurred in prevail-ing in first-party declaratory judgment actions for coverage or benefits**

Most American courts have rejected attempts by insureds to obtain their attorney fees in proceedings under declaratory judgment statutes.<sup>11</sup> Nationally, the majority rule refuses attorney fees to the insured in declaratory actions over coverage.<sup>12</sup> Under the "New York Rule," the insured cannot recover in the action he initiates even if he prevails against the insurer in enforcing coverage.<sup>13</sup> Nevertheless, nationally there is a split of authority on recovery of attorney fees in declaratory actions over the insurer's duty to defend.<sup>14</sup> If the insured has to defend himself where the insurer takes the legal action to avoid coverage, and the insurer is found to have wrongfully refused coverage, courts do award the insured attorney fees.<sup>15</sup> Those courts that deny the fees generally follow the American Rule that, absent statutory or contractual provision, there can be no recovery of attorney fees.<sup>16</sup>

### (1) Under equity power to remedy unfairness in a declaratory action

Montana has developed a significant body of common law allowing attorney fees in declaratory actions involving insurance. In 1978, the court, in *Foy v. Anderson*,<sup>17</sup> established that it could award attorney fees in a declaratory action under its inherent equity power. In that case, injured plaintiffs, Foy and Gilreath, brought claims against Anderson, the driver who rear-ended them. A third passenger in the Gilreath vehicle, Karen Eggan, apparently suffered some injury but chose not to bring a claim. Driver Anderson sought defense and indemnity from his insurer, Farmers Insurance Exchange, which refused. Anderson then brought a declaratory judgment action against Farmers and included as party defendant the unwilling Karen Eggan, who subsequently prevailed on the court to dismiss her and award her attorney fees incurred in getting out of the declaratory action.

On appeal, the court upheld the award of attorney fees in the declaratory action citing its “power to grant complete relief under its equity power.” The court found persuasive the fact that Anderson made Eggan a party defendant when she had no intention of making a claim and said, “If defendant Eggan is dismissed from the case and not awarded attorney fees, she will not be made whole or returned to the same position as before plaintiff Anderson attempted to bring her into the lawsuit.” Obviously, Foy wasn’t a first-party insured, but the case reflects the theory that the court can, within its inherent equity power, award attorney fees in a declaratory action involving insurance in order to avoid unfairness.

### (2) As “reasonable expenses incurred by the insured at the request of the insurer”

The Montana Federal District Court awarded attorney fees to the insured in a declaratory action on the theory that his expenses in defending the action were expenses incurred by the insured at the request of the insurer under the cooperation and reimbursement clause of the policy. In *American States Ins. Co. v. Angstman Motors, Inc.*,<sup>18</sup> a grain truck at Havre was involved in a collision during harvest that resulted in injury to occupants of an automobile. At the time of the collision, the grain truck was the subject of an uncompleted “sale,” since the truck was being used on “approval,” the buyer had only paid half the price in cash, and no title transfer documents had been executed. Consequently, a dispute developed over whether the buyer Johnson’s insurer, American States, or the dealer’s insurer, USF&G, would have primary liability. The buyer’s insurer, American States, sued USF&G and its own insured, Johnson, in a declaratory judgment action in federal court to determine which carrier had primary responsibility. The court ruled that the truck still belonged to the dealer, that the dealer’s insurer, USF&G had primary coverage, and that American States had excess coverage.

Johnson sought attorney fees from his insurer, American, on the theory that they were reasonable costs incurred at the request of the company. Johnson based his claim on the policy clause that provided that his insurer would reimburse him for loss of wages or salary in connection with his attendance at hearings or trials and “to pay all reasonable expenses which the insured incurs at the request of American.” The court awarded Johnson the attorney fees reasoning that American had named him a party in a dispute that really only affected the two carriers. The issue wasn’t whether he had coverage, but which of the two carriers had primary liability. The court said, “American has, by naming him as party defendant, *required* that Johnson make an appearance in a case which involves only the duties of the opposing carriers.” The court deemed the question of which carrier must cover Johnson to be “collateral” to the duties American owed Johnson and ruled that his carrier must pay his attorney fees. The court said, “Johnson is entitled to recover *reasonable* attorney fees under the theory of *Standard Accident Ins. Co. of Detroit v. Hull*, 91 F.Supp. 65 (S.D. Cal. 1950).” It is interesting that in other jurisdictions this theory that the insured’s attorney fees are incurred at the request of the insurer and reimbursable under the expenses clause of the policy is roundly rejected and has been characterized as “manifestly unreasonable” by Windt.<sup>19</sup> This holding of the Federal Court in Montana does not appear to be supported by any Montana Supreme Court authority.

One could formulate from the *Angstman Motors* case a rule that, where the dispute is between carriers, and the insured is entitled to defense and indemnity in any event, he should recover attorney fees if he is made a party to a resulting declaratory judgment action.

On the other hand, in *Bill Atkin Volkswagen, Inc. v. McClafferty*,<sup>20</sup> the court refused to grant attorney fees in an action brought to determine which of two auto carriers had primary coverage liability and which was excess. In *Atkin Volkswagen*, the issue was whether the dealer’s garage liability policy or the customer’s personal auto policy would cover the damage caused when the customer negligently caused a collision while driving a “loaner” from Atkin Volkswagen. The plaintiff sued the defendant customer, McClafferty, who tendered the suit to Universal Underwriters Insurance Company for defense. Universal refused, and McClafferty’s personal carrier, Safeco, defended and settled the case. Meanwhile, Universal settled with its insured garage for a portion of the damage to the “loaner,” after which Atkin Volkswagen sued McClafferty on behalf of itself and Universal to recover the damage suffered to the “loaner.” McClafferty sued Universal by third-party complaint claiming to be Universal’s insured and sought to recover Safeco’s money paid to the plaintiff, Ogrin. McClafferty also sought attorney fees and costs under the law of *Home Ins. Co. v. Pinski*.

The Montana Supreme Court held that Universal’s coverage of the “loaner” was mandatory but that the two carriers would be pro rata responsible for primary coverage. Having so held, the court refused McClafferty’s request for attorney fees

and costs. The court found distinguishing the fact that *Pinski* involved a suit by the insurer against its own insured, which the court in *Atkin Volkswagen* described as “a wrongful attempt by an insurance company to bring an action which violates basic equitable principles of sound public policy.” The court said of *Atkin*, “This is essentially a suit between two insurance companies to determine which of two applicable overlapping policies provides coverage.”

It appears from reading the decision that actions taken by McClafferty may have been taken by his insurer in his name for the benefit of insurer and client. This was not a case in which the insured had to defend himself in the face of a refusal to defend; to defend a declaratory action brought by his insurer against him; or to bring a declaratory action to force his insurance carrier to defend or indemnify. In short, if the action involves a coverage dispute between two carriers, neither will be awarded attorney fees.

### **(3) As remedy for wrongful conduct of the insurer**

In *Lindsay Drilling & Contracting v. United States Fidelity and Guaranty Co.*,<sup>21</sup> USF&G refused to defend its insured, Lindsay Drilling, on claims that the company salted core samples to make it appear that certain mining properties contained more minerals than in fact existed. In a case filed under the Uniform Declaratory Judgment Act by Lindsay Drilling, the District Court held for USF&G. However, the Montana Supreme Court reversed, holding that the counterclaim alleging the salting did state claims covered by USF&G’s policy. The court held the insurer “liable for reasonable attorney fees, expenses and court costs occasioned thereby” citing *Home Insurance Company v. Pinski Brothers, Inc.* The court’s stated basis for the award was that “It was USF&G’s wrongful refusal to defend Lindsay which led to this action.” The case was remanded for determination of the attorney fees, expenses and costs. It appears that the attorney fees in question were those involved in the declaratory judgment action brought by the insured. Simply put, *Lindsay Drilling* fits under the insurance exception to the American Rule.

### **(4) Where the insured is required to defend a “frivolous or malicious” declaratory action brought by the insurer**

In *Goodover v. Lindsey’s, Inc.*<sup>22</sup> in 1992, the court, as a prerequisite to an award of attorney fees in a declaratory action that didn’t involve insurance, required that the prevailing party show he was “forced into a frivolous lawsuit and must incur attorney fees to dismiss the claim.” This was the “frivolous or malicious action” requirement for obtaining an award of attorney fees. Arguably, because *Goodover* was not an insurance case, its law would not apply in an insurance declaratory action. However, in 2001, the court applied the “frivolous or malicious action” restriction in an insurance interpleader action in *National Cas. Co. v. American Bankers Ins. Co. of Florida*.<sup>23</sup> There, Summers, a homeowner insured his premises with National Casualty intending to replace his American Bankers policy. However, through some error, he paid premiums and kept both policies in effect. When his place burned, a dispute arose over which carrier was primary under the “other insurance” clause. American Bankers paid the insured’s loss, while National Casualty interpleaded its benefit naming American Bankers and Summers in the declaratory action. American Bankers prevailed in its claim to the fire insurance proceeds interpleaded by National Casualty Company. However, the court refused American Banker’s request for attorney fees and costs on the ground that the action of National Casualty was not “frivolous or malicious.”

We can conclude that, if the insurer involves the insured in a declaratory action that is “frivolous or malicious,” the insured can invoke the insurance exception to the American Rule and will be entitled to attorney fees. However, the corollary that the insured’s request for attorney fees must be based on “frivolous or malicious” conduct of the insurer in bringing the declaratory action may not be true. Under the recently decided case of *Trustees of Indiana University v. Buxbaum*, (2003)<sup>24</sup> the “frivolous or malicious” standard is abandoned if the attorney fees are sought under the “supplemental relief” provision of the Uniform Declaratory Judgment Act, § 27-8-313. The remedy of award of attorney fees under that provision only requires a showing of “necessary or proper,” and the parameters suggested by the court as guidelines for that standard don’t appear to require any showing of “frivolous or malicious.”

### **Attorney fees for prevailing against a self-insured party on coverage**

In *Trustees of Indiana University v. Buxbaum*,<sup>25</sup> the sued party who sought defense and indemnity coverage from Indiana University and prevailed in the coverage dispute filed by the University was confronted with multiple problems in recovering attorney fees. First, Indiana University was self insured, so it was not an insurance company and did not have an insurance policy contract with the party demanding defense. Accordingly, the insurance exception to the American Rule did not apply to provide a legal basis for attorney fees.

In the case, three Indiana students and another Indiana resident were involved in the rollover of a Chevrolet Suburban owned by Indiana University and operated in Montana on a summer research project. Three deaths and a serious injury resulted. In the ensuing lawsuit, the estate of the driver, Jones, demanded defense and indemnity from Indiana University as a self-insurer. Multiple issues developed regarding the University’s duty to indemnify the responsible driver, the University’s status as an insurer, and coverage. Indiana University brought a declaratory action against the Jones estate and the estate of deceased passenger, Krueger, to resolve the issues.

After denying cross motions for summary judgment, the court heard the matter in non-jury trial and found for the estates over the University of Indiana. The judge awarded the estates their costs, expenses, and attorney fees but later altered the judgment to delete those amounts on the ground that there was no contractual or statutory basis for their award. Though the court found an award of attorney fees to be within its equitable power under the 1978 case of *Foy v. Anderson*,<sup>26</sup> it also found the University's action did not meet the "frivolous or malicious action" restriction placed on that equitable power to award attorney fees as set forth in *National Cas. Co. v. American Bankers*.<sup>27</sup> There being no basis for an attorney fee award under an insurance exception, the estates argued that the Uniform Declaratory Judgment Act provided for attorney fees.

Consequently, the sole issue on appeal was whether the District Court erred when it denied the prevailing estates their attorney fees. The estates argued that the court could award attorney fees as "costs" under §27-8-311 of the Uniform Declaratory Judgments Act, since §27-8-311 provides for recovery of "costs" in the following language: "In any proceeding under this chapter the court may make such award of costs as may seem equitable and just." The estates further argued that the attorney fees could be awarded as "supplemental relief" under §27-8-313 of the Act, which provides:

Further relief based on a declaratory judgment or decree may be granted whenever necessary or proper. The application therefore shall be by petition to a court having jurisdiction to grant the relief. If the application be deemed sufficient, the court shall, on reasonable notice, require any adverse party whose rights have been adjudicated by a declaratory judgment or decree to show cause why further relief should not be granted forthwith.

One problem with any theory based in the UDJA was that the Montana Supreme Court had explicitly stated in 1978 in *State ex rel. Dept. of Health and Environmental Sciences v. Lincoln County*,<sup>28</sup> in 1994 in *McKamey v. State*,<sup>29</sup> and in 1998 in *Dorwart v. Carraway*,<sup>30</sup> that there is no provision for an award of attorney fees in a declaratory judgment action. This may seem surprising given cases like *Lindsay Drilling* mentioned above where the insureds recovered attorney fees in declaratory actions to secure defense from their insurers. However, those recoveries were premised on the insurance exception to the American Rule and not on any provision of the UDJA. Consequently, in *Indiana University*, the court had to reevaluate its position and analyze whether attorney fees were awardable under theories that they were "costs" under §27-8-311 or "supplemental relief" under §27-8-313.

The court's review of precedent clearly established that attorney fees are not included in "costs" in Montana and hence, not available under §27-8-311. However, the court held that attorney fees could be awarded as "supplemental relief" under §27-8-313 if the court determined that they were "necessary or proper" within the language of the statute. In order to arrive at that result, the court overruled the *Lincoln County*, *McKamey* and *Dorwart* cases insofar as they indicated attorney fees could not be recovered in declaratory actions.

The court then wrestled with what it termed the nebulous nature of the words "necessary and proper" to "articulate some tangible parameters" in awarding attorney fees and costs. To do so, the court reviewed the Ohio Appellate Court's 1999 case of *McConnell v. Hunt Sports Ent.*<sup>31</sup> to arrive at the following guidelines or parameters:

1. Attorney fees are appropriate in the "anomalous result" circumstance in which, without an attorney fee award, the insured "would have been worse off than if a declaration of their rights had never been made." For instance, if the insured doesn't receive attorney fees in the declaratory action and has to bring a bad faith suit to be made whole, it is an anomalous result.
2. Attorney fees are appropriate in declaratory actions when no other alternative is available. If the insured must file a declaratory action to obtain the benefit of the insurance, then attorney fees are necessary and proper.
3. On the other hand, if the declaratory action is filed "for purely tactical reasons," attorney fees may not be appropriate.

Technically, one could argue that *Indiana University* is not about insurance but declaratory judgment actions. However, the court used the case to provide an attorney fee remedy against a self-insurer one week and cited the case as a means to provide attorney fees to a prevailing third-party in an insurance declaratory action, *Mountain West Farm Bureau Mut. Ins. Co. v. Brewer*,<sup>32</sup> the next week. In *Brewer*, the court declined to expand the Insurance Exception to the American Rule to include attorney fees for third-party claimants who had no contractual relationship with the insurer involved. However, the court asserted that its holding "does not leave the Christensons without recourse in their attempt to recover their attorney fees." The court cited the recently decided *Trustees of Indiana University* case and said, "§27-8-313, MCA, authorizes a court to award attorneys fees when the court, in its discretion, deems such an award 'necessary and proper.'" The court remanded *Brewer* to the District Court for a determination of whether attorney fees and costs were "necessary or proper," and in what amount.

In essence, *Indiana University* provides an additional theoretical basis for an award of attorney fees in a case that will not fit under the insurance exception. The legal import is clear insofar as the ruling will allow attorney fees where the third-party

has prevailed in the declaratory action against the insurer. That is a significant incentive for the injured third party who is tempted to file his own declaratory judgment action.

### **Attorney fees for refusal to indemnify the first-party insured**

Until recently, the court awarded attorney fees in liability coverage disputes only in those cases of failure to defend. The court would not award such fees for failure to indemnify. The court historically distinguished between the insurer's refusal to defend, for which it would allow fees, and the refusal to indemnify for which it would not. In *Yovish v. United Services Auto. Ass'n*,<sup>33</sup> USAA had refused to indemnify and the insured successfully established right to indemnity in a declaratory action. In refusing the prevailing insured's plea for attorney fees, the court acknowledged the artificiality of the distinction between refusing defense and refusing indemnity but said, "[t]he legislature, not the courts, must remedy the wrongs created by this situation." Given the Montana Legislature's reticence to grant consumer remedies against insurance companies, continued adherence to that principle of deference would have prevented any expansion of attorney fee awards.

Such was the state of Montana law when the Ninth Circuit Court of Appeals looked to Montana law to decide *Troutt v. Colorado Western Ins. Co.*<sup>34</sup> in 2001. In *Troutt*, the insurer agreed to cover the insured tavern owner, Troutt, for liability caused by injury arising out of the sale, service or furnishing of alcohol. The claimant, Engstrand, had most of his fingers amputated when he and others were using a mechanical log splitter behind the tavern premises. During the insurer's investigation of Engstrand's claim, no disclosure was made to the insurer by witnesses that alcohol was involved. Neither did the pleadings make any such allegation. It became apparent at the underlying trial, which the carrier had refused to defend, that the tavern's alcohol was significantly involved in the accident. Consequently, after the fact, the United States District Court decided, and the Ninth Circuit affirmed, that the carrier did have a coverage obligation but did not fail to investigate or wrongfully refuse to defend. Looking at Montana law, the Circuit Court followed *Yovish* affirming that there could be no attorney fees for a wrongful failure to provide coverage absent a breach of the duty to defend.

Fortunately, the court recently reassessed its deferral to the legislature in the salutary decision of *Mountain West Farm Bureau Mut. Ins. Co. v. Brewer*.<sup>35</sup> There, the court expanded the insurance exception to the American Rule to include attorney fees expended in establishing a duty to indemnify. In doing so it overturned *Yovish*. The court cited *Pence v. Fox (1991)*,<sup>36</sup> for the principle that "[t]he courts have the responsibility to reform common law as justice requires." Because *Yovish* also involved the question of attorney fees to secure indemnity, its rule of legislative deference was an impediment to any judicial expansion of the attorney fee remedy in *Brewer*, so that the court overruled it. The court expressly rejected the "transparent" distinction between an insurer's refusal to defend for which the common law allowed attorney fees, and a challenge to existence of coverage for indemnity for which the courts traditionally have refused attorney fees.

Consequently, the court said, "we hold that an insured is entitled to recover attorney fees, pursuant to the insurance exception to the American Rule, when the insurer forces the insured to assume the burden of legal action to obtain the full benefit of the insurance contract, regardless of whether the insurer's duty to defend is at issue." While the benefit at issue in *Brewer* was clearly the duty to indemnify, it is interesting to note the breadth of the holding which would appear to apply "when the insurer forces the insured to assume the burden of legal action to obtain the full benefit of the insurance contract, regardless of whether the insurer's duty to defend is at issue." Does the holding apply to any benefit or just the benefit of indemnity? Are "benefit" and "indemnity" interchangeable in this context, since an insurance benefit indemnifies the insured for loss? The language is not restricted, and the court could easily have limited the award to legal actions to obtain defense or indemnity. The problem being remedied in the holding is forcing the insured "to assume the burden of legal action to obtain the full benefit of the insurance contract." That problem exists in many situations where the benefit is neither defense nor indemnity. Predictably, the insurers will take the position that *Brewer* applies only to refusal to provide indemnity to a first-party insured. It remains for insurance consumer counsel to establish the limits of this very important case.

### **The quest for attorney fees in the third-party action for indemnity**

On occasion, when the insured's liability carrier disputes coverage so as to deny indemnity, it is the injured third-party plaintiff who has the most urgent interest in securing a court determination of coverage. For instance, the first-party insured may, by reason of insolvency, have insufficient interest to expend his own money for attorney fees and costs in securing the coverage denied by the insurer. In such a case, the injured third-party may have to assume the burden of forcing a coverage determination. The investment may be risky, because the carrier's evaluation is that there is no coverage, and the court may agree. In fact, the additional risk likely falls on the plaintiff's lawyer who often undertakes the work of coverage enforcement under the standard contingent fee agreement as part of the underlying tort claim. Nevertheless, because the American Rule applies in the underlying tort case, it is in the plaintiff client's interest to recover reasonable attorney fees and costs if he or she prevails in the declaratory action in the ever-necessary effort to be made whole.

In *Mountain West Farm Bureau Mut. Ins. Co. v. Brewer*,<sup>37</sup> the parents of the injured minor passenger, Angie Christenson, successfully pressed the third-party declaratory action to enforce coverage by Mountain West. Having prevailed, they sought attorney fees and costs under dual theories that (1) the insurance exception to the American Rule should be

expanded to provide attorney fees to an injured third-party who prevails in an insurance coverage action against a motor vehicle insurer, and (2) the “supplemental relief” provision<sup>38</sup> of the Uniform Declaratory Judgment Act allows an award of attorney fees to the third-party prevailing in such a declaratory action.

As reported above, the court in *Brewer* agreed that the insurance exception to the American Rule should be expanded to provide for attorney fee awards in declaratory actions for indemnity. However, the court declined to expand the exception to include declaratory actions on indemnity brought by third-party claimants. The court noted that their decision expanding the insurance exception to indemnity determinations rested almost entirely upon authority found in first-party cases. The court considered the absence of the traditional contractual relationship in third-party cases and found there was no exploitation of inherently unequal bargaining power in such situations, nor was there frustration of any “justifiable expectation of insurance protection” held by the injured third-party. Moreover, the court refused Christenson’s contention that, by enacting compulsory motor vehicle liability insurance, the legislature set a public policy to “extend the right to enforce the insurance contract to injured persons, not just insureds” thereby raising a justifiable or reasonable expectation on the part of the third party or creating a sort of third-party beneficial interest in the coverage. This holding is consistent with other jurisdictions. Even when tort plaintiffs who are named as party defendants by insurers seeking a determination that there is no coverage prevail to win coverage, they are held not to be entitled to their attorney fees.<sup>39</sup>

Ironically, therefore, Christenson’s crowning achievement of extending attorney fee awards to declaratory actions for indemnity in the *Brewer* case did not apply to Christenson’s own third-party claim. Justice Trieweiler dissented from that result on the ground that distinguishing between first-party and third-party on the issue of whether the company has a duty to indemnify is artificial. Fortunately, the court did not leave Christensons without remedy regarding attorney fees, but agreed they could be available, in the court’s discretion, under Christenson’s second theory of “supplemental relief” under the Uniform Declaratory Judgments Act.<sup>40</sup> The court cited *Indiana University* and remanded the case for a hearing on whether the attorney fees were “necessary and proper” under the “supplemental relief” provision, §27-8-313 MCA. All’s well that ends well!

#### **Attorney fees for bad faith refusal of benefits**

Several jurisdictions have awarded attorney fees where the insured has prevailed in a coverage action and the insurer acted in bad faith in refusing the coverage.<sup>41</sup> This exception applies where the “conduct of the insured in refusing a defense reflects fraud, bad faith, or stubborn litigiousness.”<sup>42</sup> The rule in the 1985 California case of *Brandt v. Superior Court*,<sup>43</sup> states the theory best:

When an insurer’s tortious conduct reasonably compels the insured to retain an attorney to obtain the benefits due under a policy, it follows that the insurer should be liable in a tort action for that expense.

Unfortunately, in 1986, in *Tyne v. Bankers Life Co.*,<sup>44</sup> the Montana Supreme Court said of that quote, “We have not adopted this policy in Montana and do not choose to do so today.” The court vacated a District Court award of roughly \$20,000 in attorney fees assessed against Bankers Life for the company’s failure to pay approximately \$50,000 in medical bills. Banker’s conduct in the case included excessive and repeated delays in investigation, failure to make a timely coverage determination, changing determinations on coverage, and providing to a treatment center written confirmation of coverage and then revoking coverage while the insured was in treatment for severe psychosis. The jury’s award of \$100,000 damages for emotional distress and \$200,000 in punitive damages reflects the wrongful nature of Banker’s conduct in the case. Nevertheless, the court declined to adopt an award of attorney fees for bad faith conduct.

In essence, until the recent decision in *Brewer*, claims for benefits other than defense were claims for “indemnity” for which an insured could not recover attorney fees after prevailing in a declaratory action. Now, with *Brewer’s* rule expanding the right to attorney fees to those cases where the insured establishes the right to “indemnity” (i.e., reimbursement of any money loss), there is arguably a basis for allowing attorney fees in an independent tort action for bad faith.

This issue may be complicated by the fact that in 1987, the Montana legislature intended to corral all potential claims for bad faith refusal of benefits under one statute, the “Independent Cause of Action” of MCA §33-18-242. The statute doesn’t mention attorney fees, but provides in pertinent part as follows:

(1) An insured or a third-party claimant has an independent cause of action against an insurer for actual damages caused by the insurer’s violation of subsection (1), (4), (5), (6), (9), or (13) of 33-18-201.

\* \* \*

(4) In an action under this section, the court or jury may award such damages as were proximately caused by the violation of subsection (1), (4), (5), (6), (9), or (13) of 33-18-201. Exemplary damages may also be assessed in accordance with 27-1-221.

Based on prior case law, it seems quite certain that “actual damages” under the statute would have to include the insured’s costs of defense in cases where the insurer, acting in bad faith, has refused defense. Are the attorney fees expended in engaging in a successful effort for court declaration of coverage “actual damages” recoverable under the statute? Are attorney fees expended in enforcing coverage “proximately caused” so as to be proper for award under §33-18-242 (4)? Those issues remain to be resolved.

### **Attorney fees for third-party bad faith claims**

In *Morris v. Nationwide Ins. Co.*,<sup>45</sup> Morris, a rancher, brought a third-party action against Nationwide Insurance Company for its breach of the Unfair Claims Settlement Practices Act<sup>46</sup> for its conduct in conducting negotiations in Morris’s fire damage claims against its insured, Sun River Electric Co-op. The trial court instructed the jury that, if they found Nationwide violated its duty under the statute, they could award “all losses proximately caused thereby” and that such award “shall include . . . Attorney fees and costs incurred in prosecuting the lawsuit against Nationwide’s insured, Sun River Electric Co-op.” The only issue on appeal was whether the court erred in restricting the attorney fee to the percentage contingent fee agreed between plaintiff and his lawyer or whether it should have been the much larger reasonable fee calculated on an hourly basis. What appears not at issue in the case is the premise that attorney fees in trying the underlying case are recoverable damages where the insurer has engaged in bad faith breach of the UTPA by such conduct as failing to attempt to effectuate prompt and fair settlement. This case preceded the “Independent Cause of Action” statute of 1987. One can assert that the case provides authority for the proposition that attorney fees incurred in trying a third-party bad faith claim for failure to negotiate should be included in the “actual damages” referred to in the statute. Moreover, based on the 1999 *Brewington v. Employers Fire Ins. Co.*<sup>47</sup> decision, third-party common law bad faith is still alive in Montana. Consequently, in such cases, *Morris* is authority for recovering the attorney fees from the underlying action.

### **Conclusion**

The Montana Supreme Court has developed a significant set of attorney fee remedies in cases in which insured consumers or third-party tort victims prevail in legal actions to establish coverage and right to defense or indemnity. Under basic contract law, when the insurer refuses defense, the insured is entitled to recover his costs of defense of the underlying action as compensatory damages for breach of contract. A first-party insured can recover attorney fees under the insurance exception to the American Rule when he prevails in a declaratory action establishing coverage for defense or for indemnity. Though a third-party insured cannot recover attorney fees under the insurance exception when he prevails in a declaratory action to establish coverage for defense or indemnity, he can recover such fees under the “supplemental relief” provisions of the UDJA if the attorney fees are deemed “necessary and proper” by the court. A party establishing coverage for defense or indemnity against a self-insurer can also recover attorney fees under the “supplemental relief” provisions of the UDJA even absent an insurance contract or an “insurer.” The first-party insured can make a case that any “independent cause of action” under §33-18-242 should include in “actual damages” allowed the attorney fees incurred in enforcing the insurer’s promises. The third-party in a bad faith action also can make the case for recovery of attorney fees incurred as a result of the carrier’s bad faith conduct.

The continued development of the remedy of attorney fees in cases against insurers will help resolve the problem of insurers denying claims based on the simple economics of saving money by failing to pay claims. The powerful attorney fee remedy makes it possible to take on cases for insurance consumers that would otherwise lack financial viability. Review of the Montana Supreme Court’s holdings on attorney fee recovery in insurance cases as compared to the general common law in the United States reminds one to take a minute to feel gratitude for the level playing field we enjoy in Montana and the care with which this court crafts its decisions for justice. ♦

1. Mt. W. Farm Bureau Mut. Ins. Co. v. Hall, 2001 MT 314, 308 Mont. 29, 38 P.3d 825.

2. Id.

3. 2003 MT 98, 315 Mont. 231, 69 P.3d 652.

4. 2003 MT 97, 69 P.3d 663.

5. See, Munro, The Insurer Reservation of Rights Letter and the Duty to Defend, TRIAL TRENDS, Summer 2001, for a full treatment of insurer’s defense under reservation of rights.

6. MCA §27-8-101 et. seq. (2001).

7. Irvin E. Schermer, Automobile Liability Insurance vol. 2, §29.08 (3d ed., Clark, Boardman, Callaghan 1995).

8. 150 Mont. 182, 433 P.2d 795 (1967).

9. 160 Mont. 219, 500 P.2d 945 (1972).

10. 212 Mont. 418, 687 P.2d 1022 (1984).

11. Barry R. Ostrager and Thomas R. Newman, Handbook On Insurance Coverage Disputes, §5.05(b), (11th ed., Aspen L. And Bus. 2002).
12. Id
13. Id.
14. Id.
15. Id.
16. Id.
17. 176 Mont. 507, 580 P.2d 114 (1978).
18. 343 F. Supp. 576 (Dist. Mont.1972).
19. Alan D. Windt, Insurance Claims and Disputes vol. 2, §8:14 (4th ed., West 2001).
20. 213 Mont. 99, 689 P.2d 1237 (1984).
21. 208 Mont. 91, 676 P.2d 203 (1984).
22. 255 Mont. 430, 843 P.2d 765(1992).
23. 2001 MT 28, 304 Mont. 163, 19 P.3d 223.
24. 2003 MT 97.
25. Id.
26. 176 Mont. 507, 580 P.2d 114.
27. 2001 MT 28.
28. 178 Mont. 410, 584 P.2d 1293 (1978).
29. 268 Mont. 137, 885 P.2d 515 (1994).
30. 1998 MT 191, 290 Mont. 196, 966 P.2d 1121.
31. 725 N.E. 2d 1193 (1999).
32. 2003 MT 98.
33. 243 Mont. 284, 794 P.2d 682 (1990).
34. 246 F.3d 1150 (9th Cir. 2001).
35. 2003 MT 98.
36. 248 Mont. 521, 813 P.2d 429 (1991).
37. 2003 MT 98.
38. Mont. Code Ann. §27-8-313.
39. Schermer, supra n. 7, at §29.08.
40. Mont. Code Ann. § 27-8-313.
41. Windt, supra n. 19, at § 9:24; Ostrager and Newman, supra n. 11, at §5.05(b).
42. Schermer, supra n. 7, at §29.08.
43. 693 P.2d 796 (1985).
44. 224 Mont. 350, 730 P.2d 1115 (1986).
45. 222 Mont. 399, 722 P.2d 628 (1986).
46. Mont. Code Ann. §33-18-201.
47. 1999 MT 312, 297 Mont. 243, 992 P.2d 237.