

# Special Bulletin

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## California Court Of Appeal Finds That Supplementary Payments For "Costs Taxed" Can Be Recovered Through Settlement And Does Not Require Actual Taxing By A Court.

by Linda Tai Hoshide and Monica C. Mendes

On November 19, 2008, the Court of Appeal in *Employers Mutual Casualty Co. v. Philadelphia Indemnity Insurance Co.*, 169 Cal. App.4th 340 (2008) affirmed the trial court's ruling that the defendant insurer must contribute an equitable share of a settlement payment made on behalf of the parties' mutual insured, including a payment of attorneys' fees under the supplementary payments provision of the applicable policy.

In *Employers Mutual*, the insured, Louis Simpson doing business as Villa Park Mobilehome Park ("Simpson"), was sued by the Villa Park residents in the underlying action pursuant to the Mobilehome Residency Law. The Villa Park residents alleged that Simpson failed to maintain a number of things at the mobile home park such as the sewer, electrical, water, and gas systems, the streets, the fences and walls, and the laundry facilities.

Simpson tendered the underlying action to Philadelphia Indemnity Insurance Company ("Philadelphia"), Employers Mutual Casualty Company ("Employers"), Evanston Insurance Company ("Evanston"), and Scottsdale Insurance Company ("Scottsdale").

Employers and Evanston agreed to provide a defense for Simpson in the underlying action, but both Philadelphia and Scottsdale denied coverage.

The underlying action eventually settled for \$3 million and Employers and Evanston each contributed \$1.5 million. The settlement allocated \$1.8 million of the proceeds to plaintiffs' attorney's fees and costs and the remainder covered damages. Employers and Evanston also paid post-tender attorney fees and costs for a total of \$740,759.16. Subsequent to the settlement, Evanston assigned its contribution rights to Employers.

Employers sued both Philadelphia and Scottsdale for contribution toward the \$3.7 million it paid in the underlying action. The trial was bifurcated and after the first phase, the trial court ruled that Philadelphia and Scottsdale had a duty to defend Simpson.

In the second phase, the trial court issued a statement of decision and judgment. *Id.* The trial court applied the "time on the risk" method of allocating costs relative to the underlying action and found that the pertinent time period was between 1995 and 2004 and thus, 2/9ths of the burden was placed on Scottsdale (1995-1997) and 2/9ths on Philadelphia (1997-1999).

Under the supplementary payments provisions within both policies, the trial court found that Scottsdale and Philadelphia owed Employers contribution of 2/9ths of the \$1.8 million payment for attorney fees.

The trial court reasoned that the "word 'taxed' [within the supplementary payments provision] does not literally require a court order of taxation. The word 'taxed' properly encompasses this situation, where the settling parties forecasted and compromised their estimates about the sums likely if the matter went to trial and to an eventual court order. Neither Philadelphia nor Scottsdale gave a restrictive definition of this word 'taxed' in their policies. In fact, they did not define the key word at all." Philadelphia subsequently appealed the trial court's judgment.

On appeal, Philadelphia argued that it was not required to contribute to the \$1.8 million Employers sought to recover for attorneys' fees and costs it paid to Simpson in the underlying action. In the supplementary payments coverage, the Philadelphia policies provided that it would pay "[a]ll costs taxed against the insured in the 'suit.'"

The parties specifically disagreed on the meaning of the word "taxed." In its analysis, the court first looked to the dictionary definition of "taxed." According to the court, the dictionary defines "tax" as "to judicially assess the amount of costs; levying a tax on; making an onerous demand on."

Philadelphia argued that the first definition was the definition intended by the parties, but the court found that the word “taxed,” as used in the Philadelphia policies, was ambiguous. Specifically, the court held that it “narrowly could refer to a judicial assessment of costs or broadly to any levy of an assessment.” Accordingly, the court construed the term broadly.

To support its argument, Philadelphia relied on the holding in *Pritchard v. Liberty Mutual Insurance Co.*, 84 Cal. App. 4th 890 (2000) where the court held that a settlement following a judgment included the cost award.

Specifically, Philadelphia argued that the court’s holding in *Pritchard* established “that costs can only be taxed against a party after a judgment.” The court noted, however, that the *Pritchard* court failed to address that issue. Philadelphia also relied on *Insurance Co. of North America v. National American Insurance Co.*, 37 Cal. App. 4th 890 (1995) where “an award of attorney’s fees following judgment was a cost taxed against the insured.”

The court ultimately found that the holdings in both of those cases did “not establish that costs taxed cannot include attorney fees paid in settlement.” The court further found:

As a matter of public policy and equity, our interpretation is sensible. It permits an insured to settle a claim instead of pursuing an action to judgment and risking a greater liability. It also permits one of multiple insurers to settle an action and seek contribution of taxed costs. Public policy encourages settlement....Additionally, if taxed costs did not include anticipated costs in a settlement, insurers would be discouraged from settling cases with high costs because they would be barred from seeking contribution. Our holding eliminates that dilemma.

Philadelphia also argued that Employers was “estopped from claiming that statutory attorney fees fall within the supplementary payments coverage of the Philadelphia policies...because there is no evidence that Employers or Evanston paid any portion of the [underlying] settlement out of their own supplementary payments coverage.” The court, however, rejected this argument and found that Philadelphia failed to establish any of the elements of estoppel, “including that Philadelphia relied to its detriment on Employers and Evanston disavowing the application of their own supplementary payments coverage.”

Finally, Philadelphia attempted to argue that its obligation to pay costs taxed to the insured arises only after liability is established and liability was never established in the underlying action. The court rejected this argument and found that although Simpson did not admit liability in the underlying settlement, it established Simpson’s liability for purposes of insurance.

The court explained that where an insured is forced to defend itself in an underlying action and then subsequently sues its insurer for reimbursement, the insured’s reasonable settlement of the underlying action may be used as a presumption of evidence of the insured’s liability in the underlying action and the amount of such claim.

## COMMENTARY

The *Employers Mutual Casualty Co. v. Philadelphia Indemnity Ins. Co.* case is a case of first impression in California construing the phrase “costs taxed” in the Supplementary Payments provision. This decision allows recovery between carriers under the “costs taxed against the insured” provision for money paid in settlement on behalf of the mutual insured. The Court of Appeal specifically rejected the argument that “costs taxed” can only arise after liability is established in the underlying action. We also note that payments made under the Supplementary Payments provision will likely fall outside the policy limits.

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