

No Coverage for Complaints Against Insured Law Firm Alleging Improper Withholding of Fees

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The United States District Court for the Northern District of California, applying California law, has held that coverage is not available under a lawyers professional liability policy for two suits alleging that the insured law firm wrongfully withheld amounts exceeding the statutorily allowable fees recovered in an underlying matter because such allegations are not based on the provision of "legal services." *Colony Ins. Co. v. Fladseth*, 2013 WL 1365988 (N.D. Cal. Apr. 3, 2013). The court also held that coverage for one of the suits was further precluded because the complaint sought only restitution or disgorgement of funds, which are carved out from the definition of covered "Damages" under the policy. Finally, the court held that coverage also would be precluded by the fee dispute and personal profit exclusions.

The insured law firm and its sole practitioner were sued in two separate actions, each alleging that the insured improperly withheld fees in excess of the maximum amount allowed under California law pursuant to California Business and Professions Code Section 6146. Each of the lawsuits asserted causes of action against the insured for money had and received, fraud, conversion, accounting and violations of California's Unfair Competition Law. The lawsuits sought, among other forms of relief, disgorgement, as well as punitive and special damages. The insured tendered notice of the actions to its insurer, which agreed to defend under a reservation of rights. The insurer then filed a declaratory judgment action seeking a declaration that it did not owe a defense or indemnity for the actions, and filed a motion for summary judgment.

The California federal district court granted the insurer's motion for summary judgment. First, the court held that the underlying actions did not trigger the insuring agreement, which provided coverage for "sums any insured becomes legally obligated to pay as 'damages' because of an act, error or omission arising out of your 'legal services' rendered or that should have been rendered." In so holding, the court found that "the underlying complaints do not create the potential for coverage because they are not based on providing legal services," which are defined in relevant part as the "usual and customary services of a licensed lawyer in good standing." The court explained that "the billing and fee-setting acts at issue are administrative tasks and not the usual and customary services of a lawyer." The court held that "legal services," and the more general phrase "professional services," each make a "distinction between skills or knowledge specific to the profession, and administrative tasks, such as billing, inherent to all businesses, and . . . found that the latter is

not encompassed with these terms.”

Next, the court held that coverage also was not available for one of the actions because the complaint sought only restitution or disgorgement of funds improperly gained, which are not covered “damages” under the policy. The court noted that a declaration filed in the suit “makes clear that these claims seek return of the money wrongfully taken as fees” and that there is no evidence “that would support an award of damages beyond the compensation of the money that [the insured] is alleged to have acquired wrongfully, apart from the request for exemplary and punitive damages.” With regard to the second action, the court found that the insurer had not met its burden to establish the absence of the potential for coverage based upon the allegations in the second complaint that the insured should pay a “penalty” for his improper actions.

The court also found that “[e]ven if there were coverage for either case, there is no material dispute of fact that the [underlying] actions fall into two different exclusions contained in the policy, for disputes over fees for services and the gaining of personal profit or advantage to which the insured was not entitled.” The exclusion for fee disputes bars coverage for claims “[b]ased on or directly or indirectly arising out of the rights or duties under any agreement including disputes over fees for services.” The court held that the claims at issue “indisputably” concerned disputes over fees, implicating the exclusion. The court rejected the insured’s contentions that the underlying plaintiffs might assert additional allegations in the future, stating that, “[b]ecause [the insured is] ‘not entitled to justify an argument for coverage based on speculation about claims that have not been alleged or asserted,’ the arguments are unavailing.”

Finally, the court held that indemnity coverage was precluded by the policy’s personal profit exclusion, which barred coverage for claims “[b]ased on or directly or indirectly arising out of or resulting from . . . the gaining by any insured of any personal profit, gain or advantage to which an insured is not legally entitled; . . . [h]owever, [the insurer] shall defend such allegations against any insured if it involves a ‘claim’ otherwise covered under the Policy until final adjudication.” The court held that, because the claims “arise out of the insured’s unlawful gaining of a profit or advantage to which it wasn’t entitled” and because the claims at issue are not otherwise covered by the policy, this exclusion barred indemnity coverage.