

New York Federal Court Holds Insurer Has Duty to Defend Fee Dispute, Claims Are Related

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The United States District Court for the Southern District of New York, applying New York law, has held that an insurer must defend a law firm in connection with an adversary proceeding filed by a bankrupt client of the firm regarding a dispute over the law firm's fees. *Mandel Resnik Kaiser Moskowitz & Greenstein P.C. v. Exec. Risk Indem. Inc.*, 2005 WL 1712024 (S.D.N.Y. July 15, 2005). In so holding, the court relied heavily on extrinsic evidence of the insurer's internal claims handling process. Further, *in dicta*, the court agreed with the insured that the adversary proceeding was a related claim under the applicable policy language but disagreed with its contention that the insurer was equitably estopped from denying coverage.

The insurer issued a professional liability insurance policy to a law firm. During the policy period, the law firm filed an application with the bankruptcy court overseeing a client's bankruptcy seeking \$7 million in fees owed to the firm. The client filed an objection to the application, and the law firm notified the insurer of the objection in a timely manner. The insurer acknowledged that the objection met the definition of a claim under the policy and consented to the retention of counsel to defend the law firm. The client subsequently filed suit against the law firm, seeking to recoup allegedly fraudulent transfers to the firm. The law firm again notified the insurer and requested that the same counsel representing it in connection with the prior objections to its fee application represent the firm in the client's adversary proceeding. Three months after the adversary proceeding was filed, the insurer indicated for the first time that it would not cover the costs of defending the adversary proceeding because it did not allege a "wrongful act" in the provision of professional services but was simply a "billing dispute." The law firm filed the instant action shortly thereafter seeking a declaration that the insurer had breached its coverage obligations.

Treating the question as whether the duty to defend had been breached, the court rejected the insurer's contention that the policy did not require it to defend the law firm in the adversary proceeding. First, the court reasoned that the policy did not contain an exclusion that expressly precluded coverage for "billing disputes." The court noted that New York law imposes the burden on the insurer to "show that the claims in the complaint fall 'solely and entirely within the policy exclusion, and further, that the allegations *in toto* are subject to no other interpretation." Applying this standard, the court concluded that the law firm's "decisions about how and whom to charge for its legal work could certainly be found to be 'services provided . . . as an

attorney,' as the Policy defines 'Professional Services.'" Based on this observation, the court held that "the Complaint on its face does not unequivocally excuse [the insurer] from indemnifying its policyholder."

The court further reasoned that extrinsic evidence—in this case an internal claims memo tracking the law firm's claim—also supported its conclusion regarding the insurer's duty to defend. The internal memo detailed the setting of reserves for the initial objections and noted that the reserve would need to be modified if a malpractice suit were filed. The court held that "it is evident from this entry that [the insurer] expected to defend the claim." The internal memo also contained a report of a meeting at which employees of the insurer discussed coverage for the claim at issue and reached a conclusion at odds with the insurer's refusal to defend the law firm. The court noted that the insurer's "attempt to dispute coverage began a few weeks after this internal assessment was made, and soon after the deductible on the policy had been exhausted."

Although noting that its conclusion regarding the insurer's duty to defend relieved the court of the necessity of determining whether the initial objection filed by the client was related to the adversary proceeding the client filed later, the court proceeded to set forth the analysis. In this regard, the court noted "that the lawsuit is manifestly related to the objection, and under the policy must be afforded the same 'treatment' as the initial claim." The court rejected the insurer's contention that the related claims language in the policy applied solely to matters of timing, concluding that "[i]f [the insurer] intended to limit the scope of the 'related claim' language to reporting obligations only, it could have done so." The court reasoned that the policy at issue obligated the insurer to treat the objections and the adversary proceeding as a single claim and that the insurer "having recognized th[e] objection as a Claim under the Policy, cannot refuse coverage of the Complaint as unrelated."

As a final matter, the court rejected the law firm's contention that the insurer was estopped from denying coverage because the law firm undertook its defense in reliance on the insurer's initial approval. The court reasoned that "to make out a successful estoppel claim in New York, the insured must show it was prejudiced by an unreasonable delay." Here, the court found that the insured undertook its own defense during the period it was waiting for the insurer's coverage position and was not deprived of the opportunity to defend itself. The court expressly rejected the law firm's contention that it was prejudiced by the delay because it spent more money to defend itself than it otherwise would have in the belief that the insurer would pay for the defense.

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