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Expert Analysis

Case Law Suggests Counsel Should Advise Clients About Available Insurance

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Over the years, we have often reminded insureds of the importance of promptly placing their insurance carrier on notice of new claims. Based on recent case law, defense counsel are advised to raise the issue of available insurance with their clients when counsel are retained to defend a new claim.

In many insurance policies, timely notice is a condition precedent to coverage. Thus, the failure to provide timely notice can, in some cases, result in a loss of the right to insurance. Many states, including New York, have acted to reduce the impact of such policy conditions, by imposing a prejudice requirement and forcing the insurer to demonstrate that the late notice caused prejudice before permitting the insurer to deny coverage. But even so, there remain many other reasons that providing prompt notice of claim is important. For example, a carrier's obligation to pay defense costs is typically not triggered until after tender, so defense costs incurred before notice are unlikely to be covered. In addition, the claims process, and payment of defense costs, is more likely to go smoothly if the carrier is kept apprised of the status of the litigation and the defense strategy.

For these reasons, and others, notice to the insurance carrier should be placed high up on the risk manager's checklist of immediate steps to take when a claim comes in the door. Given the Second Department's ruling this past summer in *Soni v. Pryor*, addressing the potential availability of insurance should likewise be placed high up on the checklist for defense counsel.

'Soni v. Pryor'

While New York courts have not yet expressly stated that defense counsel have a duty to advise their clients regarding the potential existence of insurance to cover a claim, they have implied that such an obligation exists. In *Soni v. Pryor*, the plaintiffs had retained the defendants, Robert L. Pryor, A. Scott Mandelup, and Pryor & Mandelup, LLP, to represent them in an action brought against them by CIT Healthcare. CIT alleged that the plaintiffs, in their roles as directors and officers of several corporations, had aided the corporations "in committing acts of fraud[.]" At some point, defendants withdrew from the representation without having advised the plaintiffs that the CIT's claims might be covered under the directors and officers (D&O) insurance policy issued to one of the corporations controlled by plaintiffs. 139 A.D.3d 841, 842 (N.Y. App. Div. 2016).

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Plaintiffs then commenced an action against their former lawyers, alleging that defendants failure to advise them of the existence of insurance that would cover CIT's claims constituted legal malpractice. Pryor and Mandelup moved for summary judgment on the grounds that any failure to advise the plaintiffs of the existence of insurance coverage could not be the proximate cause of plaintiffs' loss because the D&O policy did not actually provide coverage for the claims at issue. The Supreme Court denied the motion

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and Pryor and Mandelup appealed. Id. On appeal, the Appellate Division, Second Department, first reviewed the standard for legal malpractice, explaining that in order to recover damages for legal malpractice, "a plaintiff must demonstrate that the attorney failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession and that the attorney's breach of this duty proximately caused plaintiff to sustain actual and ascertainable damages." Id.

In their motion, Pryor and Mandelup argued that plaintiffs could not demonstrate proximate cause because (1) the fraud exclusion in the insurance policy barred coverage for the insurance claim; and (2) plaintiffs had failed to provide timely notice to the insurer. Id. at 842-44.

The Second Department rejected these arguments, affirming the order denying plaintiffs' motion for summary judgment. The court explained that the fraud exclusion contained a final adjudication requirement, which made it effective only where "final adjudication establishes that such criminal, fraudulent or dishonest act occurred." Id. at 843-44.

Since there had been no such final adjudication in the underlying case, the court held that defendants were not entitled to summary judgment on that basis. Likewise, the Second Department found that the defendants could not demonstrate that notice to the insurer would have been untimely as a matter of law. Id. at 844.

The Second Department ruling permitted plaintiffs to continue to prosecute the legal malpractice claim before the Supreme Court, implying that the law firm's alleged failure to advise its clients of the potential for insurance coverage might constitute malpractice. This is consistent with prior New York precedent, including a ruling issued by the Court of Appeals.

Court of Appeals: 'Darby & Darby'

This issue of whether defense counsel has a duty to investigate and inform a client of potential insurance coverage appears to have first been discussed by the Court of Appeals in 2000. In *Darby & Darby v. VSI International*, plaintiff Darby & Darby withdrew from its defense of VSI in a patent and trademark infringement case after VSI failed to pay all of its legal fees. Darby & Darby then sued VSI for the outstanding fees. VSI counterclaimed, alleging legal malpractice based on Darby & Darby's failure to investigate and inform VSI that the underlying patent infringement claims might be covered by VSI's general liability insurance policy. 739 N.E.2d 744, 745-46 (N.Y. 2000).

The Supreme Court denied Darby & Darby's motion to dismiss VSI's counterclaim for legal malpractice, finding that plaintiff's failure to investigate insurance coverage presented an issue of fact regarding the scope of the retention. Id. at 746.

On appeal, the Appellate Division modified the ruling and dismissed the counterclaim for failure to state a cause of action, holding that in the absence of an express statement in the engagement letter, counsel owed its client no duty to investigate insurance coverage. Id.

The Court of Appeals affirmed the dismissal of VSI's counterclaim for legal malpractice, but based on a different rationale. The Court of Appeals noted that whether an attorney has breached the standard of care owed to its client is measured by the circumstances existing at the time of the representation. According to the court, at the time of the Darby & Darby representation, both New York and Florida (the other potentially relevant jurisdiction) had rejected insureds' claims that general liability policies provide coverage for patent infringement claims like the those faced by VSI. At that time, in fact, only California and a handful of other jurisdictions had recognized such claims. Id. at 747.

The court affirmed dismissal of the counterclaim, ruling that Darby & Darby could not be held liable for failing to advise VSI about a "novel and questionable theory pertaining to their insurance coverage" and explained that "[b]ecause plaintiff acted in a manner that was reasonable and consistent with the law as it existed at the time of the representation, it had no duty to inform defendants about possible … insurance coverage for their patent infringement litigation expenses." Id. at 748. Although the court upheld dismissal of the malpractice claim, the ruling implies that, had insurance coverage for the patent infringement claims been widely acknowledged, counsel might have committed malpractice by failing to investigate and inform its clients of the availability of insurance to cover the pending claims.

Southern District: 'O'Shea'

In *O'Shea v. Brennan*, the U.S. District Court for the Southern District of New York addressed a similar counterclaim for legal malpractice under New York law. Once again, a law firm sued a former client for outstanding legal fees, and the former client counterclaimed alleging legal malpractice for failure to investigate potential insurance—this time with regard to an underlying tortious interference with contract claim filed against the client. No. 02 Civ. 2296(KNF), 2004 WL 583766, at *5 (S.D.N.Y March 23, 2004).

Relying on *Darby & Darby*, the client contended that the Court of Appeals had implicitly recognized that defense counsel has a duty to advise its client about possible insurance coverage, at least in circumstances where the question of

coverage is straight-forward and does require a novel theory. Id. at *14.

The Southern District was not persuaded by the argument and granted plaintiff's motion for summary judgment with regard to the legal malpractice claim. The court pointed out that what may be implicit in *Darby & Darby* does not constitute "viable authority." Id.

Further, the Southern District indicated that, if such a duty did exist, the client could not have prevailed without submitting expert testimony in support of the breach claim and to demonstrate proximate cause. Id.

Second Dep't: 'Shaya B. Pacific'

In *Shaya B. Pacific v. Wilson Elser*, the Second Department was faced with a legal malpractice claim filed against defense counsel appointed by the primary insurer. A construction worker who was injured on the job sued Shaya B. Pacific, seeking more than $52 million in damages. Shaya B. Pacific's primary insurer retained Wilson Elser Moskowitz Edelman & Dicker to defend the case and, in a letter, suggested that Shaya B. Pacific review whether it had excess coverage, because the primary policy had a $1 million limit of liability. Wilson Elser allegedly did not initially investigate the existence of excess insurance coverage. After a judgment on liability was entered, Wilson Elser then tendered the claim to the excess insurer but the insurer denied the claim, in part based on late notice grounds. Subsequently, Shaya B. Pacific filed suit against Wilson Elser alleging legal malpractice based on a failure to investigate possible insurance coverage and notify the insurer of a claim on the client's behalf. 38 A.D.3d 34, 36-37 (N.Y. App. Div. 2006).

The Supreme Court granted Wilson Elser's pre-discovery motion to dismiss the legal malpractice claim and plaintiff appealed to the Appellate Division. Id. at 37. Wilson Elser argued that there is no New York authority that supports the proposition that a client may maintain a legal malpractice action against its attorney for failure to investigate insurance coverage. The Second Department, based primarily on its reading of *Darby & Darby*, rejected this argument, explaining that, in *Darby & Darby*, the Court of Appeals' ruling turned on the fact that the existence of insurance coverage for the claims at issue was far from clear and required advancement of a novel insurance theory. The Second Department emphasized that the Court of Appeals had not ruled that "an attorney may never be held liable for failing to discover available insurance coverage." Id. at 41. Consequently, the Second Department reversed the order that had granted Wilson Elser's motion to dismiss and refused to find that, as a matter of law, defense counsel retained by the insurer can never be liable for the failure to investigate coverage. Id. at 43.

The prudent practice, given the state of the law, is for defense counsel to consider the issue of available insurance soon after retention in connection with a new claim. This practice will be to the benefit of the client and will also ensure that counsel meets its obligations, implied or possibly otherwise.

Fourth Dep't: 'Utica Cutlery'

Finally, in *Utica Cutlery v. Hiscock & Barclay*, a plaintiff sued its former attorney, alleging legal malpractice based on the attorney's failure to timely notify the plaintiff of available insurance coverage in connection with a trade dress infringement case filed against it. The law firm, Hiscock & Barclay, moved for summary judgment but the motion was denied by the Supreme Court. On appeal, the law firm focused on causation, arguing that it was not the proximate cause of Utica Cutlery's injury. The firm also argued that plaintiff was comparatively negligent because it had also failed to investigate the potential for insurance coverage. The Fourth Department affirmed denial of the motion for summary judgment, holding that there were material issues of fact that prevented summary judgment as to both issues. 109 A.D.3d 1161, 1161-62 (N.Y. App. Div. 2013).

As to the causation issue, the Fourth Department pointed out that the attorney's action only needed to be "*a* proximate cause, not *the* proximate cause." Id. at 1162.

Looking Forward

No court in New York has held defense counsel liable for legal malpractice based on the failure to investigate potential insurance coverage for a client. In fact, no court has expressly ruled that defense counsel has an obligation to perform such an investigation. However, the decisions discussed above certainly imply that such a duty exists, at least under certain circumstances.

The prudent practice, given the state of the law, is for defense counsel to consider the issue of available insurance soon after retention in connection with a new claim. This practice will be to the benefit of the client and will also ensure that counsel meets its obligations, implied or possibly otherwise.