

Must Defense Lawyers Advise Clients About Insurance Coverage?

BY ROY SIMON

On December 19, the Second Department conjured up the ghost of an issue that I thought had been laid to rest long ago. In *Shaya B. Pacific, LLC v. Wilson Elser Moskowitz Edelman & Dicker, LLP*, 2006 WL 3733752 (2d Dep't 2006), a divided panel held that in some circumstances a legal malpractice action may be maintained against an attorney for failing to investigate an insurance coverage issue. In reaching this holding, the majority distinguished *Darby & Darby, P.C. v. VSI International, Inc.*, 95 N.Y.2d 308, 716 N.Y.S.2d 378 (2000), a case that had received tremendous press as it moved up through the courts. In this article I will recount the history of the *Darby & Darby* case, then discuss the *Shaya B. Pacific* case, and finally make some general observations about the insurance coverage issue.

Background: Darby & Darby Shocks the Legal World

In 1990, a Florida sunglass and reading glass wholesaler named VSI International, Inc. ("VSI") retained Darby & Darby, one of America's oldest intellectual property law firms (founded in 1895), to defend the company in two Florida state court suits accusing VSI of patent, trademark, and trade dress infringement in the racks that VSI used to display glasses. VSI paid most of Darby & Darby's legal bills for a couple of years, but then it fell behind. By September 1993 VSI owed Darby & Darby almost \$200,000 in legal fees, so Darby & Darby moved to withdraw. The Florida court granted leave to withdraw, and Darby & Darby turned over its litigation files to new counsel without asserting an attorney's retaining lien.

VSI's new counsel immediately advised VSI that the company's comprehensive general liability ("CGL") insurance policy might cover the legal fees and costs of the Florida litigation. VSI promptly filed a claim, and its insurance carrier agreed that the CGL policy covered the intellectual property claims. The carrier agreed to pay VSI's legal fees going forward, but denied coverage for all litigation expenses that VSI had incurred before it filed an insurance claim.

In 1996, Darby & Darby sued VSI in New York County Supreme Court for almost \$207,000 in attorney's fees, interest, and costs. VSI responded with a counterclaim alleging that Darby & Darby had committed legal malpractice by failing to advise VSI that its comprehensive general liability insurance might cover the defense of the Florida litigation.

Darby & Darby moved to dismiss the counterclaim. It argued that its professional responsibilities and duties as VSI's attorneys "only extended to the actual litigation and that it was not incumbent upon the law firm to advise the defendants about matters which related to the financing of the litigation." Darby & Darby also argued that VSI, as holder of the insurance policy, "had the sole responsibility for realizing that the policy might cover the lawsuits against them and for submitting a claim for coverage." In opposition, VSI argued that an attorney who is retained to represent a client in litigation "is not merely a technician whose responsibilities ... are limited to legal strategy," but is also "a counselor who has a duty to advise a client who has been sued on all matters pertaining to the litigation so as to minimize the

client's liability." VSI argued that it would not have incurred Darby & Darby's legal fees if the firm had advised them about the possibility that the intellectual property claims were covered by insurance.

Relying on California Decision

In his opinion, Hon. Franklin Weissberg noted that Darby & Darby had "failed to cite a single case supporting its contention that, as a matter of law, it did not owe the defendants a duty to inquire about their insurance coverage." Although the court could not find any New York authority obligating a lawyer to advise a client about insurance coverage, Judge Weissberg seized on a recent California Supreme Court case, *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison*, 18 Cal.4th 739 (1998), holding that for purposes of the statute of limitations on legal malpractice claims, Brobeck's client had suffered "actual injury" when its law firm failed to investigate its insurance coverage or advise the manufacturer to notify its insurer of the underlying suit. Implicit in the *Jordache* decision was a holding that, under certain circumstances, a law firm's failure to inquire about its client's insurance coverage is actionable.

The *Jordache* opinion persuaded Judge Weissberg that Darby & Darby's failure to investigate VSI's insurance coverage, or to alert VSI to the potential availability of insurance to cover litigation expenses might be legal malpractice. Resolution of the legal malpractice issue would depend on questions of fact, including "the sophistication of each party regarding potential insurance coverage" and the "scope" of Darby & Darby's engagement in the intellectual property matters, but Judge Weissberg considered it "particularly noteworthy" that

Darby & Darby's successor counsel had promptly and successfully pursued the insurance issue. Accordingly, the court denied Darby & Darby's motion to dismiss VSI's legal malpractice counterclaim. See 178 Misc.2d 113, 678 N.Y.S.2d 482 (1998). Many lawyers thought the sky was falling, and Darby & Darby appealed.

The Appellate Courts Side with Darby & Darby

The First Department reversed. In a short opinion, the unanimous panel said: "In the absence of a factual assertion that the scope of the task for which counsel was retained specifically included inquiry into the nature and extent of its insurance coverage and whether it was applicable to the claim, the retention of counsel for the defense of such an action simply does not include any responsibility for assisting the client in determining whether sources exist from which to pay for that defense and any ultimate liability finding."

The First Department's opinion did not put the legal world totally at ease, however, because it envisioned "particular circumstances," such as personal injury actions arising out of automobile accidents, in which defense attorneys might be obligated "to bring to the client's attention the possible existence of an insurance policy applicable to the claim." But intellectual property lawyers could relax because the First Department found "no support for the proposition that an attorney who was retained to defend a business client in intellectual property litigation has a duty to inquire into the existence, nature and scope of insurance policies previously procured by the client, and to determine whether any such policy provides the client with any entitlement in relation to the claim being litigated." A lawyer's duty to advise clients about all available causes of action and avenues of defense thus did not "translate into a broad duty to inquire into all the client's insurance coverage."

Not surprisingly, VSI could not cite any case in which a court had sustained a claim of attorney malpractice based upon "an alleged failure to advise a client to make a claim under an insurance policy, when the attorney was neither provided with the policy nor asked for advice as to the scope of its coverage." The California Supreme Court's opinion in *Jordache*, which had heavily influenced the court below, simply did not justify imposing a new professional duty upon an attorney in these circumstances, and the First Department did not perceive any other justification in law for imposing such a duty. "It was defendants themselves who procured the general liability insurance policy," the First Department said, "and they were chargeable with the knowledge of whether that insurance covered the pending litigation." Nor did the First Department consider it germane that Darby & Darby's successor counsel had immediately pursued the question of insurance coverage with successful results. "[T]his Court will not impose an obligation upon a law firm not otherwise imposed by law," the court said, "based upon the tasks performed by successor counsel."

In *Darby & Darby, P.C. v. VSI International, Inc.*, 95 N.Y.2d 308, 716 N.Y.S.2d 378 (2000), the Court of Appeals affirmed the First Department. But the Court of Appeals left some room for argument in later cases. As Judge Ciparick saw it, the gravamen of VSI's legal malpractice claim was that Darby & Darby had a duty to advise it that the company's CGL policy might cover Florida litigation costs. But this claim was based on "a then novel theory that patent insurance coverage was available under an 'advertising liability' clause in general liability policies," and on the actions of successor counsel, who later secured coverage for litigation expenses. Even assuming VSI's allegations to be true, Judge Ciparick said, Darby & Darby owed VSI no such duty. What constitutes ordinary and reasonable skill and knowledge should be measured at the time of representation, and at that time neither New York nor Florida recognized an insurer's duty to defend patent infringement claims under a general liability policy's advertising injury clause. Moreover, the theory of such coverage had remained "largely undeveloped." When Darby & Darby was representing VSI, only a "handful" of courts (mainly in California) had required CGL carriers to cover patent infringement claims. Since Florida and New York, the two most relevant States, had rejected such coverage, Darby & Darby had no duty to advise VSI of possible coverage for patent infringement claims.

VSI acknowledged the "novel nature" of its claim, but argued that Darby & Darby, as "a highly specialized patent law firm," had a duty to keep abreast of emerging legal trends. The Court of Appeals was not persuaded. "We agree that attorneys should familiarize themselves with current legal developments so that they can make informed judgments and effectively counsel their clients," the court said, "but Darby & Darby should not be held liable for failing to advise VSI about "a novel and questionable theory" about insurance coverage.

In the wake of the Darby & Darby case, concerns about a duty to advise clients about insurance coverage seemed to disappear. The only case to discuss the issue in depth was *O'Shea v. Brennan*, 2004 WL 583766 (S.D.N.Y. 2004). There, Sean O'Shea, a New York attorney, had represented Dr. H. George Brennan in connection with a defamation action that Dr. Brennan had filed against Ene Riisna, a former patient and the producer of the ABC News program 20/20. Riisna was apparently fired as a result of the suit, and he retaliated by suing Dr. Brennan for tortious interference with contract and other alleged wrongs. O'Shea defended Dr. Brennan for a time in the New York suit, but Dr. Brennan apparently did not pay his bills, and in 2002 O'Shea sued Dr. Brennan for legal fees. Taking his cue from Darby & Darby, Dr. Brennan counterclaimed for legal malpractice, alleging that O'Shea had failed to advise Dr. Brennan about his insurance coverage in connection with Riisna's tort action. Specifically, Dr. Brennan contended that the

reasoning of the Court of Appeals in *Darby & Darby*, "leaves no doubt that attorneys are now duty-bound to investigate their client's coverage in certain circumstances." According to Dr. Brennan, "Implicit in the Court's holding is that if an insurance policy clearly covers a client's litigation expenses or risk, a lawyer has a duty to advise the client about possible insurance coverage."

Magistrate Judge Fox rejected that argument, writing:

What might be implicit in the court's holding in *Darby* does not constitute viable authority in this case. Furthermore, it is not clear, given the complexity of the law in this area, whether a jury could conclude, without the benefit of expert testimony, either that O'Shea's failure to advise his client about his insurance coverage was a breach of his professional duty of care or that his conduct caused the defendant's alleged damages.

Therefore, Magistrate Judge Fox held that O'Shea was entitled to judgment as a matter of law on the insurance advice element of Dr. Brennan's counterclaim for legal malpractice.

The Facts in *Shaya B. Pacific, LLC v. Wilson Elser*

In *Shaya B. Pacific, LLC v. Wilson Elser Moskowitz Edelman & Dicker, LLP*, 2006 WL 3733752 (2d Dep't 2006), the Second Department addressed a slight twist on the insurance issue. "The principal issue presented on this appeal," Justice Fisher wrote for the majority, "concerns whether a law firm, retained by a primary carrier to defend its insured in a pending action, has any obligation to investigate whether the insured has excess coverage available and, if so, to file a timely notice of excess claim on the insured's behalf." The facts were straightforward. In April 2000, Kazimierz Golebiewski was seriously injured while performing demolition work at the premises of Shaya B. Pacific, LLC ("Pacific"). Golebiewski commenced a personal injury action against Pacific. In July 2000, Pacific's primary carrier, Certain Underwriters at Lloyds of London ("Lloyds"), retained Wilson Elser, to defend against the personal injury action. The policy limit of the Lloyds primary policy was \$1,000,000, but Golebiewski sought damages of \$52,500,000, so in January 2001, Lloyds wrote Pacific to say, "[Y]ou may wish to check with your insurance agent to determine if any excess insurance coverage is in force. If so we would urge you to quickly notify any excess insurance carrier of this suit situation."

In February 2003, Golebiewski won summary judgment on liability under Labor Law § 240(1) and trial was set on damages only. In late April 2003, before the damages trial began but more than two years after Lloyds had urged Pacific to notify its excess carrier, Wilson Elser tendered the case to National Union Fire Insurance Company ("National Union") for further defense and for indemnification on the excess claim. National Union had issued a commercial umbrella policy to Grendel Developers, Ltd. ("Grendel"), which was not a party to Golebiewski's action against Pacific and whose relationship to Pacific was not revealed in the appellate record. In May 2003, in a letter addressed to both Grendel and Pacific, National Union declined the tender and disclaimed coverage on the grounds that (a) it had not received timely notice of Golebiewski's action, and (b) it could not confirm that Pacific was even an insured under the excess policy. In October 2003, Golebiewski won a judgment against Pacific of more than \$5,600,000, far in excess of the Lloyds \$1,000,000 policy.

In March 2004, Pacific sued Wilson Elser for legal malpractice and breach of contract, claiming that Wilson Elser had been negligent in failing to advise National Union of the underlying action. Wilson

Elser moved to dismiss, arguing that it never had a duty to advise Pacific concerning coverage issues. The Supreme Court granted the motion and dismissed the complaint. Pacific appealed.

The Second Department's Analysis

On appeal, the "central question" was whether a law firm retained by a carrier has a duty to ascertain "[w]hether the insured has available excess coverage, or to file a timely notice of excess claim on the insured's behalf." The court divided the issue into two questions: (1) under ordinary circumstances, does an attorney retained directly by a defendant in a personal injury action have an obligation to investigate the availability of insurance coverage for his client and to see that timely notices of claim are served? And (2) if such an obligation exists, does it also bind an attorney who is retained in a personal injury action not by the defendant directly but by the defendant's carrier?

On the first question, Wilson Elser contended that no New York authority supported the proposition that a legal malpractice action may be maintained against an attorney for failing to investigate an insurance coverage issue or for failing to notify a client's carrier of a potential claim. The Second Department disagreed, but the two cases the court discussed did not support the court's view. In the first case cited, *Fireman's Fund Ins. Co. v. Farrell*, 289 A.D.2d 286 (2d Dep't 2001), the defendant's lawyer knew that the contractor- defendant in a construction accident case had paid unemployment insurance and that the injured plaintiff was seeking lost wages, but the lawyer forgot to notify the State Insurance Fund about the accident until three years after suit was commenced. When the contractor sued the lawyer for legal malpractice, the Second Department affirmed the Supreme Court's refusal to dismiss the case. That holding is correct because defense lawyers know (or should know) that employers who pay unemployment insurance must notify the State Insurance Fund promptly after an injury suit is brought, but the reasoning does not necessarily apply in the context of private insurance. In the second case cited, *Perks v. Lauto & Garabedian*, 306 A.D.2d 261 (2d Dep't 2003), the plaintiff's lawyer had neglected to investigate the defendant's insurance coverage in an auto accident case - a basic fact needed to evaluate settlement possibilities. Neither *Fireman's Fund* nor *Perks* discussed a defense lawyer's duty to investigate his own client's insurance coverage in a situation where the client knew (or could easily have found out) about its insurance coverage but the lawyer was not advised of the coverage. That is a powerful distinction, because the record does not show that Wilson Elser knew about Pacific's excess coverage.

Court Distinguishes Darby

The Second Department's discussion of Darby is more illuminating. The Second Department correctly observed that the Court of Appeals did not hold in Darby that an attorney may never be held liable for failing to discover available insurance coverage. Rather, by stressing the "novel and questionable" nature of the theory of coverage involved in the case, the Court of Appeals "may well have been implying that, had the availability of coverage been clear at the time of the representation, a different result would have been reached." In any event, the Second Department continued:

[I]t seems self-evident that the question whether, in the ordinary case, an attorney could be found negligent for failing to investigate insurance coverage would turn primarily on the scope of the agreed representation - a question of fact - and on whether, in light of all relevant circumstances, the attorney "failed to exercise the reasonable skill and knowledge commonly possessed by a member of the legal profession" We cannot say, as a matter of law, that a legal malpractice action may never lie based upon a law firm's failure to investigate its client's insurance coverage or to notify its client's carrier of a

potential claim. In a footnote, the court responded to the dissent's view that, as a matter of law, no viable malpractice claim can be asserted unless the plaintiff specifically pleads evidentiary facts sufficient to establish the existence of such duty under the particular circumstances of the case. The court rejected that principle because it would, in effect, "work a judicial amendment of CPLR 3016 by adding legal malpractice to the list of actions subject to specific pleading requirements."

The court then turned to its second question: even if an attorney retained directly by a defendant in a personal injury action has an obligation to investigate the availability of insurance coverage for his client, does an attorney retained by the defendant's carrier have the same obligation? On this point, Wilson Elser argued that insurance defense counsel "never" has any obligation to investigate coverage issues because that "would violate every principle of the tri-partite relationship that exists between an insurer, an insured, and appointed defense counsel."

The court noted that the so-called "tri-partite relationship" of insured, insurer, and insurance defense counsel had been "extensively examined." In some jurisdictions, an attorney retained by a carrier has an attorney-client relationship only with the insured, but in other jurisdictions, under certain conditions, defense counsel may also have an attorney-client relationship with the carrier. Wilson Elser argued that it had an attorney-client relationship with Lloyds as well as with Pacific, and that the interests of Lloyds and Pacific with respect to insurance coverage were in conflict. Assuming (without deciding) that a New York law firm retained by a carrier to represent its insured may have an attorney-client relationship with both the carrier and the insured, the Second Department saw no conflict of interest in the circumstances at bar. Both Lloyds and Pacific had a "shared interest" in defeating Golebiewski's claim, the court said. Beyond that, "Lloyds' interest was in keeping the verdict as low as possible and below its policy limit." If the verdict could not be kept within its policy limit, Lloyds had no interest in the amount by which that limit was exceeded, whereas Pacific had an interest in keeping the verdict within its overall coverage. "Thus, while the plaintiff had an important interest in the existence, availability, and amount of excess coverage, Lloyds did not."

The court recognized that a conflict might have arisen if the issue in the case had concerned the scope or nature of the coverage afforded to Pacific by the Lloyds primary policy. But Lloyds had no interest in the "existence or extent" of excess coverage available to Pacific, so Wilson Elser "would not have breached any duty owed to Lloyds by advising the plaintiff [Pacific] on issues of excess coverage."

Thus, the court said, "just as we are unprepared to say, as a matter of law, that a failure to investigate the existence of excess insurance coverage may never give rise to a legal malpractice action against an attorney retained directly by a defendant in a personal injury action, we take the same view with respect to an attorney who is retained, not by the defendant directly, but by its carrier." Accordingly, the court below should have denied Wilson Elser's motion to dismiss Pacific's legal malpractice claim.

Judge Lifson's Dissent

Judge Lifson dissented. He believed the majority's decision "would impose a duty on lawyers that has heretofore not been recognized by any court in this State" No case law in New York requires an attorney assigned by a primary carrier to ascertain whether coverage does or does not exist. Judge Lifson accepted that "there may be situations where an attorney in the representation of a client may have a duty to investigate the existence of additional insurance coverage," But under *Fireman's Fund Ins. Co. v*

Farrell and Perks v. Lauto & Garabedian (which the majority relied upon), an attorney's duty to investigate insurance coverage arises only if the attorney is in a better position than the client to ascertain the existence of such coverage. "[W]here the circumstances are such that the client has superior or equal knowledge of potential sources of additional coverage, unless requested to investigate by the client, the attorney has no duty to explore hypothetical theories of additional insurance coverage."

Here, the facts were compelling. The only party who knew about the potential existence of (or need for) excess coverage was Pacific. The excess policy had obligated Pacific to notify the excess carrier about the accident even before Lloyds had designated a law firm to defend the suit. "The insured's contractual responsibility to notify its alleged excess insurance carrier cannot be avoided or diminished through the subterfuge of attempting to foist such obligation on an unsuspecting law firm selected by the primary carrier," the dissent said. Therefore, the dissent believed that the legal malpractice complaint had been properly dismissed, and it would have affirmed the dismissal.

Wilson Elser has sought review of the Court's decision in the Court of Appeals, but the court has not yet ruled on the application.

Conclusion: A Middle Ground

If the scope of a lawyer's retention includes investigating insurance coverage, then all agree that the lawyer must do so. But the question here is whether a lawyer chosen by a primary insurance carrier to defend a personal injury action must investigate whether the client (the insured) has additional coverage. I would not impose such a duty because it is inefficient and will lead to higher legal bills and either higher premiums or less service from insurance companies. If the law imposes a duty on attorneys to investigate a personal injury client's insurance coverage in every case, then insurance carriers will have to pay lawyers to undertake that investigation, even if the client could undertake the same investigation at lower cost.

I would instead impose a duty on attorneys only to advise their clients to ascertain promptly whether they have insurance coverage (or additional coverage, if the attorney was selected by the primary carrier). If the client does not know, then the attorney either should offer to investigate or should suggest ways in which the client can find out on his own. In many instances, a client will already know about its insurance coverage (including excess coverage) or can ascertain the nature and extent of its coverage with a single phone call to its insurance broker.

Shaya B. Pacific, LLC could have made that call, especially after Lloyds urged it to do so. Therefore; unless Pacific can demonstrate that the scope of Wilson Elser's engagement specifically included a duty to investigate whether Pacific had excess insurance coverage, Pacific's legal malpractice claim against Wilson Elser should fail. The law should not impose on lawyers a duty to investigate insurance coverage in situations where the client can do the same thing just as easily.

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