

Insurer Has a Duty to Defend Law Firm in Suits by Two Other Firms Regarding Referral Fee Arrangement

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A federal district court in the Southern District of New York, applying New York law, has held that an insurer had a duty to defend a law firm in connection with two suits brought by two other law firms alleging breach of contract, fraud and breach of fiduciary duty concerning referral fee arrangements. *Napoli, Kaiser & Bern, LLP, v. Westport Ins. Co.*, 2003 WL 22953171 (S.D.N.Y. Dec. 15, 2003).

An insurer issued a claims-made professional liability policy to a law firm. The coverage provision stated "[t]he Claim must arise by reason of an act, error, omission or Personal Injury... Coverage shall apply to any such Claims arising out of services rendered or which should have been rendered by any Insured, and arising out of the conduct of the Insured's profession as a lawyer...." The policy contained an exclusion for "any Claim arising out of any dishonest, fraudulent, or malicious acts, errors, omissions, or deliberate misrepresentations."

In November 2001, two law firms filed suit against the policyholder law firm. The plaintiff law firms had referred thousands of diet drug litigation clients to the policyholder law firm, which was already representing numerous clients in the same matter. The policyholder law firm accepted the representation of the referred clients, and in return, agreed to share with the plaintiff law firms a specified percentage of the fees earned for the referred cases. The plaintiff law firms alleged that the policyholder firm obtained higher settlements for its direct clients, and misrepresented settlement terms to obtain approval from referred clients. As a result, the plaintiff law firms argued that they were entitled to higher fees than those received for the referred clients. The two complaints alleged breach of contract, fraud and breach of fiduciary duty to the plaintiff law firms and referred clients. After the insurer determined that it had no duty to defend because the underlying complaints alleged fraud, the policyholder law firm filed suit.

The court held that the insurer had a duty to defend. Although the court recognized that the fraud claims were excluded by the policy, the court concluded that the breach of fiduciary duty claims fell squarely within the four corners of the policy issued. As a result, the court found that a duty to defend existed, noting that if a single claim potentially falls within the coverage of a policy, the insurer has a duty to defend the entire action. In reaching this decision, the court ignored the insurer's arguments concerning the legal merits of the fiduciary duty claims, focusing on the fact that, so long as there was a possibility that the defendant firm faced liability

on the claim, the insurer had a duty to defend. Additionally, the court rejected the insurer's argument that the "gravaman" of the underlying complaints was fraud, explaining that a breach of fiduciary duty claim could be based on negligent conduct. The court explained that the underlying complaints did not allege that the breach was intentional, but rather alleged facts that if proven could support a claim for negligence, which the court found is potentially covered under the four corners of the policy.

The court also rejected the insurer's argument that the underlying suit was based on a commercial dispute and did not "aris[e] out of the conduct of the insured as an attorney." In so holding, the court distinguished the present case from cases involving fee disputes. The court reasoned that the plaintiff law firms' claims stemmed from the policyholder firm's alleged failure to manage its cases in a professional manner, and that the lowered fees were simply a consequence of these actions. The court found that although it was arguable that the claims "arise out of" referral agreements, not unique to the practice of law, the language of the policy on this point was ambiguous, and therefore must be resolved against the insurer.

Finally, the court rejected the insurer's argument that an exclusion for fraud in the policy relieved it of the duty to defend. The court applied the same analysis to the scope of the exclusion issue that it applied to the scope of coverage question, noting that the exclusion did not apply to all conduct alleged in the plaintiffs' complaints. The court therefore held that the insurer had a duty to defend and that the insurer was required to reimburse the defendant firm for legal fees already incurred. It also held that the insurer was entitled to discovery and a trial on whether the amount of fees incurred was reasonable.

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