

Lawyer's Insurer Estopped from Denying Coverage Based on Unreasonable Delay

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The U.S. Court of Appeals for the Second Circuit has held that an insurer that commences the defense of an insured may be estopped from asserting a defense to coverage, no matter how valid, if the insurer unreasonably delays in disclaiming coverage and the insured suffers prejudice as a result of the delay. *Bluestein & Sander v. Chicago Ins.*, 2002 U.S. App. LEXIS 338 (2d Cir. Jan. 9, 2002).

A law firm was sued for malpractice for allegedly failing to file an action on behalf of a client before the statute of limitations expired. The firm's professional liability insurance policy provided coverage against malpractice claims and specifically promised to indemnify plaintiff for damage awards, including "compensatory judgments, settlements or awards." The policy, however, did not provide coverage for "the return of fees or other consideration paid to the Insured."

Upon receiving notice of the malpractice action, the Bluestein firm forwarded a copy of the complaint to its insurer, Chicago Insurance Company ("CIC"). The complaint listed "legal fees" as part of the claimed damages. CIC responded to the complaint by engaging a law firm to represent Bluestein in the malpractice action. However, CIC did not disclaim coverage for the legal fees sought by plaintiff in the malpractice case. Subsequently, during the pre-trial discovery process, the malpractice plaintiff responded to an interrogatory by indicating that it was seeking return of legal fees paid to the Bluestein firm, as such fees "had no value." Despite this notice to the insurer that the plaintiff in the malpractice action was seeking to recover its legal fees, it did not disclaim coverage for such fees until nine months after the malpractice plaintiff filed its interrogatory responses.

After CIC denied coverage for the claim for legal fees, the Bluestein firm filed a complaint against CIC and moved for summary judgment, contending that the policy afforded coverage for legal fees sought by the malpractice plaintiff and, alternatively, that CIC should be estopped from raising any coverage defenses, no matter how valid, because the insurer had delayed an unreasonable period of time before disclaiming coverage, resulting in prejudice to Bluestein. The district court agreed with the latter argument, finding that CIC had unreasonably delayed in issuing its disclaimer, resulting in actual prejudice to Bluestein. Therefore, CIC was estopped from denying coverage.

The U.S. Court of Appeals for the Second Circuit affirmed, finding that where an insurer unreasonably delays in disclaiming coverage and the insured is prejudiced as a result, the insurer is estopped from denying coverage. First, the Court held that CIC's delay of at least nine months in disclaiming coverage was unreasonable and that CIC had failed to provide a reasonable explanation for the delay. Moreover, the Court of Appeals found that prejudice to an insured could be presumed "where an insurer, though in fact not obligated to provide coverage, without asserting policy defenses or reserving the privilege to do so, undertakes the defense of the case, in reliance on which the insured suffers the detriment of losing the right to control its own defense." Since CIC's designated counsel handled the malpractice case for more than two years before CIC disclaimed coverage for legal fees, the court held that prejudice to Bluestein could be presumed. The court further found that the Bluestein firm had suffered actual prejudice because the insurer did not disclaim coverage for these fees until near the end of pre-trial discovery, providing defense counsel with insufficient opportunity to explore the attorneys fees issue during discovery.