

Insurer Liable for Negligent Monitoring of Defense, under Duty to Defend Policy, Prior to Withdrawal of Defense

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The Supreme Judicial Court of Massachusetts has held that an insurer is liable for damages resulting from negligence by the insurer in monitoring the underlying defense, under a duty to defend policy, during the period of time before the insurer withdrew a defense of the claim. *Sullivan v. Utica Mut. Ins. Co.*, 788 N.E.2d 522 (Mass. 2003).

The insurer issued a duty to defend E&O policy to a company that provided risk management and insurance agency services. The policy contained an exclusion for any claims relating to the payment of premiums.

The policyholder company was sued in connection with its role in securing certain insurance coverage for the underlying plaintiff. The complaint contained allegations relating to premiums, as well as claims for negligence. The insurer agreed to provide a defense, subject to a reservation of rights, and it hired an attorney to defend the company in the underlying action. The underlying plaintiff subsequently amended its complaint, removing all claims for negligence. Since the amended complaint contained only allegations relating to the payment of premiums, the insurer withdrew its defense. The policyholder company sued the insurer, alleging, among other things, breach of contract and negligence for failing to employ competent counsel and to supervise counsel. The trial court granted summary judgment to the insurer on all issues, except negligence. After a trial on the negligence claim, the jury awarded the company \$607,000 for out-of-pocket expenses, including legal fees, and \$500,000 for lost profits.

The Massachusetts high court held that the insurer was entitled to withdraw its defense once the underlying complaint was amended to remove any covered claims. The court also held that the insurers could not be found liable for breach of contract for its conduct prior to withdrawing the defense because it fulfilled its contractual obligation by hiring an attorney. The court explained, however, that the insurer could be found liable for negligence if it breached its "duty of reasonable performance" in providing a defense.

The Massachusetts high court explained that, on the record, a jury could reasonably have found the insurer to have been negligent. The court noted that the insurer's claim representatives had "testified that as long as an insurance company is providing the defense, it has an obligation to make sure that the defense is adequate."

The court concluded that, based on testimony about how the underlying defense attorney was handling the case, including "discovery problems," a reasonable inference could be drawn that the insurer had failed to satisfy this duty of care, articulated by its own claims representative, in providing a defense.

The court held, however, that the insurer could not be held to be vicariously liable for the negligence of the underlying defense attorney. It reasoned that the attorney "was subject to a professional duty to attend to the interests of his client...and not to allow [the insurer's] financial underwriting of the expense to infringe on his duty of competent representation."

With respect to damages, the court held that the insurer was responsible for additional legal fees incurred only to the extent that those fees (i) were incurred prior to the insurer's withdrawal, and (ii) resulted from the insurer's negligent handling of the matter. The court noted that it is a "long-standing rule" in Massachusetts that lost profits are not available as damages, except in cases involving personal injury or property damage. However, since the insurer had not made the argument in this case, the court held that it was waived and the policyholder company was therefore entitled to recover lost profits.

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