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NEWSLETTER

Delay Causes Insurer to Be Estopped from Disclaiming Coverage for Legal Malpractice Claim under N.Y. Law

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The United States District Court for the Southern District of New York has held that a legal malpractice insurer was estopped from disclaiming coverage for a claim for the return of fees because of its delay in disclaiming coverage after defending the policyholder for two-years. *Bluestein & Sander v. Chicago Ins. Co.*, No. 99 Civ. 11519 (RCC), 2001 U.S. Dist. LEXIS 1587 (S.D.N.Y. Feb. 16, 2001).

The insurer issued a lawyers professional liability policy. Upon receipt of a timely notice of a legal malpractice action for failure to prosecute an action, the insurer appointed counsel to defend the policyholder and reserved its rights to "deny coverage exceeding the policy limits, or in the event that [the policyholder] was aware of the claim prior to the inception of the policy." In December 1998, during discovery in the malpractice case, it became clear that the plaintiffs sought the return of legal fees paid to the policyholder in their malpractice action. On September 3, 1999, the insurer disclaimed coverage for the return of fees because such amounts did not constitute "damages" within the meaning of the policy.

The court held that the insurer was estopped from disclaiming coverage because it offered no explanation for its nine-month delay in disclaiming coverage for these amounts. The court noted that under New York law a policyholder claiming estoppel must prove an unreasonable delay in disclaiming coverage resulting in prejudice. According to the court, where an insurer assumes the defense of a claim and then later disclaims coverage, New York courts presume prejudice to the policyholder because it was unable to control its own defense. As a result, the insurer was estopped from denying coverage for these amounts.