

Court Holds Insurer Had Duty to Defend Attorneys against Claims By Non-Clients

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The United States District Court for the Northern District of Texas, interpreting a lawyers professional liability policy under Texas law, has held that there is a duty to defend claims against attorneys by non-client third parties, based upon the attorneys' actions in representing an opposing party in underlying litigation, *Westport Ins. Corp. v. Cotton Schmidt, LLP*, 2009 WL 701054 (N.D. Tex. Mar. 18, 2009).

The insurer issued a "Customized Practice Policy" to the insured law firm. The policy provided specified coverage for "wrongful act[s]," defined in relevant part as "any act, error, omission, circumstance, PERSONAL INJURY or breach of duty in the rendition of legal services for others in the INSURED's capacity as a lawyer, and arising out of the conduct of the INSURED'[s] profession as a lawyer." Attorneys at the insured firm filed suit on behalf of their clients in connection with a failed business relationship. The attorneys obtained default judgments in favor of their clients, and subsequently obtained a writ of attachment on the opposing parties' property, which later was sold at auction as a result of the attachment. Following the auction, the opposing parties successfully vacated the default judgments for lack of proper service. The opposing parties then filed suit against the insured attorneys based on the attorneys' purported improprieties and misrepresentations in connection with obtaining the default judgments and writ of attachment, and in connection with the auction of the parties' property.

In the coverage litigation that followed, the insurer sought a declaratory judgment that there was no duty to defend or indemnify the insured in the underlying suit because the suit did not allege a wrongful act and because various policy exclusions operated to bar coverage. The court rejected the insurer's arguments, concluding that there was a duty to defend.

The court first concluded that the underlying suit alleged a wrongful act, as the policy defined that term. The court rejected the lawyers' argument that the suit did not allege a wrongful act because they were not being sued in their capacity as lawyers. In this regard, the insurer had asserted that the attorneys necessarily were not being sued in their capacity as attorneys because Texas's common-law rule of privity bars suits by non-clients against lawyers. The court disagreed, concluding that the rule of privity was inapplicable because the insured attorneys were not being sued for malpractice, but instead were being sued for conversion and wrongful levy, execution and sale, in connection with their actions in obtaining default judgments and

executing on those judgments.

The court next held that the policy's prior knowledge exclusion did not operate to bar coverage. The policy's prior knowledge exclusion precluded coverage for "[a]ny act, error, or omission, circumstance or PERSONAL INJURY occurring prior to the effective date of this POLICY if any INSURED at the effective date knew or could have reasonably foreseen that such act, error, omission, circumstance or PERSONAL INJURY might be the basis of a CLAIM." The court employed a two-part subjective/objective test in applying this exclusion. With respect to the subjective inquiry, the court concluded that the underlying complaint did not allege or suggest that the insured attorneys knew a claim was forthcoming prior to the effective date of the policy. Accordingly, the court proceeded to the second prong of the prior knowledge inquiry, which asked whether, based on the insured attorneys' subjective knowledge, as indicated in the underlying complaint, "an objectively reasonable attorney would have foreseen that their actions might give rise to a suit" as of the effective date of the policy. In this regard, the court noted that the underlying complaint alleged that the insured attorneys "knew, should have known, or are charged with knowledge" that certain representations that they had made in the default judgment action were false or incorrect. The court stated that, to the extent that the attorneys should have, but may not have, known that their representations were false at the time such representations were made, such conduct would not be actionable by non-client third parties. The court concluded, therefore, that a reasonable attorney would not necessarily have anticipated that such actions might result in a claim.