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No Coverage In NY For 'Hybrid Role' Malpractice Claims

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In April 2015, the Appellate Division of the New York Supreme Court ruled that a business enterprise exclusion bars coverage for a legal malpractice claim that is based partly on the insured attorney's law practice and partly on the attorney's activities on behalf of a business enterprise he controlled. The ruling in Lee & Amtzis LLP v. Am. Guarantee & Liab. Ins. Co.[1] confirms that courts will enforce business enterprise exclusions in accordance with their plain and broad meaning to bar coverage for claims arising out of an attorney's business pursuits — even where the claim also alleges legal malpractice.

The Facts in Lee & Amtzis

In Lee & Amtzis, the insured lawyers were partners in a law firm. One of the lawyers also served as the managing member of a real estate development company that was involved in a condominium project. In 2006, that lawyer drafted and signed a promissory note on behalf of the real estate company, pledging to pay a law firm client $25,000 every time a condominium unit closed. In 2010, the same lawyer drafted and signed a second promissory note, representing a personal loan by the client to the lawyer. Later in 2010, the client filed suit against the law firm, both lawyers and the real estate company, asserting claims for breach of contract and unjust enrichment based on the alleged nonpayment of the promissory notes. The client also asserted a claim for legal malpractice premised on the law firm's alleged negligence in failing to advise her sufficiently of the lawyer's conflict of interest and failing to recommend that she obtain independent counsel.

Authors

Kimberly A. Cereijo
Partner
202.719.7326
kcereijo@wiley.law

Practice Areas

Insurance
Privacy, Cyber & Data Governance
Professional Liability Defense

After the law firm's professional liability insurer denied coverage for the underlying lawsuit, the attorneys and the firm sued. The trial court granted the insureds' motion for summary judgment and held that the insurer had a duty to defend the law firm and the lawyers in the client's lawsuit.

The Appellate Division's Decision

On appeal, New York's intermediate appellate court reversed the trial court's decision and concluded that the insurer had no duty to defend or indemnify pursuant to two policy exclusions: (1) the insured status exclusion, which barred coverage for claims based upon or arising out of "the insured's capacity or status as ... an officer, director, partner, trustee, shareholder, manager or employee of a business enterprise"; and (2) the business enterprise exclusion, which barred coverage for any claim based upon or arising out of "the alleged acts or omissions by any insured, with or without compensation, for any business enterprise ... in which any insured has a controlling interest." The court reasoned that the record clearly demonstrated that the lawyer's activities on behalf of the client were of a "hybrid" nature, in that he provided legal advice to the client while simultaneously pursuing his own business interests on behalf of an entity in which he held a controlling interest. The court concluded that this is precisely the type of situation that the business enterprise and insured status exclusions were intended to exclude. The court also noted that the client's claims for legal malpractice sought to recover the very same losses that she suffered in connection with the nonpayment of the promissory notes.

The court further held that because the business enterprise exclusion barred coverage for claims based on the alleged acts and omissions of any insured for a business enterprise in which any insured has a controlling interest, the exclusion precluded defense and indemnity coverage for the law firm and the second lawyer, neither of which actually held an interest in the real estate company.

Analysis

The decision in Lee & Amtzis illustrates a trend among courts to hold that business enterprise exclusions apply broadly to bar coverage for claims against attorneys who are alleged to have worn multiple "hats" as both legal adviser and business actor.

Lawyers often engage in private business activities outside of the practice of law. Lawyers professional liability policies, however, are not intended to cover ordinary business disputes. To address this concern, many legal malpractice policies contain express business enterprise exclusions that bar coverage for claims arising out of an insured attorney's outside business pursuits.

In some policies, the business enterprise exclusion is worded to apply to claims arising from an insured's capacity at a separate business entity — for example, as the manager or director of an outside entity. In other policies, the business enterprise exclusion is drafted to apply to claims arising from acts by an insured on behalf of an entity in which an insured has a significant financial interest. Some policies (including the policy

at issue in Lee & Amtzis) include both formulations of the business enterprise exclusion.

The applicability of business enterprise exclusions is often contested by insureds in cases where an attorney's business pursuits intermingle with his legal practice. In one common scenario, a client to whom the lawyer has provided legal services becomes a participant in the lawyer's business venture. When the venture ends poorly, the client asserts a claim against the lawyer that is largely a business dispute but also contains allegations of legal malpractice. The lawyer, in turn, seeks coverage from his professional liability carrier and argues that the allegations of malpractice trigger a duty to defend under the terms of the policy.

As illustrated by the Lee & Amtzis decision, courts in New York and elsewhere will enforce broadly worded business enterprise exclusions to bar coverage for this type of "hybrid" claim.[2] Courts recognize that the purpose of a business enterprise exclusion is to eliminate the risk that an insurer will have to cover legal malpractice claims relating to the conduct of the insured's outside business ventures rather than arising solely out of his professional practice. Thus, claims arising partly from an attorney's legal services and partly from the attorney's status or activity pursuing his own business interests fall squarely within the scope of a typical business enterprise exclusion.

Conclusion

The Lee & Amtzis decision demonstrates that alleging malpractice is not always enough to trigger coverage under a lawyers professional liability policy. Even where an insured attorney provides legal services to the claimant, a business enterprise exclusion will bar coverage for a claim if the legal services at issue are connected to the attorney's acts as a businessperson. The well-reasoned opinion in Lee & Amtzis is consistent both with the plain language of the policy at issue in that case and with the weight of authority nationwide.

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[1] 2015 (N.Y. App. Div. Apr. 7, 2015).

[2] E.g., Burke & Reedy, LLP & James Burk v. Am. Guarantee & Liab. Ins. Co., No. 13-890, 2015 U.S. Dist. LEXIS 35878 (D.D.C. Mar. 23, 2015); K2 Inv. Grp., LLC v. Am. Guarantee & Liab. Ins. Co., 22 N.Y.3d 578, 983 N.Y.S.2d 761, reargument denied, 23 N.Y.3d 939, 987 N.Y.S.2d 591 (2014).