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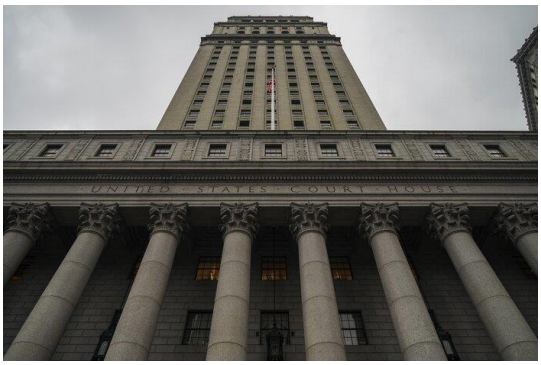
2nd Circ. Insurer Win Stirs Fears Over Mixed Coverage Claims

By **Abraham Gross**

Law360 (October 25, 2023, 7:20 PM EDT) -- A Second Circuit decision freeing a New York law firm's insurer from defending it in a suit against an attorney's construction management company raises questions about how courts treat cases involving mixed coverage claims and parties.

LePatner & Associates LLP, or L&A, submitted a petition Saturday, urging the full court to reconsider a panel's ruling that a suit against the law firm and LePatner Project Solutions LLC did not trigger RSUI Group Inc.'s professional liability policy, saying the panel's decision guts an insurer's duty to defend.



Experts say the Second Circuit's disputed decision avoided some of the thornier questions surrounding how coverage is managed between mixed parties. (Drew Angerer/Getty Images)

The panel ruled that the policy covers "only professional services provided as a lawyer" and, therefore, the underlying allegations in the lawsuit against Barry LePatner's firm and an affiliated construction consulting firm do not fall within the scope of coverage.

Experts told Law360 that the disputed decision avoided some of the thornier questions surrounding how coverage is managed between mixed parties. Still, counsel for carriers and policyholders disagreed over the court's method and what precedent it sets for the duty to defend.

L&A lodged the coverage action against RSUI in June 2021, saying the insurer covered LePatner for claims made only against the law firm but not for those targeting the construction company. L&A asserted that because the underlying action named both of his firms as defendants and failed to clearly define which charges were leveled at which company, RSUI should have a duty to cover costs for the entire lawsuit.

In March 2022, U.S. District Judge Jed S. Rakoff in New York ruled favor of RSUI. The judge said "admissions and other formal submissions in the underlying complaint make clear that the thrust of the complaint was about failure to finish the construction project on the timeline promised" and that LPS did not provide professional services as a lawyer.

In an added twist to the case, after the insurer provided defense to L&A under reservation of rights and denied coverage to LePatner Project Solutions, LePatner independently hired the same counsel to represent it in the underlying dispute.

The appeals court avoided explaining how to parse legal expenses for the same counsel retained by both an insured and non-insured party in a dispute since they found there was no duty to defend, said Meagher and Geer PLLP's Kurt Zitzer, who represents carriers.

"I wish they would have answered the other question, which is a difficult question in the real world for carriers to deal with, but they didn't have to answer that question because they came to the conclusion [that] there really isn't any duty to defend here," he told Law360.

Zitzer said courts have not clearly articulated how a carrier should allocate funds under the circumstances, whether by allocating based on the portion of a counsel's work that can truly be distinguished as benefiting a noninsured alone or by resorting to an even split of defense costs.

Anthony Crawford of Reed Smith LLP, representing policyholders, told Law360 that the insurer had initially provided coverage to L&A based on the allegations in the underlying lawsuit while acknowledging that some claims may fall outside the scope of its policies.

By ruling that the entire suit did not involve legal services, the court also saved itself the issue of parsing mixed claims.

"In other instances, though, this gets a little bit more nuanced where there is a mixture of covered and uncovered allegations in there and they're so intertwined that you can't really tease out the defense of one particular claim versus the other because they still relate to each other," Crawford said.

The appeals court decision offers warnings for future disputes. Counsel for carriers said the court emphasized the importance of policyholders delineating work covered by a professional liability policy. In contrast, policyholders found that the court, by omission, set a lax standard for carriers.

Aaron French, a carrier-side attorney for Sandberg Phoenix & von Gontard PC, told Law360 that as firms or their attorneys diversify into related services, it is essential to clearly define the scope of their work or seek policy endorsements for nonlegal work.

"It is a bit of a cautionary tale for for law firms that are involved in ancillary businesses that the courts are looking at this and are able to delineate and draw some lines here," French said of the decision.

Experts detailed concerns over the court's rejection of the law firm's claims that the insurer interfered with coverage through the counsel shared with the construction company, raising fears that the court tolerated carrier misbehavior.

According to court documents, the insurer asked counsel not to defend the construction company. It sought new counsel because, in its view, the firm and construction company had a conflict of interest that precluded representation by the same attorney. After L&A opposed the insurer's appointed counsel appearance in court on the firm's behalf, the appointed counsel withdrew, and the shared counsel for the companies continued representing them both.

The appeals court found that, based on the claims falling out of coverage, the insurer was not acting up when it insisted that counsel not service the construction firm and that there was no evidence that the temporary substitution of counsel harmed L&A.

Sheri Pastor of McCarter & English LLP, who represents policyholders, said the conclusion insurers might draw from the court's decision was a no-harm, no-foul approach to representation, where insurers escape consequences if they back away from their decisions in response to policyholder opposition.

"Not every policyholder will have the finances, the ability and the awareness of their rights to have pushed back in that way," she told Law360.

It would have been more helpful if the court had recognized that the insurer's conduct regarding its policyholder's counsel was inappropriate, Pastor said, or at least added qualifications around its finding that there was no evidence the insurer's actions caused harm.

In its petition, L&A argued that the panel's decision "effectively eliminates" an insurer's duty to defend an insured "in full" when some allegations in an underlying action are covered and others may not be covered.

The law firm pointed to the case of Colon v. Aetna Life & Casualty Insurance Co., saying an insurer must defend "a total stranger to the policy if the interests of the insured and noninsured co-defendants are aligned."

Because the liability of the law and consulting firms were never resolved, L&A asserted that RSUI owes a defense to the underlying action.

Zitzer said both the trial court and panel concluded that the construction management agreement was the sole basis for any liability and that none of the alleged claims of breach arose from the contract to provide legal services, which would be the basis for the insured's liability.

"This really isn't a mixed claim in the traditional sense where covered and uncovered claims are being made against a single insured," Zitzer said. "This is a claim involving one party who is insured under a policy, and another party not insured under a policy."

The petition also argued that the insurer interfered in the insured's right to control its defense by directing counsel to file a motion to dismiss the covered claims "so that the insurer could discontinue the defense of the underlying action and leave the insured to defend the remaining action itself."

Crawford said insurers have a financial incentive to swiftly eliminate claims cut off their duty to defend as soon as possible, which may not be the best strategy for a policyholder's defense.

"The policyholder was entitled to conflict-free counsel that was not trying to mold this case to get the insurance company out of coverage as quickly as possible," he added.

The case is LePatner & Associates LLP v. RSUI Group Inc., case number 22-762, in the U.S. Court of Appeals for the Second Circuit.

--Additional reporting by Emily Enfinger and Christine DeRosa. Editing by Emma Brauer.
