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On INSURANCE

Lawyers may assume that a carefully drafted engagement letter protects them from liability arising out of matters outside the scope of the defined engagement. Such an assumption, however, may be ill-founded when it comes to failing to advise the client on insurance issues relating to the core engagement. A recent New York case held that a law firm's obligation to defend a lawsuit may include a duty to advise the client on insurance issues, even if such an obligation falls outside the scope of the engagement letter. *Shaya B. Pacific, LLC v. Wilson, Elser, Moscowitz, Edelman and Dicker, LLP*, 827 N.Y.S.2d 231 (2006).

Ironically, the *Shaya B.* ruling arose in the context of a lawsuit where the law firm was retained by an insurance company to defend its insured, rather than by the insured. Shaya B. was sued for a bodily injury claim. Its primary general liability insurer retained the firm to defend the company. The insurer advised Shaya B. in the retention letter that the primary policy was $1 million. It further advised that in view of the severity of the claim, the insured should retain counsel to protect itself with respect to any excess judgment and should consult with its insurance agent regarding applicable excess coverage.

Differences Between California and New York Law

Apparently the insured did neither. Summary judgment on the issue of liability was entered against Shaya B. in the underlying action. Before trial commenced as to damages, the defense firm notified the excess carrier of the lawsuit and the potential for a judgment in excess of the primary limit. This was the first notice the excess insurer had received of the claim. While California law applies the "notice-prejudice" rule with respect to an insurer's defense of late notice, New York law was not at the time as kind to insureds. Consequently, the excess insurer denied coverage on the ground of late notice.


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After a $6 million judgment was entered against it, Shaya B. sued the defense firm for malpractice, for failing to timely notify the excess insurer of the claim. The firm contended that it had no duty to advise the client concerning coverage issues. Indeed, the insurer's letter informing Shaya B. of the firm's retention specifically advised the insured to explore the possibility of excess insurance.

The *Shaya B.* court held: "We cannot say, as a matter of law, that a legal malpractice action may never lie based upon a law firm's failure to investigate its client's insurance coverage or to notify its client's carrier of a potential claim." The court explained that while the retention letter advised the client to explore the potential for excess insurance, it did not expressly advise

the insured that the law firm would *not* undertake such efforts as part of its representation. The court placed the burden on the law firm to demonstrate that the allegedly negligent conduct fell *outside* the scope of the engagement, rather than on the client to show that the conduct fell within the scope of the engagement.

No California court has yet addressed the precise issue raised in *Shaya B., i.e.*, whether the law firm bears the burden of proving that the alleged negligence involved matters outside the scope of the engagement. But at least one California court has assumed that a lawyer owes a duty to its client to advise on potential insurance coverage in a litigation matter. *See, e.g., Jordache Enterprises v. Brobeck Phleger & Harrison*, 18 Cal. 4th 739 (1998). In that case, Jordache retained a firm to defend it in a lawsuit. The parties did not discuss the potential for insurance coverage for the lawsuit. Eventually new counsel substituted into the case and began to investigate insurance coverage. While the opinion focused on when "actual injury" was triggered so as to commence the running of the applicable statute of limitations, the decision was premised on the assumption that the firm's failure to advise the insured re garding coverage was in fact actionable.

Keeping Up with Evolving Insurance Laws and Policies

Insurance law and policies are constantly evolving. Insurers may offer new types of coverage for corporate or intellectual property exposures. Such products may expand coverage for claims beyond what a litigator might otherwise assume. Further, many corporations obtain insurance under third-party contractual arrangements, either through additional insured endorsements or indemnification provisions. Throwaway allegations in a complaint may be sufficient to trigger coverage, or at least a defense, for what would otherwise appear to be an uncovered claim. Even if a claim has not yet matured into a covered claim, there may be contractual or strategic reasons to notify the insurer.

Litigators should be aware that clients (and courts) may assume that advice regarding coverage available for the claim is an inherent part of the defense of the litigation, and that failure to provide such advice can lead to a malpractice claim if coverage opportunities are lost, no matter how carefully the engagement letter is drafted.

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