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Client Alert

A report for clients and friends of the firm

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Insurance Coverage Litigation: Who Pays The Attorneys?

This week, in *Liberty Surplus Insurance Corporation v. The Segal Company*,____F.3d___, 2005 WL 1869146 (2d Cir. August 9, 2005), the Second Circuit addressed whether a recent New York Court of Appeals decision had expanded the obligation of an insurer to pay the attorneys' fees of an insured who prevailed in a coverage action. The court answered in the negative.

In some states, the insurer pays the insured's attorneys' fees if the insured prevails in a coverage action. Under New York law, however, the general rule is that an insured cannot recover its legal expenses in a controversy with an insurer over coverage even though the insurer loses the controversy and is held responsible for the risk. *Sukup v. State*, 19 N.Y. 2d 519, 227 N.E. 2d 842, 281 N.Y.S. 2d 28 (1967).

In *Mighty Midgets, Inc. v. Centennial Insurance Co.*, the New York Court of Appeals carved out an exception to New York's general rule when it decided that an insured may recover attorneys' fees and costs when it "has been cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations." 47 N.Y. 2d 12, 21, 289 N.E. 2d 1080, 1085, 416 N.Y.S. 2d 559, 564 (1979).

Last year, in *U.S. Underwriters Insurance Co. v. City Club Hotel LLC*, 369 F.3d 102 (2d Cir. 2004), the Second Circuit certified to the New York Court of Appeals the question of whether *Mighty Midgets* applies where an insurer has provided a defense in an underlying action but then brings an action for a declaratory judgment alleging that it has no duty to defend. The New York Court of Appeals answered in the affirmative, and the Second Circuit then awarded attorneys' fees to the insured.

The recent *Segal Company* case involved a suit brought by a second-layer excess insurer against the Segal Company to disclaim coverage for certain claims. The duty to defend was not involved. The Segal Company defeated the insurer's suit, but the District Court dismissed Segal's counterclaim for attorneys' fees incurred in defending the suit because the duty to defend had not been involved.

Relying on *City Club Hotel*, the Segal Company argued to the Second Circuit that the New York Court of Appeals had expanded *Mighty Midgets* by allowing for attorneys' fees when an insurer brings suit to escape the duty to defend *or* indemnify.

The Second Circuit disagreed. The Court said that *Mighty Midgets* only applied when an insurer sought a declaratory judgment that it had no duty to defend. Because the insurer's suit against the Segal Company only involved the insurer's duty to indemnify, the Segal Company could not recover attorneys' fees even though it had won.

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