



## Alerts

### Insurer Owes No Coverage Due to Lawyer's Failure to Report a Potential Claim

October 2, 2013

*Lawyers for the Profession® Alert*

*Pelagatti v. Minnesota Lawyers Mut. Ins. Co.*, 2013 WL 3213796 (E.D. Pa.)

#### Brief Summary

Plaintiff, an insured attorney, filed a complaint against defendant, his professional liability insurer, seeking a declaratory judgment and damages arising from its alleged breach of its contractual duty to defend him and of Pennsylvania's bad faith statute. The insured moved for summary judgment, arguing that the phrase "reasonably support" in the policy was ambiguous, and that his failure to report a potential claim did not violate the policy. The court applied a hybrid subjective/objective test and granted summary judgment in favor of the insurer.

#### Complete Summary

The insured purchased a legal malpractice insurance policy from the insurer and renewed it annually between 2003 and 2010. In late 2009, the insured completed a Firm Information Verification Form, which noted that his firm had changed its name. He did not disclose any potential or outstanding claims as required by the form. He then executed a request to issue insurance coverage, and the policy became effective in February 2010. The policy specified that a claim is made when "an insured first becomes aware of any act, error or omission by any insured which could reasonably support or lead to a demand for damages."

In 2006, the insured represented a father in a wrongful death action against a New Jersey city concerning the drowning of the client's child. Not only was the insured not admitted to practice law in New Jersey, but he failed to file a "Notice of Claim" with the city within 90 days of the accident. The appellate court affirmed dismissal of the case in October 2009, and the client sued the insured for legal malpractice. The insured was served on February 23, 2010, and he informed the insurer of the suit a week later. The insurer declined to defend and indemnify the insured because he had failed to give the insurer timely notice of the claim and had not notified the insurer of the claim within the relevant claims period. Specifically, the insurer pointed out that the claim arose in 2006, when the insured became aware that the underlying case was dismissed because of his failure to comply with the relevant statute of limitations.

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The insured filed a complaint against the insurer, seeking a declaratory judgment and damages arising from its alleged breach of its contractual duty to defend and of Pennsylvania's bad faith statute. The insured moved for summary judgment, arguing that the insured waived its defense by failing to comply with the Federal Rules of Civil Procedure and, alternatively, that it did not "prove" that the insured violated the policy because the phrase "reasonably support" in the policy was ambiguous. The insurer also moved for summary judgment on the ground that there was no genuine issue of material fact regarding whether the insured violated the policy. The insurer also argued that it did not act in bad faith because it acted reasonably in declining to defend the insured.

The court granted the insurer's motion for summary judgment and denied the insured's motion. The court rejected the insured's argument that the phrase "reasonably support" in the policy was ambiguous and stated that "courts have consistently interpreted such clauses as those in the Policy to impose an objective standard on the insured." After applying an objective standard, the court held that the language was not ambiguous.

The court then addressed the issue of whether the insured violated the policy by failing to notify the insurer of the potential claim. The court noted that whether the insured violated the policy's terms should be determined under a hybrid subjective/objective test. The insurer needed to establish two factors to satisfy the two-pronged test: (1) that the insured was aware of a given set of facts; and (2) that a reasonable attorney in possession of those facts would have believed that those facts could support or lead to a demand for damages. The court stated that under this two-pronged test, it "considers the subjective knowledge of the insured and then the objective understanding of a reasonable attorney with that knowledge." *Baratta & Fenerty*, 264 F.3d 306.

Applying this hybrid subjective/objective test, the court held that the insured was subjectively aware that his former client's initial suit and subsequent appeal were both dismissed on procedural grounds, and that he was practicing law in New Jersey without a license to do so. The insured did not report any of those circumstances to the insurer despite the language in the policy. Under the objective component of the test, the court held that the insurer was justified in refusing to defend the insured because a reasonable attorney with the insured's knowledge of the dismissal of the underlying case would have reported the potential claim when reapplying for insurance.

The court also rejected the insured's argument that the insurer violated Pennsylvania's bad faith statute. The court noted that the insured needed to produce clear and convincing evidence sufficient for a reasonable trier of fact to find that the insurer lacked a reasonable basis for believing that the insured violated the policy, and that it knowingly or recklessly disregarded that lack of a reasonable basis. Applying that clear and convincing standard, the court held that the insured provided no evidence that rebutted the insurer's reasons for denying him coverage and, therefore, the insured's claim failed as a matter of law.

### **Significance of Opinion**

This case is an important case because it underscores the importance of disclosing potential claims to professional liability insurers. The failure to disclose a potential claim has serious consequences. Attorneys must be diligent in their disclosures to insurers.

For more information, please contact [Terrence P. McAvoy](#) or [Kate Schnake](#).

*This alert has been prepared by Hinshaw & Culbertson LLP to provide information on recent legal developments of interest to our readers. It is not intended to provide legal advice for a specific situation or to create an attorney-client relationship.*