

Newsletter-August 25, 2008

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Declaratory Judgment Actions: Who Pays Counsel Fees Of The Insured

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DECLARATORY JUDGMENT ACTIONS: WHO PAYS COUNSEL FEES OF THE INSURED

It is well established that a prevailing party may not recover attorneys' fees from the losing party except where authorized by statute, agreement or court rule (*U.S. Underwriters Ins. Co. v City Club Hotel, LLC*, 3 NY3d 592, 596 [2004]). However, an insured who is cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations, and who prevails on the merits, may recover attorneys' fees incurred in defending against the insurer's action (*see U.S. Underwriters Ins. Co.*, 3 NY3d at 596; *Mighty Midgets, Inc. v Centennial Ins. Co.*, 47 NY2d 12, 21-22 [1979]; *Johnson v General Mut. Ins. Co.*, 24 NY2d 42, 46 [1969]). The reasoning for the exception to the general rule is that an insurer's duty to defend an insured extends to the defense of any action arising out of the occurrence, including a defense against an insurer's declaratory judgment action (*see U.S. Underwriters Ins. Co.*, 3 NY3d at 596).

In determining whether an insured is entitled to recover for counsel fees incurred in a declaratory judgment action, the initial inquiry is whether the insured has commenced the declaratory judgment action. The established rule of law is that when an insured commences a declaratory judgment action against an insurer, it is not entitled to recover for the legal fees incurred in prosecuting that claim (*see Mighty Midgets*, 47 NY2d at 21-22; *Hedaya Home Fashions, Inc. v American Motorists Ins. Co.*, 12 AD3d 639, 640-641 [2d Dept 2004], *lv denied* 4 NY3d 708). This rule applies even if the insured is successful in its attempt to compel its insurer to comply with the duty to defend and indemnify under the policy (*see Mighty Midgets*, 47 NY2d at 21; *Kramarik v Travelers*, 25 AD3d 960, 963 [3d Dept 2006]).

Conversely, when an insurer compels an insured to defend in an action for a declaration that the insurer has no duty to defend or indemnify, the insured may recover counsel fees if successful (*see U.S. Underwriters Ins. Co.*, 3 NY3d at 596; *Mighty Midgets*, 47 NY2d at 21-22; *Kramarik*, 25 AD3d at 963; *Mohawk Minden Ins. Co. v Ferry*, 251 AD2d 846, 849 [3d Dept 1998]).

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Because an insurer's responsibility to defend reaches any actions arising out of the occurrence, including a declaratory judgment action commenced by the insurer, an insured is entitled to an award of attorneys' fees where an insurer brings an action seeking relief from its policy obligations (*see Mighty Midgets*, 47 NY2d at 21; *U.S. Fid. & Guar. Co. v New York, Susquehanna & W. Ry. Corp.*, 277 AD2d 1026, 1026 [4th Dept 2000]; *Chase Manhattan Bank v Each Individual Underwriter Bound to Lloyd's Policy No. 790/004A89005*, 258 AD2d 1, 5 [1st Dept 1999]).

Likewise, an insured may also be entitled to an award of counsel fees where it is cast in a defensive posture by a tactic of the insurer in an action commenced by the insured. For example, an insured forced to defend against a motion brought by an insurer after the court has awarded summary judgment in the insured's favor in an action brought by the insured may be entitled to attorneys' fees to the extent that it was cast in a defensive posture by the legal steps taken by the insurer (*see City of New York v Zurich-American Ins. Group*, 27 AD3d 609, 611 [2d Dept 2006]). Moreover, an insured is also entitled to an award of attorneys' fees where the insured brings a declaratory judgment action against an insurer and the insurer counterclaims against the insured (*see Hurney v Mattson*, 59 AD2d 934 [2d Dept 1977]).

It also bears noting that an insured must be successful in the declaratory judgment action in which it is cast in a defensive posture in order to recover attorneys' fees. In the landmark case of *Mighty Midgets, Inc. v Centennial Insurance Co.* (47 NY2d 12 [1979]), the New York State Court of Appeals left open the possibility that an insured unsuccessful in its defense of a declaratory judgment action may be entitled to attorneys' fees. There, the Court of Appeals established the following rule governing recovery of counsel fees by an insured in a declaratory judgment action:

"It is the rule in New York that such a recovery may not be had in an affirmative action brought by an assured to settle its rights, but only when he has been cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations" (*Mighty Midgets*, 47 NY2d at 21).

Conspicuously absent from the Court's opinion was language limiting the right of recovery to those insureds who are successful in their defense of a declaratory judgment action.

Any window of opportunity for an insured unsuccessful in its defense of a declaratory judgment action brought by its insurer was, however, recently closed by the opinion rendered in *U.S. Underwriters Insurance Co. v City Club Hotel, LLC* (3 NY3d 592 [2004]).

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There, the Court of Appeals adopted the *Mighty Midgets* rule that “an insured who is ‘cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from policy obligations’ ” is entitled to an award of counsel fees. Further, though, the *U.S. Underwriters* Court established the additional requirement that an insured seeking an award of counsel fees must “prevail[] on the merits” (*U.S. Underwriters*, 3 NY3d at 597). For that reason, only an insured successful of its defense of a declaratory judgment action brought by an insurer may recover attorneys’ fees associated with the defense of that action.

In sum, to the extent that an insured commences an action seeking a declaratory judgment for enforcement of an insurer’s obligation to defend and indemnify, that insured is typically not entitled to an award of attorneys’ fees incurred in the prosecution of that matter. However, to the extent that the insured is a defendant in an action commenced by an insurer or is otherwise cast in a defensive posture by the insurer, an award of attorneys’ fees is appropriate so long as the insured is successful in its defense of the subject legal action.

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