

New York Court Enforces Legal Malpractice Policy's Business Pursuit and Business Enterprise Exclusions

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In *Abrams, Fensterman, Fensterman, Eisman, Greenberg, Formato & Eininger, LLP v. Underwriters of Lloyds, London*, no. CV11-665, 2013 U.S. Dist. LEXIS 1204 (E.D. N.Y. January 2, 2013), the District Court for the Eastern District of New York upheld a legal liability insurer's denial of coverage to a law firm. The court agreed with the insurer that although two complaints filed against the law firm and its partners alleged professional malpractice, the policy's business pursuit exclusion and business enterprise exclusion applied.

Professional Liability Policy and Exclusions at Issue

Underwriters of Lloyds, London issued a liability policy insuring the firm's legal liability arising out of any act, error or omission of the insured in rendering or failing to render professional services for others in the insured's capacity as a lawyer "but solely for acts on behalf of the Named Insured." The policy was subject to several exclusions, including exclusion IV(F) and IV(G). Exclusion IV(F), a business pursuit exclusion, negated coverage for "any Claim arising out of any insured's activities as a trustee, partner, officer, director or employee of ... [a] corporation, company or business other than the Named Insured." Exclusion IV(G), the business enterprise exclusion, negated from coverage "any Claim made by or against the insured in connection with any business enterprise ... not named in Item 1 of the Declarations, which is owned by an Insured or which is directly or indirectly controlled, operated or managed by any Insured in a non-fiduciary capacity" The business enterprise exclusion applied only to interests in which an insured had a specified level of ownership interest.

The Claims Against the Firm – The Burman and Morell Actions

The insured law firm sought coverage for two separate claims: (1) the *Burman* action, filed in Delaware Chancery Court; and (2) the *Morrell* action, filed in New York Supreme Court. The *Burman* action named several defendants including the insured law firm and its managing partner. The suit arose out of the defendants' alleged scheme to induce the *Burman* plaintiffs to invest in American Gulf Insurance, LLC (American Gulf). After the defendants allegedly misappropriated the plaintiffs' funds, the plaintiffs filed suit. The suit's allegations referenced the managing partner's 25 percent interest in the company formed to manage American Gulf. The *Burman* plaintiffs alleged they invested upon the advice of the managing partner, as their attorney. In its malpractice cause of action, the complaint alleged the managing partner and the firm committed malpractice by failing to conduct requisite due diligence, failing to investigate the documents, failing to disclose the conflict of interest, failing to obtain a waiver of the conflict, and failing to perform professional duties as the plaintiffs' attorneys.

The *Morrell* action named as defendants the insured firm and an attorney who served the firm in an "of counsel" capacity. The suit similarly arose out of loss of investment funds in reliance on the attorney's advice. The *Morrell* suit alleged the insured firm and its "of counsel" attorney induced the plaintiffs to invest in and extend a loan to a company doing business as MYZIVA. The suit also alleged that, upon the advice of the attorney, the plaintiffs entered a share abandonment

agreement, which resulted in loss to the plaintiffs. The *Morrell* plaintiffs alleged the firm and the attorney committed malpractice by breaching fiduciary obligations by inducing the plaintiffs to abandon their rights, and for breaching a fiduciary duty by putting the firm's interests ahead of the plaintiffs.

The Coverage Litigation

The insured law firm brought the action against the professional liability insurer seeking a defense against the *Burman* and *Morrell* actions and, if necessary, indemnity. The parties filed cross-motions for summary judgment. The district court granted the insurer's motion and denied summary judgment to the law firm.

The Business Pursuit and Business Enterprise Exclusions Apply to Claims Alleging Malpractice

The court found that both exclusion IV(F) and IV(G) applied to both actions. As to exclusion IV(F), the court noted the exclusion began with the words "any Claim arising out of" The court explained that the phrase "arises out of" is commonly understood to mean "originating from, incident to, or having connection with." The court also found that by using the phrase "any Claim," a claim that alleges malpractice nonetheless falls within the exclusion if it alleges a sufficient relationship between a business venture in which an insured has an interest, other than the law firm, and the particular lawyer's conduct. The court found that both the *Burman* and *Morrell* actions arose out of activities by an insured who was an officer, director or employee of a company other than the named insured firm, and alleged conduct connected with the non-insured entity.

Although the court observed it was unnecessary to determine if exclusion IV(G) also applied, the court found that both matters fell within that exclusion as well. The *Burman* action alleged that exclusion IV(G) applied because the managing partner had more than the sufficient ownership interest in the

non-insured entity to invoke the exclusion. As to the *Morrell* action, the court observed the requisite ownership interest was revealed in discovery.

Significance of the Abrams Decision

Many cases stand for the principle that legal liability policies do not cover the risk created by attorneys acting outside of the legal profession. The *Abrams* decision is significant because it recognizes that even where the insured provides legal services, malpractice allegations remain outside of coverage if the attorney's conduct on behalf of the client is connected with the attorney's interest in an entity other than the insured law firm. The opinion makes clear that allegations of legal malpractice do not themselves establish coverage.

As practitioners, we appreciate the reasoning provided by the district court to illustrate the soundness of its holding. First, the court explained that if allegations of legal malpractice sufficed to invoke coverage, as urged by the insured law firm, the exclusions would be meaningless. Second, the court explained that its finding of no coverage was consistent with the recognized purpose of the exclusions, of not imposing on an insurer the additional risk of claims that relate to the conduct of a business other than the legal profession. Third, the court observed that imposing a duty to defend and indemnify malpractice claims related to attorneys' business interests would increase legal malpractice premiums. By explaining the logic behind the exclusions, and the alignment of the holding with public policy, the New York District Court provides insurers with an opinion more persuasive than one resting only on precedent.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact Deborah M. Minkoff at dminkoff@cozen.com or 215.665.2170.

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