

Court Resolves Issue on Insurer and Attorney's Fees

U.S. Underwriters Insurance Company v City Club Hotel, LLC

Decided on December 16, 2004
No. 173

[*1]U.S. Underwriters Insurance Company, Respondent-Appellant,

v

City Club Hotel, LLC, Shelby Realty, LLC, Forthright Develop- ment, LLC, Metropolitan Hotels, LLC, Stephen Brighenti and Jonathan P. Zambetti, Appellants-Respondents, and Marek Szpakowski and Agnes Szpakowski, Respondents.

Mark J. Bunim, for appellants-respondents.
Steven Verveniotis, for respondent-appellant.
Complex Insurance Claims Litigation Association;
CNA Insurance Companies; United Policyholders, amici curiae.

G.B. SMITH, J.:

The United States Court of Appeals for the Second Circuit, by two certified questions, has asked this Court to clarify whether an insured who prevails in an action brought by an insurer seeking a declaratory judgment that it has no duty to defend or indemnify the insured, may recover attorneys' fees expended in defending against the declaratory judgment action [*2]regardless of whether the insurer provided a defense to the insured. We answer that question in the affirmative.

Plaintiff, U.S. Underwriters Insurance Company, issued a commercial general liability policy for the policy period of May 15, 1999 to May 15, 2000, to defendants City Club Hotel, LLC and Shelby Realty, LLC, as named insureds, in connection with renovation work City Club was to perform on Shelby's property. On April 27, 2000, while performing the renovation work, Marek Szpakowski, a construction worker employed by City Club, fell from a scaffold and sustained serious injuries. In July 2000, U.S. Underwriters received notice of Szpakowski's claim and a copy of his counsel's letter to Shelby informing it that it might be sued. When the insurer confirmed receipt of the notice of claim, it identified City Club and Shelby as "Our Insured." In November 2000, Mr. Szpakowski and his wife brought a personal injury action in Supreme Court asserting various labor and industrial law claims against Shelby, Forthright Development, LLC and Metropolitan Hotels, LLC. A copy of the verified complaint was sent to U.S. Underwriters on or about December 13, 2000. By letter dated December 20, 2000, approximately five months after it received notice of the claim, the insurer disclaimed coverage of City Club and Shelby with respect to the claims based on the Employee Exclusion clause of the policy, but nonetheless provided Shelby a defense in the underlying action.

In September 2002, U.S. Underwriters, asserting diversity jurisdiction, brought the instant action in the United States District Court for the Southern District of New York seeking a declaratory judgment that it has no duty to defend or indemnify defendants Shelby, City Club, Forthright and Metropolitan, or their named officers. The insurer moved, and defendants subsequently cross-moved, for summary judgment. The District Court granted summary judgment to defendants on the issue of disclaimer of coverage, finding that the disclaimer was untimely as a matter of law. The court, however, denied defendants' motion to recover attorneys' fees incurred in successfully defending the declaratory judgment action, ruling that attorneys' fees were not warranted because U.S. Underwriters did not breach the duty to defend.

In its appeal to the Second Circuit, U.S. Underwriters challenged the District Court's finding that its disclaimer of coverage was untimely. Defendants challenged the denial of attorneys' fees. The Second Circuit affirmed and held that U.S. Underwriters' disclaimer of coverage as to Shelby, Forthright and Metropolitan was untimely as a matter of law; that U.S. Underwriters is obliged to defend and indemnify Shelby in the underlying action; and that the complaint against defendants City Club and the named officers must be dismissed as these parties do not seek coverage under the policy. As to whether attorneys' fees can be awarded to defendants, the Second Circuit noted a division in interpreting the relevant law and certified the [*3]following two questions to this Court:

"1. Whether, in a case in which an insurance company has brought a declaratory judgment action to determine that it does not have obligations under the policy but has defended in the underlying suit, a

defendant prevailing in the declaratory judgment action should be awarded attorneys' fees expended in defending against that action?"

"2. Whether, in the special circumstances of this case, attorneys' fees should be awarded to one or more of the defendants?" (369 F3d 102, 113 [2d Cir 2004].)

We accepted certification (2 NY3d 787 [2004]) and now answer the first question in the affirmative as to Shelby, a named insured under the policy. Since it is not clear what is meant by the "special circumstances of this case,"^[FN1] we decline to answer the second question, concluding it is more appropriate for the District Court or the Second Circuit to resolve this issue.

It is well settled in New York that a prevailing party may not recover attorneys' fees from the losing party except where authorized by statute, agreement or court rule (see *Chapel, et al. v Mitchell, et al.*, 84 NY2d 345, 348-49 [1994], quoting *Hooper Associates, Ltd. v AGS Computers, Inc.*, 74 NY2d 487, 491 [1989]; *Mighty Midgets, Inc. v Centennial Insurance Company*, 47 NY2d 12, 21-22 [1979]). 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 (*Mighty Midgets*, 47 NY2d at 21). The reasoning behind *Mighty Midgets* 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.

In the instant case, it is undisputed that Shelby, a named insured under the policy, was cast in a defensive posture by U.S. Underwriters in their dispute over whether the insurer had a duty to defend and indemnify Shelby in the underlying personal injury action. Further, it is undisputed that Shelby successfully defended against the insurer's summary judgment motion and thereby prevailed in the matter.

Based on *Mighty Midgets*, Shelby is entitled to recover attorneys' fees. We hold that under *Mighty Midgets*, an insured who prevails in an action brought by an insurance company seeking a declaratory judgment that it has no duty to defend or indemnify the insured [*4] may recover attorneys' fees regardless of whether the insurer provided a defense to the insured. Given that the expenses incurred by Shelby in defending against the declaratory judgment action arose as a direct consequence of U.S. Underwriters' unsuccessful attempt to free itself of its policy obligations, Shelby is entitled to recover those expenses from the insurer. In other words, Shelby's recovery of attorneys' fees is incidental to the insurer's contractual duty to defend.

Accordingly, certified question No. 1 should be answered in the affirmative and certified question No. 2 not answered.

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Following certification of questions by the United States Court of Appeals for the Second Circuit and acceptance of the questions by this Court pursuant to section 500.17 of the Rules of Practice of the New York State Court of Appeals, and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified question No. 1 answered in the affirmative and certified question No. 2 not answered. Opinion by Judge G.B. Smith. Chief Judge Kaye and Judges Ciparick, Rosenblatt, Graffeo, Read and R.S. Smith concur.

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Footnotes

Footnote 1: In their briefs and at oral argument before this Court, counsel had differing views as to what the "special circumstances" were.