

Law360 Insurance Authority: NY Court Rebuffs 2nd Circ. On Atty Fee Coverage

Second Circuit decisions “misapprehend” New York state appellate precedent on whether an insurer must cover the attorney fees its insured incurs when the insured prevails in coverage litigation, a New York trial judge found, in a dispute over whether a window company’s insurers must indemnify underlying construction defect claims. On Monday, Judge Gerald Lebovits dismissed without prejudice Utica Mutual Insurance Co.’s and Utica National Assurance Co.’s declaratory action against Crystal Window and Door Systems Ltd. and Crystal Curtain Wall System Corp., finding that Utica’s suit since key underlying factual issues still need to be resolved.

Judge Lebovits noted that Utica has not disputed it has a duty to defend, but instead only challenged if it had a duty to indemnify, teeing up an attorney fee reimbursement dispute that he said “New York appellate courts appear not to have considered.”

But because Utica’s declaratory action put Crystal into a “defensive posture” to argue that it must be indemnified, it would “appear to follow straightforwardly, therefore, that the Crystal entities are entitled to attorney fees,” Judge Lebovits said. He cited the state high court’s 2004 decision in *U.S. Underwriters Insurance Co. v. City Club Hotel LLC* and the 1979 decision in *Mighty Midgets Inc. v. Centennial Insurance Co.*

The Second Circuit decisions Utica cited to argue the opposite, meanwhile, “misapprehend the governing precedents in this area of the Court of Appeals and the Appellate Division,” he said.

According to the decision, the coverage dispute centers on Crystal's work as subcontractor designing and installing window and curtain wall systems for a mixed-use residential and commercial building in Lower Manhattan. After a construction consultant found that the building's curtain wall was leaky and recommended remediation steps in 2008, Crystal said it complied with those recommendations. As unit owners started to move in that year, however, a May rainstorm caused water infiltration damage and subsequent mold problems.

The building's board of managers and individual unit owners then kicked off the underlying dispute in 2011 against numerous defendants, demanding in part that Crystal pay damages for the curtain wall's repair and replacement costs, damage to unit owners' own personal property, the units' diminution of value and costs from alleged construction delays. The underlying dispute is still pending, court records show.

Utica has not disputed that it owes Crystal a defense in the underlying action, but argued in its July 2022 declaratory action that it has no duty to indemnify. The window company filed its motion to dismiss in November 2022, arguing that the coverage litigation should at least be stayed until the underlying dispute is resolved.

While Utica said faulty workmanship exclusions in Crystal's policies apply to bar coverage, it's still unclear whether the issues with the curtain wall arose from defective design and installation, or from some other defective work on other building components, Judge Lebovits said Monday.

Further declining to stay the coverage litigation instead, Judge Lebovits noted that even Utica "does not attempt to provide clarity" on when underlying factual determinations relevant to its duty to indemnify will be made.

"This court declines to leave the current action in a holding pattern for an open-ended (and presumably lengthy) period," he said.

As for Crystal's bid for attorney fees incurred thus far in the coverage litigation, New York appellate courts have not appeared to consider whether an insured must reimburse its insurer for such costs if the insurer already acknowledges it must defend the insured, the judge also noted.

According to excerpts of the City Club Hotel and Mighty Midgets decisions included in Monday's decision, New York's highest court found that when an insured is "cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations," but nonetheless prevails, it is thus entitled to attorney fees.

And New York doctrine provides that an insurer's duty to defend extends to "any action arising out of the occurrence, including a defense against an insurer's declaratory-judgment action," the high court has further held in those decisions. The high court also noted that such a finding was not an exception to the so-called American rule, where parties generally pay their own litigation costs, but instead originates from an insurer's own contractual obligations.

"This is true when an insurer contests both the duty to defend and to indemnify," Judge Lebovits continued Monday, highlighting the high court's reference to "any action" and "policy obligations" writ large. "No logical reason exists why it should be different — why an insurer's duty to defend its insured should suddenly cease — when the insurer disputes only the duty to indemnify."

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Though the Second Circuit expressed concern that ordering an insurer to pay attorney fees after it disclaimed its duty to indemnify would "dramatically expand" the "Mighty Midgets exception," the

“solution to that problem” is to just analyze whether an insurer has a duty to defend before awarding attorney fees, Judge Lebovits concluded.

“It is not to hold instead, as the Second Circuit has done, that where a duty to defend does exist, an insurer need not pay fees if it has unsuccessfully challenged only the duty to indemnify,” he said.

Representatives of Utica and Crystal declined to comment.

Utica is represented by M. Paul Gorfinkel and Jay D. Kenigsberg of Rivkin Radler LLP.

Crystal is represented by Keith McKenna and Chelsea Ireland of Cohen Ziffer Frenchman & McKenna LLP.

The case is Utica Mutual Insurance Co. et al. v. Crystal Curtain Wall System Corp. et al., case number 652632/2022, in the Supreme Court of New York County.

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