Insurance Coverage for Attorney Fees in Legal Malpractice Suits

Legal malpractice suits are often triggered by the desire of a disgruntled client to recoup or avoid paying a former attorney’s legal fees. Although these suits may allege attorney misconduct, the true substance of these actions is generally the legal fees charged by former counsel.

Professional liability policies preclude coverage for actions relating to attorney fees charged by an insured. However, professional liability insurers are often compelled to defend these actions because they include allegations of legal malpractice. Consequently, professional liability insurers pay significant defense costs in what are essentially fee disputes.

There are certain options available to professional liability insurers faced with incurring substantial defense costs related to legal malpractice cases involving fee disputes. The best strategy will depend on the nature of the allegations in the legal malpractice suit.

A professional liability insurer must first determine if the allegations of the underlying complaint relate to the performance of legal services, the charging of fees, or some combination of the two. The insuring agreement of a professional liability policy generally limits coverage to claims arising out of an act or omission in the performance of legal services. The policy usually defines “legal services” as those services performed by an insured for others as a lawyer, arbitrator, mediator, title agent or notary public. Lawyers Professional Liability Insurance Coverage Form, ISO Form No. GL 00 23 03 81.

Secondly, the insurer must determine if the legal malpractice complaint seeks recovery of covered damages. Professional liability policies typically state that “damages” exclude legal fees, costs and expenses paid or incurred or charged by the insured, no matter whether they are claimed as restitution of specific funds, forfeiture, financial loss, set-off or otherwise, and injuries that are a consequence of any of the foregoing. Lawyers Professional Liability Insurance Coverage Form, ISO Form No. GL 00 23 04 81.

There are few Illinois decisions which provide guidance to professional liability insurers in assessing potential coverage of legal malpractice allegations relating to attorney fees. Two cases decided by the Illinois Appellate Court First District address the issue of insurance coverage for attorney fees claims.

In Continental Casualty Co. v. Law Offices of Melvin James Kaplan, 345 Ill. App. 3d 34, 801 N.E.2d 992, 994 (1st Dist. 2003), a former client filed a negligence action against his attorney for failing to obtain a bankruptcy discharge of pre-petition fees that he owed the attorney. The attorney’s professional liability insurer filed a declaratory judgment suit. Kaplan, 801 N.E.2d at 994. Subsequently, the court granted the motion of the insurer for summary judgment, finding that the former client’s complaint sought recovery for injuries incurred as a consequence of legal fees charged by the attorney and were, as a result, excluded from coverage under the terms of the policy. Id.

On appeal, the court asserted that two requirements must be met in order to trigger coverage under the policy: (1) the claim made against the attorney in the underlying action must have arisen as a result of an act or
omission in the performance of legal services; and (2) the recovery sought in the underlying action must fall within the policy’s definition of damages. *Kaplan*, 801 N.E.2d at 995. The appellate court held that the allegations in the complaint of the former client clearly satisfied the first requirement. *Kaplan*, 801 N.E.2d at 996. With regard to the second requirement, the insurer argued that the injury for which recovery was sought was a consequence of legal fees charged by the insured attorney and, as such, fell outside the policy’s definition of damages. *Id.*

The appellate court asserted that the fact that the damages sought may be measured by the sums paid to the attorney post-discharge for legal services rendered prior to the filing of the bankruptcy petition did not mean that the injury occurred as a consequence of the fees charged. *Kaplan*, 801 N.E.2d at 996. Rather, the court found that the injuries suffered were a consequence of the attorney’s alleged negligent failure to secure a discharge of the client’s obligations to pay those fees. *Id.* The court concluded that the former client’s complaint alleged facts and a theory of liability against the attorney which potentially fell within the coverage afforded under the policy and, as a consequence, the insurer was obligated to defend the attorney. *Kaplan*, 801 N.E.2d at 996-97.

In *Continental Casualty Co. v. Donald T. Bertucci, Ltd.*, 399 Ill. App. 3d 775, 926 N.E.2d 833 (1st Dist. 2010), a former client filed a complaint alleging that her attorney had retained an excessive amount of fees from the settlement of her medical malpractice suit. The former client asserted claims of breach of contract, unjust enrichment, conversion, breach of fiduciary duty, fraud, and violation of an Illinois statute that limits contingent legal fees in medical malpractice actions. *Bertucci*, 926 N.E.2d at 837. The complaint sought recovery of the unauthorized fees, interest, new legal expenses, and punitive damages. *Id.*

The attorney’s professional liability insurer denied coverage for the former client’s suit. In the insurer’s declaratory judgment suit, the court ruled that there was no coverage for the underlying action because it did not seek “damages” as that term was defined in the policy. *Id.*

On appeal, the court stated that the insuring agreement of the policy expressly limited the scope of coverage to legal proceedings which allege both covered “damages” and “an act or omission in the performance of legal services.” *Bertucci*, 926 N.E.2d at 839. The court concluded that the former client’s action alleged only noncovered direct and consequential injuries from the excessive legal fees the attorney charged, and did not allege damages within the meaning of the policy. *Id.*

The *Bertucci* court stated that its opinion was influenced by California, Idaho and Massachusetts cases which analyzed similar attorney—client disputes and concluded the injuries were not the type covered by the attorney’s professional liability insurance. *Bertucci*, 926 N.E.2d at 840. The court asserted that fee disputes do not become covered damages merely because the damages are called “compensatory” or are sought under a claim of “negligence” or “breach of fiduciary duty.” *Bertucci*, 926 N.E.2d at 840, quoting *Tana v. Professionals Prototype I Insurance Company*, 47 Cal. App. 4th 1612, 55 Cal. Rptr.2d 160, 163 (1996). The *Bertucci* court compared the language of the policy with the facts alleged in the complaint, rather than examine whether the client had plead any particular theory of relief such as the attorney’s breach of legal duty, violation of a statute, or a disregard for an equitable duty. *Bertucci*, 926 N.E.2d at 842. The court concluded that the lawsuit of the former client was a fee dispute and did not allege damages within the meaning of the policy. *Id.*

Accordingly, the *Bertucci* court held that the former client’s lawsuit failed to allege an act or omission in the performance of “legal services” by the insured, within the meaning of the insuring agreement of the policy. *Bertucci*, 926 N.E.2d at 842. The court concluded that the attorney’s retention of money could not be construed as the provision of any type of service for another person, and was a business practice independent of the lawyer-client relationship. The *Bertucci* court relied upon *Gregg & Valby, L.L.P. v. Great American Insurance Co.*, 316 F. Supp. 2d 505 (S.D.Tex. 2004), wherein the court held that professional services within the context of insurance contracts were only “those acts which use the inherent skills *typified* by that profession, not all acts associated with the profession.” *Bertucci*, 926 N.E.2d at 843, quoting *Gregg & Valby*, 316 F. Supp. 2d at 513 (emphasis in original). The *Bertucci* court held that the billing function of a lawyer is not a professional service. *Id.* at 844.
The Bertucci court distinguished its earlier decision in the Kaplan case on the basis that the alleged negligence in Kaplan arose during the core representation of the client. Bertucci, 926 N.E.2d at 845. The client in Bertucci made no accusations about the legal services the attorney rendered, whereas in Kaplan the claim arose because the lawyer incorrectly performed the task he was hired to perform in the bankruptcy court. Id.

The Bertucci case includes a good analysis of the issue of potential coverage for professional liability actions involving attorney fees claims. However, the allegations in Bertucci related solely to attorney fees and, as such, the court had little difficulty concluding that the claim was not covered. Courts in other jurisdictions have also emphasized the lack of allegations of attorney misconduct in holding that attorney fees claims fall outside the scope of a professional liability policy. Tana, 55 Cal. Rptr.2d at 163; Gregg & Valby, L.L.P., 316 F. Supp. at 513.

There may be cases where the alleged legal malpractice and attorney fees claims are so closely intertwined that significant questions exist with respect to whether the allegations concern the performance of legal services and seek covered damages. A client may allege that an attorney was negligent for failing to timely litigate a case, spending excessive time researching issues, drafting pleadings, motions, or other documents, or spending an inordinate amount of time preparing for hearings, depositions, or other tasks. A client may allege that an attorney breached his fiduciary duty by charging fees for services which were never performed, charging excessive fees for a particular task, or performing unnecessary services which did not aid or advance the client’s case. In these instances, the client may allege that the attorney failed to exercise a reasonable degree of professional skill and care.

In the instances described above, a professional liability insurer should urge the court to analyze the language of the policy and the facts alleged in the complaint, rather than the particular theory of relief plead by the client. As the Bertucci court admonished, fee disputes do not become covered damages merely because the damages are called “compensatory” or are sought under a claim of “negligence” or “breach of fiduciary duty.” Bertucci, 926 N.E.2d at 840, quoting Tana, 55 Cal. Rptr.2d at 163. A professional liability insurer should assert that the charging of fees is not an activity particular to an attorney, and thus, does not constitute the performance of legal services.

A professional liability insurer should rely upon the line of cases cited in Bertucci, wherein the courts emphasized that the “widely accepted standard” when determining whether a particular act is a professional service is to look to the act itself, not the title or character of the party performing it. Bertucci, 926 N.E.2d at 843, quoting Marx v. Hartford Accident & Indemnity Co., 183 Neb. 12, 157 N.W.2d 870, 872 (1968). In those cases, the courts held that billing is largely ministerial, and does not draw on special learning acquired through rigorous intellectual training. Bertucci, 926 N.E.2d at 844, quoting Reliance National Insurance Co. v. Sears, Roebuck & Co., 58 Mass. App. 645, 792 N.E.2d 145, 148 (2003). In certain instances, however, billing decisions may involve the application of knowledge of the law for the benefit of the client and, thus, take on the character of professional services. Reliance National, 792 N.E.2d at 148 n.4 (an attorney’s billing may have tax consequences, as in divorce cases and structured settlements in tort cases, and may also implicate attorney – client confidences, such as where an attorney bills a third-party).

Where the allegations in a legal malpractice complaint relate solely to attorney fees, a professional liability insurer could consider filing a declaratory judgment action. More troublesome are the cases where the complaint alleges that an attorney was negligent in performing legal services and also alleges some impropriety relating to attorney fees.

If an underlying complaint alleges several theories of recovery against the insured, the duty to defend arises even if only one such theory is within the potential coverage of the policy. U.S. Fidelity & Guaranty Co. v. Wilkin Insulation Co., 144 Ill. 2d 64, 578 N.E.2d 926, 930 (1991). So, if the complaint alleges a cause of action for legal malpractice, a professional liability insurer must defend the entire suit even if the majority of the allegations relate to attorney fees.

Where the legal malpractice and attorney fees actions are plead in separate counts of the complaint, a professional liability insurer may file a declaratory judgment action, obtain a declaration that it owes no duty to
defend the attorney fees action, and withdraw its defense of that count of the complaint. In most cases, however, it is very difficult to segregate defense costs.

If a professional liability insurer chooses not to pursue a declaratory judgment suit, the threat of a coverage action may be used to negotiate an agreement with the insured. The possibility of an adverse ruling in the declaratory judgment case and the costs attendant to the coverage suit are an incentive for both the insurer and the insured to negotiate an agreement.

The insured may agree to pay a percentage of defense costs, contribute money to a settlement offer, or waive attorney fees owed by the former client in the legal malpractice suit. The insured may agree to waive the right, if any, to select independent counsel at the insurer’s expense. The insurer may waive its right, if any, to seek reimbursement of defense costs associated with a fee dispute claim.

The willingness of the parties to negotiate an agreement will depend on the strength of the professional liability insurer’s coverage position, which will turn on the nature of the allegations plead in the underlying complaint. If the complaint’s allegations are likely to be interpreted as an action for attorney fees, the insured will be inclined to negotiate with the professional liability insurer. Conversely, if the allegations are likely to be interpreted as the performance of legal services, the professional liability insurer will have an incentive to negotiate an agreement. The potential liability of the insured in the legal malpractice case, and the associated defense costs are also factors to be considered in determining whether to negotiate an agreement.

In sum, when faced with the prospect of incurring significant defense costs in a legal malpractice suit involving an attorney fees dispute, a professional liability insurer should analyze the allegations of the complaint in the context of the Kaplan and Bertucci cases. If the professional liability insurer believes that the complaint allegations are likely to be interpreted as an attorney fees dispute, the insurer should file a declaratory judgment action. If there is a substantial degree of uncertainty with regard to the success of a coverage suit, or the costs associated with the declaratory judgment action will exceed the anticipated defense costs and indemnity payment in the underlying case, the professional liability insurer should attempt to negotiate an agreement with the insured.

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