Presented:
19th Annual Insurance Law Institute

November 13-14, 2014
Dallas, TX

THE COBBLER'S CHILDREN HAVE NO SHOES: PROFESSIONAL LINES ISSUES

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BACKGROUND, EDUCATION AND PRACTICE

Veronica Carmona Czuchna is a partner in the Austin firm of Duggins Wren Mann & Romero, where she concentrates her practice in insurance law and litigation, specifically litigation of insurance coverage disputes, insurance coverage opinions, and litigation of extra-contractual liability lawsuits involving the duty of good faith and fair dealing, *Stowers* liability, the Texas Insurance Code, and the Deceptive Trade Practices Act.

Veronica frequently lectures and writes in the area of insurance law. She is a Past Chair of the State Bar of Texas Insurance Law Section (2005-2006), which she has served either as an officer, Council member, or ex-officio Council member since 1999. Veronica has served on the Board of Trustees of the State Bar of Texas Insurance Trust (2005-2009). She was named to Who's Who Legal: Texas 2008 (Insurance & Reinsurance).

Veronica previously was Of Counsel to Clark, Thomas & Winters, a shareholder in the Austin firm of Jordan & Carmona, P.C., and a partner in the Dallas office of Zelle & Larson, L.L.P.

Veronica earned an A.B. in History from Princeton University and a J.D. from The University of Texas School of Law.

The Cobbler's Children Have No Shoes: Professional Lines Issues

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I. INTRODUCTION

While insurance coverage specialists may spend countless hours analyzing insurance policies and coverage for a client, they may know little about their own Errors & Omissions insurance policies. Even if they have read the terms and conditions of their professional liability insurance policies, they may be unaware of how such policies are interpreted. Whether or not the insurance practitioner's coverage practice includes lawyer professional liability, every lawyer should know how insurers and the courts construe their E&O policies. This article will explore E&O issues that every lawyer ought to know when submitting the application for insurance, evaluating available coverages, and asserting a claim under the policy. It will include a review of disclosure and reporting issues, construction and application of "innocent insured" provisions, and coverage for fee disputes.

II. WRONGFUL ACTS & LEGAL SERVICES

A. WHAT CONSTITUTES A "WRONGFUL ACT"?

Legal E&O policies generally afford coverage for damages arising out of any wrongful act, error or omission of the insured in rendering or failing to render professional legal services for others. At common law, it is recognized that Texas attorneys owe no legal duty to non-client third parties. *Barcelo v. Elliott,* 923 S.W.2d 575, 577 (Tex. 1996); *Alpert v. Crain, Caton & James, P.C.,* 178 S.W.3d 398, 405 (Tex. App. – Houston [1st Dist.] 2005, pet. denied). Notwithstanding this rule, the court in *Westport Ins. Co. v. Cotten Schmidt, LLP*, 605 F.Supp.2d 796 (N.D. Tex. 2009) held that an E&O insurer had a duty to defend a suit by third parties against whom the law firm previously had taken a default judgment.

Cotten Schmidt arose out of a suit filed by the insured law firm on behalf of its client in which it took a default judgment and then obtained a writ of attachment on the defendant's equipment, which was sold at auction for allegedly millions of dollars less than its true value. In attacking the default judgment, the defendant against whom it was taken (Russell) alleged that the law firm failed to strictly comply with an order of substituted service. The defendant successfully had the default judgments vacated for lack of proper service, and then filed suit against the law firm for wrongful execution, levy and sale, and for conversion. Westport filed a declaratory judgment action claiming that the suit against the firm did not allege a "wrongful act" as required by the policy because the firm owed no legal duty to Russell as a non-client third party. Westport's policy defined a "wrongful act" as follows:

[*] The opinions and conclusions expressed by the authors do not necessarily reflect the opinions or position of Duggins Wren Mann & Romero, LLP or its clients.

> Any act, error, omission, circumstance, personal injury or breach of duty in the rendition of legal services for others in the INSURED's capacity as a lawyer, and arising out of the conduct of the INSURED'S profession as a lawyer.

The district court rejected Westport's argument, finding that the common-law rule did not bar suit. *Id.* at 801. The court applied the complaint-allegation rule and concluded that the law firm and its lawyers were being sued because of what they did in obtaining default judgments and a writ of attachment, and in executing upon the equipment – actions which the court found to fit within the definition of "wrongful act." The court noted that, "the plain language of the policy does not limit coverage to claims of breach of duty nor to clients of Cotten Schmidt. Instead…the policy extends to '*any* act, error, [or] omission…in the rendition of legal services for others in the INSURED's capacity as a lawyer." *Id.* at 802.

B. WERE LEGAL SERVICES RENDERED?

1. Fee Disputes.

Earlier courts recognized that practices such as billing and fee setting generally are not characterized as professional services. *See Gregg & Valby, LLP v. Great American Ins. Co.*, 316 F.Supp.2d 505, 513 (S.D. Tex. 2004) (noting that it had "little trouble concluding that Plaintiff's billing and fee-setting practices are not professional services"). However, more recent cases have concluded that fee disputes do amount to or arise out of professional legal services. *See Shamoun & Norman, LLP v. Ironshore Indem., Inc.,* ___ F.Supp.3d ___, 2014 WL 5460475 (N.D. Tex. October 28, 2014); *Shore Chan Bragalone Depumpo LLP v. Greenwich Insurance Company,* 856 F.Supp.2d 891 (N.D. Tex. 2012).

Shore Chan arose out of a lawsuit against the law firm by a third party for breach of a referral agreement after the firm allegedly failed to pay a percentage of fees earned from referred clients. Greenwich declined to defend the law firm, asserting that the alleged wrongful acts did not arise out of professional services. Applying a liberal interpretation of the phrase "arising out of," the court concluded that the insured's alleged failure to pay the third party arose from professional services. 856 F.Supp.2d at 899. The court noted that, "'arise out of' requires only a causal connection or relation between the act and the alleged injury." *Id*. at 898 (citing *Utica National Insurance Company of Texas v. American Indemnity Company*, 141 S.W.3d 198, 203 (Tex. 2004)). The court also referenced Fifth Circuit interpretations of Texas law holding that "the words 'arising out of,' when used within an insurance policy, are broad, general and comprehensive terms effecting broad coverage." *Id.* at 898. Although the court conceded that the firm was alleged to have breached a contract rather than performed negligently while providing legal services, it concluded that "the contractual relationship nonetheless relates to [the insured's] performance as attorneys." *Id.* at 899.

In *Shamoun & Norman, LLP v. Ironshore Indem., Inc.,* ___ F.Supp.3d ___, 2014 WL 5460475 (N.D. Tex. October 28, 2014), the insurer argued that it was not obligated to defend the firm under a professional liability policy because a fee dispute centering on billing practices did not arise out of the rendering or failure to render professional legal services. Ironshore urged the court to follow *Gregg & Valby,* and argued that the court should reject *Shore Chan* because the decision essentially eviscerates long-standing Texas law limiting professional services to specialized skills particular to a specialized vocation and excluding ordinary business tasks such as billing. The policy at issue in *Shamoun* provided as follows:

Title search: The Cobbler's Children Have No Shoes: Professional Lines Issues

First appeared as part of the conference materials for the
19th Annual Insurance Law Institute session
"The Cobbler's Children Have No Shoes: Professional Lines Issues"