



Insurance Update

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Massachusetts Confines Policyholders' Ability to Recover DJ Fees to Duty to Defend Disputes

On November 17, 2006, the Massachusetts Supreme Judicial Court ("SJC") declined to extend a policyholder's right to recover attorney's fees beyond disputes regarding an insurer's duty to defend. See *Wilkinson v. Citation Insurance Company*, 2006 Mass. LEXIS 678. From now on, a policyholder who prevails in litigation over the insurer's indemnification obligation will not be entitled to recover attorney's fees incurred in the DJ action.

The SJC had previously articulated an exception to the "American Rule" – that parties to litigation bear their own costs - in *Preferred Mut. Ins. Co. v. Gamache*, 426 Mass. 93 (1992) ("*Gamache*"). *Gamache* held that a policyholder is entitled to recover its attorney's fees when it prevails in a declaratory judgment action concerning the insurer's defense obligation, regardless of any showing of bad faith. The SJC subsequently held in *Rubenstein v. Royal Ins. Co.*, 429 Mass. 355 (1999), that *Gamache* was not limited to any particular type of liability Policy (e.g., homeowner's, business). In *Wilkinson*, the insured unsuccessfully sought to extend the right to attorney's fees to disputes concerning the insurer's indemnification obligation.

Wilkinson concerned a dispute over the "business purpose" coverage limitation in a homeowner's policy. A fire destroyed part of the homeowner's house and garage including tools and equipment used by the homeowner's son to maintain his racing cars. The policy defined "business" as including "trade, profession or occupation." The SJC noted that the policy definition added little meaning to the term business other than to "suggest its use in common parlance, which our cases have taken to be 'an activity engaged in for the purpose of gain or profit.'" *Id.* at *10.

The SJC affirmed the trial court's decision and stated that "reasonable policyholders would not understand the term 'business,' either in customary usage or under the Policy's definition, to apply to the weekend avocation of an otherwise gainfully employed individual." *Id.* at 11. Construing the facts in the light most favorable to the insured, the SJC concurred that the insured "did not at relevant times race for 'gain or profit,' that is,

for a ‘business’ purpose. *Id.* Consequently, the court affirmed the insurer’s obligation to indemnify the Wilkinsons for the full amount owed under the Policy.

Next, the insurer challenged the trial court’s award of attorney’s fees to the insureds. The insureds advanced two arguments to extend the *Gamache* rule to duty to indemnify disputes. The insureds first argued that *Gamache* and its progeny did not distinguish between the duty to defend and the duty to indemnify in any significant way. Second, the insureds argued that “the existence of a special relationship between an insured and insurer” warranted an exception to the American Rule. *Id.* at *17, quoting *Gamache*.

Rejecting the insureds’ first argument, the SJC enunciated the “meaningful difference” between the distinct duties of defense and indemnification, emphasizing that time is of the essence in the duty to defend context. The SJC similarly rejected the insureds’ second argument, i.e., that “the relative bargaining power of the parties to an insurance contract is a distinguishing feature warranting an exception to the American Rule in insurance cases.” *Id.* at *20. The SJC contrasted the insured’s “David and Goliath” argument with the reality that an insurer who correctly declines coverage sometimes incurs the expense of litigation for coverage that it never agreed to provide. The court described Massachusetts’ “comprehensive regulatory [and statutory] scheme” as an adequate safeguard to discourage unfair or abusive tactics and ensure consistency and fairness in insurance contracts.

Finally, the SJC noted that most state courts that have considered the issue have declined to create an exception to the American Rule for indemnification coverage disputes. To date, West Virginia, Wisconsin and Montana are the only jurisdictions whose state supreme courts permit policyholders to recover their legal fees when they establish a duty to indemnify. *Id.* at *27.

The SJC’s decision marks a significant victory for insurers who legitimately wish to dispute whether they have an indemnification obligation under policy terms and conditions. The decision reflects the reality that Massachusetts already has a wealth of case law and statutory protections for insurance consumers, many of whom are commercial entities or sophisticated businesspersons.

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