



attorneys' fees and costs incurred by the plaintiff in defending the underlying counterclaims before December 8, 1987 on the ground that the plaintiff did not notify it of the existence of the counterclaims or request that it provide a defense until that date. The defendant contends that the terms of the plaintiff's insurance policy require immediate notice by the insured of any claims or suits.

The defense of late notice is part of the issue of liability, which this court has already decided on the parties' previous cross-motions for summary judgment. The defendant did not raise the issue of late notice at that time, nor did it submit evidence showing prejudice attributable to late notice, as required under Maine law. *See Ouellette v. Maine Bonding & Casualty Co.*, 495 A.2d 1232, 1235 (Me. 1985) (even when an insurance policy includes a clear notice requirement, "to avoid either its duty to defend or its liability thereunder based on an insured's delay in giving notice, a liability insurer must show (a) that the notice provision was in fact breached, and (b) that the insurer was prejudiced by the insured's delay"). If the defendant wished to contest its duty to defend, in whole or in part, on the basis of late notice, it should have done so when the issue of liability was before the court.

Even if the defense of late notice could be construed as a part of the question of damages currently before the court on the plaintiff's motion for summary judgment, the defendant has not submitted any evidence in response to this motion showing it was prejudiced by the plaintiff's failure to give notice of the counterclaims before December 8, 1987.<sup>1</sup> Under Maine law, the insurer has the

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<sup>1</sup> The undisputed facts regarding the notice issue are as follows. The original counterclaims were filed on October 24, 1984. Exhibit D to Defendant's Second Statement of Material Facts. On December 8, 1987 the plaintiff first notified the defendant of the counterclaims and requested that the defendant defend these claims. April 27, 1989 Affidavit of Charles Abbott and Exhibit A. The plaintiff asserts that he did not notify the defendant earlier because he did not understand or recognize that he might be covered. August 1, 1989 Affidavit of Fred Merrill, attached to Plaintiff's Supplemental Statement of Material Facts. The underlying litigation was settled; under the terms of the settlement, the plaintiff received \$250,000 from the defendants in that action. Plaintiff's Answers to Defendant's Interrogatories #4, attached as Exhibit A to Defendant's Second Statement of Material Facts.

burden of proving prejudice, which is generally a question of fact. *Id.*<sup>2</sup> Therefore, even if this defense were not precluded by the previous grant of summary judgment in the plaintiff's favor on liability, following *Ouellette* the defendant would not be entitled to avoid liability for attorneys' fees and costs incurred before December 8, 1987 on the ground of late notice. See *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986).

The issue on which both parties seek summary judgment is ``bad faith." The plaintiff asserts that, if the defendant's refusal to honor its obligation under the policy to defend the counterclaims is attributed to bad faith, it is entitled to its attorneys' fees and costs in prosecuting the present action. *Union Mutual Fire Insurance Co. v. Inhabitants of the Town of Topsham*, 441 A.2d 1012, 1019 (Me. 1982). In *Union Mutual*, a case in which the insured sought to recover attorneys' fees incurred in defending a declaratory judgment action brought by the insurer, the Law Court held:

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<sup>2</sup> The defendant cites *Gates Formed Fibre Products, Inc. v. Imperial Casualty and Indemnity Co.*, 702 F. Supp. 343, 348-49 (D. Me. 1988), in support of its claim that it does not need to show prejudice to avoid liability on the ground of late notice. In *Gates*, this court ruled that the insurer was relieved of liability where the insured did not follow clear policy terms requiring it to notify the insurer before entering into a settlement agreement. However, this case clearly is governed by *Ouellette's* requirement that the insurer show prejudice from late notice of a duty to defend.

When the duty to defend is clear from the policy and the pleadings, so that the insurer's commencement of the declaratory judgment action must be attributed to a refusal in bad faith to honor its obligation under the policy, the insured should be entitled to his reasonable attorneys' fees in defending the declaratory judgment action as an element of damages for the insurer's breach of its contract obligation.<sup>3</sup>

*Id.* In that case, the Law Court concluded that the duty to defend was not clear for two reasons. First, *American Policyholders' Insurance Co. v. Cumberland Cold Storage Co.*, 373 A.2d 247 (Me. 1977), in which the court provided considerably more guidance than was previously available as to the nature and scope of an insurer's responsibility to defend, had not yet been decided. Second, the allegations of the underlying complaint left it "somewhat unclear" whether the theory of suit brought the insured's claim within the coverage of the policy. *Id.* The court reasoned that:

the *possibility* that [the underlying] complaint embraced a claim of negligence in the performance of street cleaning and repair operations that brought the [insured's] liability within the scope of the policy . . . as an exception to an exclusion . . . was not something that was obvious on the face of the complaint.

*Id.* (emphasis in original).

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<sup>3</sup> The Law Court specifically reserved decision on whether such fees are recoverable when the insured brings the action to compel the insurer to defend. *Union Mutual*, 441 A.2d at 1019 n.8.

At the time the defendant in the present action was called upon to defend the underlying counterclaims, it had the benefit not only of *American Policyholders'* but also of much of its ample progeny<sup>4</sup> as well as *Baybutt Construction Corp. v. Commercial Union Insurance Co.*, 455 A.2d 914 (Me. 1983). In my view, the availability of these precedents, all conveying a consistently lucid message, has a conclusive bearing on the issue whether the defendant's duty to defend in this case was "clear." While the then-existing state of the law may have left it unclear in *American Policyholders'* whether the theory of suit brought the insured's claim within the coverage of the policy, I cannot conceive that a conscientious application of the now well-developed and consistently applied Maine law for determining an insurer's duty to defend could have led an insurer to a good faith conclusion that there was no duty to defend here. See Recommended Decision on Cross-Motions for Summary Judgment. Given the salutary purposes underlying the Law Court's "duty to defend" analysis,<sup>5</sup> as well as its

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<sup>4</sup> See *J.A.J., Inc. v. Aetna Casualty and Surety Co.*, 529 A.2d 806 (Me. 1987); *Merrimack Mut. Fire Ins. Co. v. Brennan*, 534 A.2d 353 (Me. 1987); *United States Fidelity and Guarantee Co. v. Rosso*, 521 A.2d 301 (Me. 1987); *American Home Assurance Co. v. Ingeneri*, 479 A.2d 897 (Me. 1984); *American Universal Ins. Co. v. Cummings*, 475 A.2d 1136 (Me. 1984); *L. Ray Packing Co. v. Commercial Union Ins. Co.*, 469 A.2d 832 (Me. 1983); *North East Ins. Co. v. Tanguay*, 468 A.2d 600 (Me. 1983); *Horace Mann Ins. Co. v. Maine Teachers Ass'n*, 449 A.2d 358 (Me. 1982); *Travelers Indem. Co. v. Dingwell*, 414 A.2d 220 (Me. 1980).

<sup>5</sup> A defendant has no power to amend a complaint which contains an incomplete statement of facts. Whether he can obtain a defense from his insurer must depend not on the caprice of the plaintiff's draftsmanship, nor the limits of his knowledge, but on a *potential* shown in the complaint that the facts ultimately proved may come within the coverage. Even a complaint which is legally insufficient to withstand a motion to dismiss gives rise to a duty to defend if it shows an intent to state a claim within the insurance coverage. . . . If we were to look beyond the complaint and engage in proof of actual facts, then the separate declaratory judgment actions . . . would become independent trials of the facts which the defendant would have to carry on at his expense. Moreover, once an inquiry begins into the actual facts, the insured will have already begun defending against liability, and the issue in respect to the insurer will be its ultimate duty to

rationale for modifying in duty to defend cases the American Rule on the recoverability of attorneys' fees,<sup>6</sup> I conclude that the defendant's duty to defend was sufficiently clear so as to compel the imputation of bad faith to its refusal to do so. Adding considerable support to the plaintiffs' "bad faith" claim is the defendant's apparent awareness of *Baybutt*, its significance to the coverage issues in this case and the defendant's conscious decision to disregard it on the basis of idle speculation that, if revisited, the Law Court would overrule it. See Exhibit C to April 27, 1989 Affidavit of Charles Abbott.

There remains, then, the issue of whether the Law Court would recognize the right to recover attorneys' fees in a situation like that here where the insured has sued for such fees expended in providing its own defense to claims as to which its insurer owed a duty to defend but refused to do so. The specific question reserved in *Union Mutual* is whether such fees are recoverable where the

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indemnify, not its duty to defend. We see no reason why the insured, who's insurer is obligated by contract to defend him, should have to try the facts in a suit against his insurer in order to obtain a defense.

*Travelers Indem. Co. v. Dingwell*, 414 A.2d at 226-27 (emphasis in original).

<sup>6</sup> "Because the liability insurer's duty of defense is so extensive and the burden on the insured of a breach of that duty is likely to be so heavy, we conclude that the insurer should not enjoy the usual freedom to litigate without concern about the possibility of having to pay the other party's attorneys' fees." *Union Mut. Fire Ins. Co. v. Inhabitants of Town of Topsham*, 441 A.2d at 1019.

insured brings the action to compel the insurer to defend. *See* n.2, *supra*. In the present case the plaintiff did not initiate a declaratory judgment action but, rather, continued to provide its own defense when the defendant refused its request to defend. The Law Court's reference to the New York Rule is instructive. That rule entitles an insured to recover expenses incurred in defending a declaratory judgment action brought to determine an insurer's duty to defend without regard to whether the insurer's refusal to defend was in bad faith, but denies such a recovery if the insured has himself brought the declaratory judgment action. *Mighty Midgets, Inc. v. Centennial Insurance Co.*, 47 N.Y.2d 12, 416 N.Y.S.2d 559, 389 N.E.2d 1080 (1979); *Glens Falls Insurance Co. v. United States Fire Insurance Co.*, 41 App. Div.2d 869, 342 N.Y.S.2d 624 (1973), *aff'd*, 34 N.Y.2d 778, 358 N.Y.S.2d 773, 315 N.E.2d 813 (1974); *Sucrest Corp. v. Fisher Governor Co.*, 83 Misc.2d 394, 371 N.Y.S.2d 927 (Sup. Ct. 1975). By contrast, the rule adopted by the Law Court in *Union Mutual* provides no absolute right of recovery to a defending insured to whom a duty of defense is owed. Rather, the refusal to defend giving rise to the declaratory judgment action must be a bad faith refusal. Thus, unless a duty to defend is clear from the policy and the pleadings, an insured is not entitled to attorneys' fees even when he successfully defends a declaratory judgment action brought by the insurer seeking a declaration of no duty to defend. The Maine Rule, even in its limited announced application, accomplishes a balancing of competing considerations which I conclude is likely to result in its extension to include situations like that presented here. It would surely be a hollow application of the Law Court's "duty to defend" and "bad faith" holdings if, in order to secure that defense or to recover the substantial fees necessarily incurred in the wake of an insurer's bad faith refusal, the insured must bear the cost of an action he is forced to bring as the only means available to secure his rights under the policy. In this case, the defendant having made clear that it would not defend and did

not intend to initiate a declaratory judgment of its own, *see* Exhibit E to April 27, 1989 Affidavit of Charles Abbott, the plaintiff was left with little choice.

On the "bad faith" issue, I conclude that there is no genuine issue as to any material fact and that the plaintiff is entitled to a judgment (on liability) as a matter of law.

For the foregoing reasons, I recommend that the plaintiff's motion for summary judgment be **DENIED** on the damages issue (the amount of recoverable fees incurred in defending the underlying counterclaims) and that the plaintiff's motion for summary judgment be **GRANTED** on the "bad faith" issue (limited to liability for reasonable attorneys' fees and costs incurred in prosecuting the present action) and that the defendant's cross-motion for partial summary judgment be **DENIED**.

#### **NOTICE**

***A party may file objections to those specified portions of a magistrate's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. § 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.***

*Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.*

*Dated at Portland, Maine this 9th day of August, 1989.*

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*David M. Cohen*  
*United States Magistrate*