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NEWSLETTER

Related Acts Provision Does Not Bar Coverage Despite Similar Suit Prior to Policy

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In an unreported decision, the United States District Court for the Western District of Missouri has held that the prior knowledge provision of an E&O policy did not bar coverage for suits by customers even though the suits had some overlap with a suit filed against the policyholder before the insurer began providing coverage. *H&R Block, Inc. v. Evanston Ins. Co.*, 2006 WL 763177 (W.D. Mo 2006).

The policyholder-company, which provides tax-related services, obtained E&O coverage for the "performance of tax services." The primary policy provided that the primary insurer had no obligation to defend the company. The primary policy required that a claim "must be based on a wrongful act that occurred while the Policy was in effect." It provided, however, that coverage would be available for wrongful acts prior to the policy's inception if the insured "had no knowledge of the prior wrongful act on the effective date off this policy, nor any reasonable way to foresee that a claim might be brought." The company also obtained excess coverage.

Beginning in 1993, the company was named as a defendant in a number of lawsuits filed around the country in connection with the company's Refund Anticipation Loan (RAL) program, whereby it extended a short-term loan in the amount of the customer's anticipated tax return, less fees. The underlying plaintiffs alleged fraudulent misrepresentations, fraudulent omissions, breach of fiduciary duties and violations of the Truth in Lending Act. The coverage litigation involved a number of issues.

First, the insurers maintained that coverage was barred because the policy provided that "[a]ny damages incurred because of a wrongful ... series of related acts ... shall be treated as a single claim. The claim will be subject to the limit in effect at the time of the first reported wrongful act." The insurers noted that a lawsuit filed against the company in 1990, before any of the insurers provided coverage, had referenced the RAL program.

The insurers argued, therefore, that coverage was barred because the 1993 suits and the 1990 lawsuit arose from a series of related acts. The court rejected the argument, noting that the subject of the first sentence of the provision in the policy at issue was "damages" not "wrongful acts." It reasoned that the provision simply meant that all damages incurred by a single claimant would be treated as a single claim and that it was "not a directive regarding the timing for filing claims."

The court also rejected the insurers' argument that coverage was barred because the company knew of the problems with the RAL program prior to the inception of the policies because of the suit filed in 1990. According to the court, the earlier suit referenced the RAL program only tangentially and mainly focused on allegations of an entirely different nature. Moreover, the court held that "[e]ven if the claims [we]re the same, ... the fact that a single lawsuit has been filed is insufficient to put a party on notice that a second lawsuit will be filed." The court buttressed its conclusion by pointing to the fact that no additional suits were filed for two years.

However, the court reached a different conclusion regarding a second excess insurer that came on the risk only after 12 of the underlying suits, including four class action lawsuits, had been filed. The company argued that "it had no reason to know that any particular customer would file suit." However, the court regarded this argument as "irrelevant" and held that the policyholder had "reason to know that additional claims would be filed by somebody when it obtained" the second layer of excess coverage.

The court agreed in part with the insurers' contention that they had no duty to defend the policyholder or reimburse it for its defense costs. The court noted that under the primary policies, the duty to defend was expressly disavowed. Under the excess policies, the insurers were only obligated to provide a defense as under the primary policies. Therefore, the court held that "there could be no 'further' duty to defend on the primary insurers' parts because there never was such a duty." Additionally, the court determined that the policyholder never in fact tendered the suits to the insurer. However, the court held that defense costs must be reimbursed under excess policies that specifically provided for their payment.

Finally, the court held that the policyholder erred in applying the self-insured retention ("SIR") to each lawsuit, as opposed to each customer who alleged wrongdoing. The policies set a $2,500 SIR "per wrongful act." The court held that under the policies, "wrongful act" was not defined to mean "lawsuits filed against insured." Rather, the policies defined the phrase to "encompass the errors, omissions and negligent acts covered by th [e] policies." Therefore, the court held that the SIR must be applied to each customer alleging wrongdoing as a prerequisite to coverage under the excess policies.