

Utah Federal Court Holds that Prior Knowledge Exclusion Bars Coverage; Certifies Question of Whether Insurer May Recoup Defense Costs

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The United States District Court for the District of Utah, applying Utah law, has held that an insurer owed no duty to defend or indemnify under a lawyers professional liability policy because the policy's prior knowledge exclusion barred coverage. *Westport Ins. Corp. v. Ong*, 2008 WL 892941 (D. Utah Mar. 28, 2008). However, the court declined to rule on whether the insurer could recoup defense costs it had advanced to the policyholder under a reservation of rights. In light of the absence of Utah authority on the issue, the court certified to the Utah Supreme Court the question of whether an insurer may recoup defense costs under a reservation of rights absent an express policy provision permitting it to do so.

The insurer issued a lawyers professional liability policy to a lawyer and his law firm for a policy period beginning May 8, 2003. The policy's prior knowledge exclusion barred coverage for claims "based upon, arising out of, attributable to, or directly or indirectly resulting from: any act, error [or] omission . . . occurring prior to [May 8, 2003] if any INSURED at [May 8, 2003] knew or could have reasonably foreseen that such act, error [or] omission . . . might be the basis of a CLAIM."

The plaintiffs in the underlying litigation alleged that, in 2001, an accountant employed at the policyholder's law firm committed accounting malpractice and breached fiduciary duties in preparing the plaintiffs' taxes. In 2002, after the IRS rejected their tax return in 2001, the plaintiffs' counsel notified the law firm of plaintiffs' intent to recover any lost refunds and advised the accountant to put her malpractice carrier on notice. The insurer advanced \$100,000 in defense costs to the law firm under a reservation of rights but ultimately denied coverage based on the policy's prior knowledge exclusion.

The court first concluded that the insurer had properly denied coverage based on the policy's prior knowledge exclusion. Finding that the law firm had not introduced any admissible evidence to the contrary, the court held that "[u]nder an objective standard, there is no dispute that the [law firm] knew or could have reasonably foreseen that a claim might be made."

The court next addressed the insurer's argument that it was entitled to recoup the defense costs it had previously advanced to the law firm pursuant to a reservation of rights. The court noted that this issue has not yet been addressed by the Utah appellate courts and that other jurisdictions were split on the issue. In light of the absence of controlling Utah law, the court certified the question to the Utah Supreme Court. The court concluded that, if the Utah Supreme Court accepts the certified question, and determines that a reservation of rights to recoup defense costs is not permitted under Utah law, it will enter judgment in favor of the law firm. However, if the state high court determines that such a reservation of rights is permitted under Utah law, the court indicated that it will set a jury trial to determine "whether there was a meeting of the minds as to [whether the law firm] accepted the policy limit payment subject to a reservation of rights to later recoup the payment."