

Notice of Potential Claim Does Not Render Prior Knowledge Exclusion Inapplicable

August 2009

The United States District Court for the Eastern District of New York has held that notice of an error potentially giving rise to a claim provided by a policyholder before the inception of a lawyers professional liability policy does not bar applicability of the policy's prior knowledge exclusion. *St. Paul Fire & Marine Ins. Co. v. Sledjeski & Tierney, PLLC*, 2009 WL 2151425 (E.D.N.Y. July 17, 2009). The court further held that the claims-made policy's "potential claim" provision requiring that the policyholder give such notice did not render the policy ambiguous, and it rejected additional policyholder arguments regarding rescission and timely disclaimer.

The policyholder was a law firm that represented a widow and her deceased husband's estate following his death in a 2003 motor vehicle accident. The firm filed a wrongful death action in state court on behalf of the estate in 2005, on the day the statute of limitations expired. In March 2008, the estate filed a malpractice action against the firm, alleging that it had filed a defective summons and a defective, unverified complaint that was never served in the wrongful death action. In October and November 2007, prior to the filing of the malpractice action, the firm notified its professional liability insurer about the alleged errors that ultimately led to the malpractice action.

The liability policy in effect at the time the insured provided notice (the 2007 policy) contained a prior knowledge exclusion for claims arising out of errors or omissions "occurring prior to the inception date of this policy" if the insured, prior to the inception date, "knew or could have reasonably foreseen that such error... might be expected to be the basis of a 'claim' or 'suit.'" The insurer provided a defense while reserving its rights regarding this exclusion and subsequently filed a declaratory judgment action seeking a declaration of no coverage pursuant to the exclusion.

In denying the firm's motion to dismiss, the court first addressed the firm's argument that it had provided notice of the potential claim during the 2007 policy, and thus coverage was available during the subsequent 2008 policy. The court rejected that argument, noting that the insurer sought a declaration of rights under the 2007 policy, not the 2008 policy, and therefore any argument concerning the 2008 policy or actions the firm took in the fall of 2007—well after the inception of the 2007 policy—to notify the insurer about potential claims was irrelevant. In any event, the court explained, the prior knowledge exclusion did not include any type of notification requirement; it applied simply if the firm knew or could have reasonably foreseen that an error committed prior to the policy's inception date could lead to a claim or suit. The correct inquiry, the court

stated, was whether the firm could have foreseen that its alleged errors associated with the filing of the wrongful death action in 2005, well before the inception of the 2007 policy, could have led to a malpractice suit—and not whether the firm notified the insurer of the potential suit.

The court also explained that the 2007 policy could be applicable, despite the underlying suit having been filed during the 2008 policy's period, by virtue of a "potential claim" provision requiring the firm to give written notice to the insurer when it "first becomes aware of a circumstance which may give rise to a 'claim'" and that any subsequent claims arising out of that circumstance "shall be considered to have been made and reported during the 'policy period.'" Thus, the policyholder's notice in October and November 2007 may have triggered coverage under the 2007 policy, the court held.

The court then rejected the firm's argument that the "potential claim" provision's reporting requirement was essentially "occurrence-based policy language" that created an ambiguity as to whether the policy as a whole was occurrence-based or claims-made in nature and whether the 2007 policy was implicated. The court noted that the firm did not allege that the "potential claim" provision's language itself was ambiguous. The court further explained that the firm had failed to distinguish between language requiring notice of an occurrence in an occurrence-based policy and language requiring notice of a potential claim in a claims-made policy, which serve different purposes. In this case, the latter potentially enabled the firm, because it provided notice of the alleged error in 2007, to obtain coverage under the 2007 policy for any claim arising out of that alleged error, even though the malpractice claim was brought in 2008, after the 2007 policy had expired. The court then indicated that factual issues precluded it from determining whether the 2007 policy's prior knowledge exclusion barred coverage at this stage of the litigation.

Finally, the court rejected the firm's argument that the insurer's complaint should be dismissed because the insurer allegedly did not timely disclaim coverage. The court rejected the firm's reliance on New York Insurance Law § 3420(d)(2), which, while requiring a liability insurer to "give written notice as soon as reasonably possible of [a] disclaimer of liability or coverage," expressly applies only to "coverage for death or bodily injury arising out of a motor vehicle accident or any other type of accident." In this case, the court explained, the underlying claim was a malpractice suit under which no death or bodily injury arose, and therefore the provision did not apply. The court also explained that under the common-law rule, even if a delay in disclaiming coverage is unreasonable, it must prejudice the policyholder. Because the reasonableness and prejudice issues were factual inquiries, the court held that dismissal as a matter of law was unwarranted.