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NEWSLETTER

No Duty To Defend Matter About Which Insured Had Prior Knowledge

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Applying Oregon law, a federal district court has held that an insurer had no obligation to defend a claim that arose out of professional services rendered prior to the inception of the policy that the insured knew or could have reasonably foreseen could give rise to a claim. *Harris Thermal Transfer Products v. James River Ins. Co.*, 2010 WL 2942611 (D. Or. July 19, 2010).

The case involved a professional liability policy issued to a firm that designed and manufactured heat exchangers and other equipment for use in heavy industry. The policy provided specified coverage on a claims-made basis for the period of February 9, 2008 to February 9, 2009. During this period, in October 2008, the insured provided notice that a customer was alleging that several of its heat exchangers were defective and did not meet the operating conditions and specifications set forth in the parties' contract. The insured filed suit against the customer for declaratory relief, attaching to its complaint letters dated May 18, 2007 and July 25, 2007 in which the customer asserted that there were manufacturing defects and fabrication errors with the heat exchangers delivered by the insured. The customer filed a counterclaim, alleging damages arising from the defects and errors identified in its earlier correspondence. The insured tendered the defense of the counterclaim to the insurer, which the insurer rejected.

In the coverage litigation that followed, the court first considered the issue of whether the counterclaim constituted a claim first made during the policy period. In addressing this issue, the court recognized that strict adherence to Oregon's eight-corners rule would preclude it from examining the 2007 letters. The court further recognized, however, that the timing of the claim is a "determinative event" in the context of a claim-made policy and to bar extrinsic evidence of such "would improperly subvert the purpose and terms of the agreement between the insured and its claims-made insurer by requiring the insurer to undertake the insured's defense [in] circumstances where it did not agree to do so and where the insured had no contractual right to expect it." Accordingly, the court determined that an exception to the eight-corners rule was appropriate in this situation and predicted that if the issue were presented to the state high court, it would agree. Having so determined, the court examined the 2007 letters and found that the customer's claim was not first made at the time they were sent to the insured because neither letter asserted a demand for damages.

Nonetheless, the court concluded that coverage for the counterclaim was precluded by the prior knowledge exclusion. This provision in the policy excluded coverage for any claim "directly or indirectly arising out of any Professional Service rendered prior to the effective date of the Policy if [the insured] knew or could have reasonably foreseen that the Professional Service could give rise to a claim." Pointing to the 2007 letters, the court found that the insured was advised before the inception of the policy that a customer was contending that there were substantial defects and errors with respect to the insured's work and that it had suffered "extensive actual and consequential damages" as a result. According to the court, "[a] person of ordinary prudence could reasonably foresee that manufacturing defects in a large-scale industrial [project] could give rise to a demand for damages." The court therefore concluded that the insured had the requisite knowledge to trigger the exclusion, which relieved the insurer of its duty to defend.