

Fourth Circuit Holds That Prior Knowledge Provision Is an Unambiguous Condition Precedent to Coverage to Which the Innocent Insured Provision Is Inapplicable

April 2011

The United States Court of Appeals for the Fourth Circuit, applying Virginia law, has held that there is no coverage under an accountants professional liability insurance policy where the policy's prior knowledge provision, which is an unambiguous condition precedent to coverage, was not satisfied. The court further held that the policy's innocent insured provision could not be used to expand the scope of the policy's coverage and therefore was inapplicable. *Bryan Bros., Inc. v. Cont'l Cas. Co.*, No. 10-1439 (4th Cir. Mar. 24, 2011). Wiley Rein LLP represented the insurer in the trial court and on appeal.

The insurer issued a claims-made-and-reported accountants professional liability policy for the policy period July 1, 2008 to July 1, 2009. The policy's coverage agreements stated that the insurer would provide coverage for claims by reason of an act or omission in the performance of professional services, pursuant to certain terms and conditions, including that "prior to the effective date of this policy, none of you had a basis to believe that any such act or omission, or interrelated act or omission, might reasonably be expected to be the basis of a claim. . . ." The policy defined "you" to include the named insured and all of its employees.

The policy contained a dishonesty exclusion, which excluded coverage for "any claim based on or arising out of a dishonest, illegal, fraudulent, criminal or malicious act" by any insured. In addition, the policy contained an "innocent insured" provision, which stated, in relevant part, that "[i]f coverage under this policy would be excluded as a result of any criminal, dishonest, illegal, fraudulent, or malicious acts of any of you, we agree that the insurance coverage that would otherwise be afforded under this policy will continue to apply to any of you who did not personally commit, have knowledge of, or participate in such" acts or in the concealment of such acts from the insurer.

In February 2009, the insured discovered that one of its employees had been stealing money from clients' accounts beginning in 1999. The clients asserted claims against the insured, and the insured sought coverage under the policy. The insurer denied coverage for the claims because an insured (the employee who had stolen funds) had a basis to believe that her acts might reasonably be expected to be the basis of a claim

and, thus, the policy's prior knowledge provision, which was a condition precedent to coverage, had not been met and the policy's coverage agreements had not been triggered.

The insured contested the carrier's coverage denial. In the coverage litigation that followed, the insured argued that the policy's prior knowledge provision was an exclusion to coverage (vs. a condition precedent) and that, because the employee was the only insured with prior knowledge of her thefts, the policy's innocent insured provision saved coverage for all other insureds.

On appeal from the trial court's grant of summary judgment in favor of the insurer, the Fourth Circuit affirmed the decision of the trial court. In doing so, the court held that the policy's prior knowledge provision is a clear and unambiguous condition precedent to coverage which provides that, if any insured had knowledge as of the policy's inception of an act or omission that might become the basis for a claim, any claims arising from such acts or omissions are not covered under the policy. The court concluded that, based on the employee's thefts, which predated the policy, the employee, who was an insured, had a basis to believe at the time the policy inception that her acts might reasonably be expected to be the basis of a claim. Thus, the policy's prior knowledge provision had not been met, and the policy's coverage agreements had not been triggered.

The court further held that the innocent insured provision was inapplicable. The court stated that the innocent insured provision appeared to be an exception to the dishonesty exclusion. It further noted that, in any event, the provision could not be used to expand the scope of the policy's coverage and, therefore, was inapplicable where the policy's prior knowledge provision, which was a condition precedent to coverage, had not been satisfied in the first instance. Finally, the court rejected the insured's argument that the policy language was ambiguous, concluding that "a plain reading of the pertinent policy language reveals that it is not susceptible to more than one meaning. Because the language of the prior knowledge provision is unambiguous and structured as a condition precedent to the coverage agreement, we will not contort the language to find an ambiguity."