

Prior Knowledge Exclusion Bars Coverage Where Law Firm's Mistake Allowed a Seller to Void Client's Deal

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Applying Indiana law, the United States Court of Appeals for the Seventh Circuit has held that no coverage was available for a law firm that failed to notify its malpractice insurer of its mistake in purchasing a drug store on behalf of its client, where the seller rescinded its offer and filed a related lawsuit against the firm before the policy period. *Koransky, Bouwer & Poracky, P.C. v. The Bar Plan Mutual Ins. Co.*, 2013 WL 1296724 (7th Cir. Apr. 2, 2013). The court held that the firm reasonably knew or should have known that the mistake would lead to a claim, implicating the policy's "prior knowledge exclusion."

The firm's client entered negotiations to buy four drug stores from a seller. On the fourth transaction, the seller executed a sales contract and sent it to the firm, whose client executed it. The insured firm misfiled the contract, however, and did not send it to the seller. The seller decided to rescind the offer and so notified the insured firm. An attorney at the insured firm immediately emailed the seller's counsel to request that the seller complete the transaction, apologizing and stating the "whole situation is my fault." A few weeks later, the seller filed a lawsuit in Alabama, where the property was located, seeking a declaration that no contract had been formed.

During the same time period, the firm was renewing its claims-made malpractice policy. In the application, the firm stated that neither it nor any firm attorney or employee had "knowledge of any incident, circumstance, act or omission, which may give rise to a claim not previously reported." Based on the application, the policy was issued. An exclusion precluded coverage for unreported actions or omissions predating the policy period where, before the effective date, the firm "knew, or should reasonably have known, of any circumstance, act or omission that might reasonably be expected to be the basis of that Claim." After the policy inception, the firm's client sent a formal notice of a malpractice claim to the firm, which the firm forwarded to the insurer, which denied coverage.

The Seventh Circuit held that the policy's "prior knowledge" exclusion barred coverage because the firm had knowledge of an act or omission that reasonably could lead to a claim when it learned that the seller was refusing to complete a negotiated sale to its client due to the mistake of the firm's attorney. Moreover, the court held, the filing of a lawsuit by the seller informed the firm "beyond doubt" that the seller had no

intention of honoring its agreement and that the firm's failure to deliver the contract could result in a malpractice claim. The court rejected the firm's argument that it did not know the deal was truly doomed because it had assurances that the Alabama court would not exercise jurisdiction over the suit or because other counsel informed the firm that the sales contract was enforceable notwithstanding the lack of delivery. According to the court, whether the deal was ultimately enforced was irrelevant to the question whether the firm had reason to believe their acts or omissions *may* result in a claim.

In addition, the court rejected the firm's argument that the insurer was not prejudiced by its failure to provide timely notice. Under Indiana law, the court determined, prejudice is irrelevant to notice under a claims-made professional liability policy.