

Prior Knowledge Exclusion Bars Coverage for Utility's Failure to Repair Dam

June 2013

A Wisconsin intermediate appellate court has held that an insured utility's failure to maintain a dam, coupled with its knowledge that such failure was likely to precipitate a government-ordered drawdown of an adjacent lake and lawsuits by affected property owners, barred coverage for the landowners' suit based on a prior knowledge exclusion contained in the utility's directors and officers liability policy. *Laufman v. Safeco Ins. Co.*, 2013 WL 2157891 (Wis. Ct. App. May 21, 2013). The court also held that there was no coverage for the same claim under the insured's separate general liability policy because the claim arose from its intentional conduct.

The policyholder, a privately-held electric public utility, owned and operated a hydroelectric dam. In 1997, the insured learned that it would cost approximately \$1 million to bring the dam up to federal licensing standards. At that time, the policyholder knew that it would either have to abandon (and remove) the dam or transfer it to another owner. Despite its attempts, however, the insured was unable to transfer ownership of the dam. In fact, the insured could not give the dam away even when it offered to include money and land. The dam stopped producing power in 1997.

In 1998 and 1999, a state agency inspected the dam, and in May 1999, it sent the insured a copy of its inspection report together with a proposed timeline for required repairs. The following year, in June 2000, the policyholder's board of directors met and decided to abandon the dam. One month later, in July 2000, the state agency ordered the insured immediately to draw down the lake above the dam to the lowest possible level in order to complete emergency repairs. When the lake was drawn down, it reverted to a river, at which point local lakefront property owners sued the insured. The policyholder's insurers intervened in that action and moved for a coverage determination.

The trial court granted summary judgment in favor of the insurers. On appeal, the court affirmed. The court held that there was no coverage for the underlying suit under the utility's D&O policy. In relevant part, the policy provided coverage for claims arising from a "Wrongful Act," which was defined as "any error, misstatement, misleading statement, act, omission, neglect or breach of duty actually or allegedly committed or attempted by . . . the Directors." The court rejected the insured's contention that its June 2000 decision to abandon the dam was a "Wrongful Act" under the policy because the insured failed to explain how such a decision, rather than the utility's prior failures to repair the dam, constituted the relevant conduct.

The court then concluded that a provision in the policy barring coverage for any claim “[b]ased upon or attributable to a Wrongful Act which any of the Directors or Officers had knowledge of prior to 4/19/00 and that any of the Directors and Officers had reason to believe that such known Wrongful Act could reasonably be expected to give rise to a Claim” precluded coverage for the landowners' suit. Rejecting the insured's argument that the outcome of the events was previously “unclear,” the court noted that “[f]or the exclusion to apply, [the insured] need not know with certainty that it would be sued.” The policy language only required the insured to have “reason to believe” that its failure to draw down the dam “could reasonably be expected to give rise to a Claim.” The court observed that the utility “acknowledged they knew as of 1999 that they were going to receive a DNR drawdown order if they were unable to transfer ownership of the dam.” Moreover, the court noted that the insured had admitted in its deposition that it “assumed” it “would be sued” if the lake was drawn down.

The court also held that there was no coverage for the underlying suit under the policyholder's CGL policy issued by another insurer. In so ruling, the court held that there was no “event” or “accident” so as to trigger coverage because the insured's decision not to repair the dam was intentional.