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ALERT

Prior Knowledge of Catastrophic Accident Insufficient to Trigger Prior Knowledge Exclusion

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The United States District Court for the District of Connecticut has held that claims arising from a catastrophic accident that occurred prior to the effective date of the policy are not barred by an exclusion for claims arising out of circumstances "that could reasonably be expected to give rise to claims, known to the office of general counsel," prior to the effective date of the policy. *Hartford Steam Boiler Group, Inc., v. SVB Underwriting, Ltd.*, No. 3:04CV2127 SRU (D. Conn. May 19, 2011).

In 2000, the policyholder, an equipment breakdown insurer, purchased errors and omissions coverage that provided $35 million in coverage excess of a $5 million self-insured retention for claims made during the December 1, 2000 through December 1, 2005 period. Part of the equipment breakdown insurers' service to its customers included regular inspections of the boiler units at insured facilities. On November 10, 1999, an explosion occurred at one of its insured's facilities. The explosion was generally thought to have been caused by something other than the boiler unit. However, 17 plaintiffs filed suit against the policyholder between March 2001 and July 2002 for wrongful death or personal injury, alleging negligent inspection of the boiler. Also, in November 2002, a property insurer brought a subrogation action against the policyholder. The policyholder subsequently settled these suits for $8.65 million.

The insurer argued that the errors and omissions policy afforded no coverage because the policyholder knew of the catastrophic accident and so claims arising from it were precluded by the prior knowledge exclusion. The prior knowledge exclusion barred coverage, in relevant

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part, for "loss in connection with any claim or any circumstance that could reasonably be expected to give rise to a claim . . . known to the office of General Counsel, or . . . at inception hereof, 1st December 2000."

The court determined that although the explosion occurred prior to December 1, 2000 and was known to the office of General Counsel, it was, as of December 1, 2000, insufficient to give rise to a reasonable expectation that litigation would be brought against the equipment breakdown insurer. The court observed that numerous accidents occur every year involving the policyholder's clients and that very few result in claims. The court also noted that evidence available as of December 1, 2000 suggested that the boiler unit was not a factor in the explosion and that no evidence known at that time suggested that the policyholder was negligent in performing the inspection. The court observed that "there is a difference between expecting litigation—believing that it is likely [to] occur—and knowing that litigation is within the realm of possibility." Accordingly, the court held that "although perhaps [the policyholder] should have known litigation was possible, [the insurer] has not demonstrated that [the policyholder] reasonably should have expected it as of December 1, 2000." As such, the court deemed the prior knowledge exclusion inapplicable.