ANDERSON KILL
POLICYHOLDER

October 2019

ALERT

Professional Liability Policies and Prior Knowledge

By Diana Shafter Gliedman

Professional liability policies — also known as errors and omissions (E&O) or malpractice policies — provide professionals and their firms with a defense and, if necessary, indemnification for claims arising out of purportedly negligent acts, errors or omissions in the performance of professional services. Coverage is typically written for a term of one year on a "claims-made" or "claims made and reported" basis, with the policies covering claims made during the policy term or any extended reporting period.

Virtually all professional liability policies, however, contain prior acts exclusions, which exclude coverage for acts that occurred before inception of the policy — even if the actual claim for malpractice arises during the claims-made policy period — if the policyholder knew or "could have foreseen" that the act would give rise to a claim. But how does a court decide whether or not a reasonable policyholder could have foreseen a claim?

Many states apply a two-pronged test, in which a court will first review the subjective knowledge of the policyholder and then the objective understanding ascribable to a reasonable policyholder with that knowledge. For example, in *Liberty Insurance Underwriters Inc. v. Corpina Piergrossi Overzat & Klar LLP*[1], a law firm represented a client in connection with a medical malpractice claim for personal injuries allegedly caused by vaccinations administered when the client was an infant. During the course of the representation, an associate at the law firm wrote a letter to the client's father, informing him that the deadline to file a claim under the National Vaccine Injury Compensation Program (NVICP) was approaching, and requesting materials to complete the application. The application was never filed, the deadline passed, and the firm ceased representation of the client. Shortly thereafter, the law firm purchased its first legal malpractice policy from Liberty Insurance Underwriters.

Some years later, the (former) client's new attorney advised the law firm that he had been retained to bring a malpractice claim based on the failure to file the NVICP claim. The law firm provided notice to Liberty. Rather than defend, however, Liberty brought a declaratory judgment action against the firm, arguing that the policy excluded coverage for

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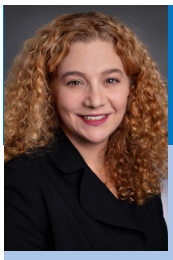

who's who

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claims occurring prior to the policy period if the policyholder had reason to foresee that a claim could be made.

The firm argued that even if the associate knew of the NVICP and the deadline, the law firm did *not* know that the failure to file a timely administrative claim under the NVICP had additional legal consequences such as foreclosing a future civil action for damages. Because they did not learn this fact until after the Liberty policy's inception, they argued, the known-claims exclusion should not apply.

New York Supreme Court agreed with Liberty. On appeal, however, the Appellate Division, First Department, applied a two-pronged test in which the court "must first consider the subjective knowledge of the insured and then the objective understanding of a reasonable attorney with that knowledge." More particularly, the court stated, "the first prong requires the insurer to show the insured's knowledge of the relevant facts prior to the policy's effective date, and the second requires the insurer to show that a reasonable attorney 'might expect such facts to be the basis of a claim.'"

The court further held:

> The insurer also objects that the attorneys "are in essence seeking to be rewarded for their ignorance . . . in connection with the medical malpractice action for which they were retained." The "reward" of coverage, however, is the necessary and intended consequence of a test with a subjective component. The insurer is in essence objecting to the practical reality that enables it to sell any malpractice coverage, including retroactive coverage on a claims made basis. *To obtain protection from the consequences of their ignorance is a key reason why attorneys purchase and insurers are able to sell malpractice insurance* [emphasis added].

Sometimes, however, a court will find that there is no argument that a reasonable policyholder would not foresee a claim. In *Becker v. Bar Plan Mutual Insurance Co.*[2], an attorney, Sheila Seck, was hired to represent a friend and client, Daniel Becker, in making loans, which were to be secured by unencumbered collateral. Seck failed to identify the fact that collateral for the loan had a lien on it. Becker terminated Seck's services and, a year later, sued Seck for malpractice. Seck's professional liability insurance company denied coverage based on the policy's prior acts provision. Litigation was filed, but the Kansas Court of Appeals determined that coverage had been properly denied:

> In this case, it is clear that Seck subjectively knew on or before February 6, 2012, [the inception date of the policy] that she had breached her standard of care owed to Becker. [. . .] A reasonable attorney in this situation would not have expected Becker to simply ignore the $5 million loss just because the two people were family friends.

As these cases demonstrate, sometimes a policyholder does not recognize that an act, error or omission is likely to give rise to a claim. The inquiry is whether or not the failure to identify a potential claim was reasonable under the circumstances.

ENDNOTES

1 *78 A.D.3d 602, 913 N.Y.S.2d 31 (1st Dep't 2010).*

2 *Becker v. Bar Plan Mut. Ins. Co., No. 113, 291, 2015 Kan. App. Unpub. LEXIS 1114 (Kan. Ct. App. Dec. 23, 2015).*