Who Knew? The Effect of Exclusions for Known Loss, Prior Knowledge, and Prior Notice

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I. Introduction

Liability policies of all types often contain exclusions designed to preclude coverage for potential liabilities known to the insured when applying for coverage. This presentation will address how courts are construing such provisions and whether such exclusions apply to innocent insureds.
II. Issues Involving Prior Knowledge Exclusions—With Multi-State Chart

NEW APPLEMAN ON INSURANCE:
Current Critical Issues in Insurance Law

Issues Involving Prior Knowledge Exclusions—With Multi-State Chart

By
Paul S. White
I. INTRODUCTION

An insurer responding to an insured’s request for coverage may discover during the course of its investigation that the insured was aware of facts or circumstances, prior to the inception of the policy, that ultimately led to the claim at issue. Aside from the awareness that such facts could potentially lead to a claim, however, the claim against the insured was not actually made until the relevant policy period and is otherwise covered.

In an effort to be prepared for such a circumstance, insurers routinely ask potential insureds in an application for insurance whether they are aware of any circumstances that might result in a future claim under the policy of insurance for which the application is being submitted. The potential insured is then usually asked to check a box “no” or “yes.” Renewal applications for insurance typically ask the same or a similar question. If the answer is yes, the potential or present insured is required to provide details regarding the facts or circumstances that may lead to a future claim. Such information then allows the underwriter to determine whether this is a risk that the insurer will accept.

Once insurers have issued a policy, however, insurers often discover as they respond to and investigate claims made under the policy that an insured was keenly aware of facts or circumstances that might lead to a claim. Such discoveries are common, even though the insured may have checked “no” on the application when asked if it was aware of any such facts or circumstances.

Many such insured responses are innocent enough:

- The insured may have forgotten about the circumstances;
- The insured may have determined that any such dispute was resolved;

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• The insured may have concluded that such circumstances could not legally justify a claim; and

• The insured may have even determined that such facts and circumstances were simply a part of its day-to-day operations and never even considered whether such circumstances could result in a claim.

Myriad reasons exist for such a denial—and many such explanations may be sufficient to preclude the insurer from considering rescission of the policy or prevailing in a rescission action against the insured.

Nevertheless, the insurer that issued the claims-made policy on the risk at the time a claim is made will often be asked to provide coverage for such a claim, notwithstanding that the facts or circumstances leading to the claim were known to the insured before the insurance application was prepared or the insurance policy issued. In response to such circumstances, insurers are increasingly including a standard or manuscript exclusion that precludes coverage where an insured was aware of facts or circumstances before the policy issued that could form the basis for a claim against the insured that would otherwise be covered under the policy.

Insurers are now expressly relying on the “prior knowledge” exclusion to deny coverage and insureds and insurers are asking courts to determine whether such exclusions are applicable or enforceable.¹ This article will examine how courts throughout the United States are responding to this issue. Reference is also made to the “prior notice” exclusion, which often works in conjunction with exclusions for prior claims or prior litigation. This article also presents an approach for insurers who have discovered that facts or circumstances leading to a claim were known to an insured that advised in its policy application that it was not aware of such facts or circumstances, including the following steps:

1. Examine the underwriting file and application;
2. Determine who is the applicant and/or the insured;
3. Examine the claim at issue and determine whether there are any related claims;
4. Determine what jurisdiction’s law applies and the general rules governing interpretation of policy exclusions;
5. Compare the claim with the policy’s prior knowledge exclusion and determine whether the applicable jurisdiction has law addressing the exclusion; and

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¹ A similar exclusion is the “prior notice” exclusion, which is often used in conjunction with a “prior litigation” and/or “prior acts” exclusion. Some courts and insurers have used a “prior notice” identifier when referring to language more commonly associated with the “prior knowledge” exclusion. Given parallels in the analysis of the prior knowledge and prior notice exclusions, this article references some decisions that rely upon the prior notice exclusion.
(6) Evaluate whether the facts and circumstances may also present a basis for rescission of the policy in the relevant jurisdiction.

As stated, the primary focus of this article is on step 5—comparing the claim with the policy’s prior knowledge exclusion and determining whether the applicable jurisdiction has law addressing the exclusion. The article provides law from several jurisdictions addressing exclusions meant to preclude coverage for such claims (as well as similarly worded exclusions such as the prior notice exclusion); it also contains a 50-state appendix that identifies law that addresses the issue directly or indirectly. The other steps are provided primarily as a backdrop for how this particular exclusion works in circumstances where it may apply. The legal discussion provided on these other steps is minimal and is provided mainly as an example.

II. POLICY EXCLUSIONS FOR FACTS OR CIRCUMSTANCES THAT EXISTED PRIOR TO POLICY INCEPTION THAT THE POLICYHOLDER WAS AWARE OF, AND THAT COULD LEAD TO A CLAIM UNDER THE RELEVANT POLICY

Insurers have utilized a variety of exclusions, both standard form exclusions and manuscript exclusions, to eliminate coverage where an insured was aware of facts or circumstances prior to the inception of the relevant coverage that could lead to a claim under the policy. As set forth below, insureds who have been denied coverage based on these exclusions are asking courts to scrutinize and find these exclusions inapplicable for a variety of reasons.

While various language is discussed below, the following is an example of language being used for this purpose:

THIS POLICY DOES NOT APPLY: …

(D) to any CLAIM arising out of any act, error, or omission occurring prior to the effective date of this policy if any INSURED at the effective date knew or could have reasonably foreseen that such act, error or omission might be expected to be the basis of a CLAIM or suit.²

III. EXAMINATION OF THE UNDERWRITING FILE AND APPLICATION

An insurer is most likely to discover that the insured was aware of facts or circumstances prior to the effective date of its policy and that could reasonably be expected to be the basis of a claim or suit through: (1) an investigation into a given claim, including receipt of information, correspondence or documents from the insured; (2) discovery in the course of litigation (either the underlying litigation against the insured or coverage litigation)—including, but not necessarily limited to written interrogatories, document productions, admissions, deposition testimony; or (3) information learned from third parties by way of subpoena, investigation, or interviews. There may be other sources as well such as government agencies, other insurers, or internal documentation from the insured’s own files.

Irrespective of the source, an insurer uncovering information that an insured was aware of the facts and circumstances that lead to the claim against it prior to the inception of the policy it purchased usually leaves the insurer questioning whether an insured is entitled to coverage under such circumstances.

Because claims and underwriting are generally separated at most insurance companies, an adjuster discovering such facts should first check the underwriting file. Often, but not always, an application for insurance requests that the applicant identify whether it is aware of any facts or circumstances that could lead to a claim or lawsuit against it. For example:

"Is the applicant aware of any fact, circumstance or situation that gives the applicant reason to believe that it might result in any future claim under the insurance for which this application is made?"

If such a question exists, and the insured checked “no,” the insurer should proceed with its analysis as to whether the prior knowledge exclusion applies. If the representation is false and was material to the risk, the insurer may also want to evaluate whether the rescission laws in the applicable jurisdiction may apply, discussed below.

However, if the insured checked “yes,” the insurer must evaluate (1) whether the insured provided details of such facts or circumstances; (2) if details were provided, whether they were accurate; (3) what steps the insurer took in response to the insured’s disclosure of information, if any; and (4) whether the insurer’s underwriters took such facts or circumstances into consideration in binding coverage and issuing the policy.

IV. WHO IS THE APPLICANT OR THE INSURED?

In considering whether a prior knowledge exclusion applies, the insurer should evaluate who prepared the response to the application for insurance. Specifically did the insured prepare the response or was it prepared by an agent or broker. Was the application signed and prepared by an individual at the insured’s business with authority to act on behalf of the insured?

Similarly, in construing the prior knowledge exclusion, the insurer should evaluate who at the insured’s business was aware of such facts or circumstances.

As indicated in the information to follow, such information can be a factor in some jurisdictions in determining whether the prior knowledge exclusion applies. More specifically, the law can vary among jurisdictions with respect to whether the knowledge of an individual preparing an application for insurance is imputed to the insured as a whole or whether there are limitations on such knowledge being imputed. Law on this issue is generally found in rescission and misrepresentation cases. However, errors and omissions (“E&O”) and directors’ and operators’ (“D&O”) insurance insureds periodically argue that the knowledge or actions of a non-professional employee—even though an insured—should not be imputed to the insured entity.

For example, in *Petersen v. TIG Ins.Co.*, the court declined to apply a prior knowledge exclusion based on information that was in the possession of a non-professional employee, but that otherwise could enable an insured to reasonably conclude such information could form the

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basis for a potential claim. The court refused to impute the knowledge of a non-lawyer employee
to professionals insured under policy and, consequently, found that the prior knowledge exclusion
did not apply. As the court stated,

However, the argument made by TIG that her status as an
employee makes her an agent of the Law Firm and therefore her
receipt of the letter is imputed to the professional staff so as to
deny coverage, requires more leaps and jumps than I am willing
to make.4

V. ARE THERE RELATED CLAIMS?

Another factor in conducting an analysis of whether the prior knowledge exclusion applies
is to gain an understanding as to whether there were similar or related claims previously made
against the insured. Many claims expressly link multiple claims arising out of the same facts or
circumstances and treat them as a single claim. For instance, some policies provide:

All Related Claims will be treated as a single Claim made when
the earliest of such Related Claims is treated as having been
made in accordance with GENERAL CONDITION (C)(2)
below, whichever is earlier.

“Related Claims” is then defined under the Policy to mean:

(i) Claims for Wrongful Acts, and

(ii) Claims for Bodily Injury, Property Damage, Advertising Injury or Personal
Injury caused by a Wrongful Act.

By way of example, California courts have addressed the issue of what makes claims
“related” in several decisions. In Bay Cities Paving & Grading, Inc. v. Lawyers’ Mut. Ins. Co.,5
which involved an attorney E&O policy, a general contractor, Bay Cities, retained an attorney to
represent it in connection with construction work it was performing. Bay Cities completed work
on the project, but was unable to collect a substantial portion of the amount it was owed. Its
attorney filed a mechanic’s lien, but did not serve a stop notice on the project’s construction
lenders. Nor did he timely seek to foreclose the mechanic’s lien. Bay Cities sued its attorney for
legal malpractice; the attorney tendered defense of the action to his insurer. At issue was whether
the failure to file a stop notice and the failure to timely file an action to foreclose the mechanic’s
lien constituted one or two claims under the policy. The attorney’s E&O policy contained a
provision limiting coverage to a maximum of $250,000 “for each claim” and further provided
that, “two or more claims arising out of a single act, error or omission or a series of related acts,
errors or omissions shall be treated as a single claim.”6

The California Supreme Court held that the two claims for malpractice asserted in the

4 Id. at *18.
5 5 Cal. 4th 854 (1993).
6 Bay Cities, 5 Cal. 4th at 857.
same suit constituted a single claim, subject to a single claim limit. The court reasoned that the two claims were part of a “single injury,” and thus must be treated as related.

Bay Cities was not asserting two causes of action. Bay Cities had a single injury and thus a single cause of action against its attorney. California has consistently applied the “primary rights” theory, under which the invasion of one primary right gives rise to a single cause of action. Bay Cities had one primary right—the right to be free of negligence by its attorney in connection with the particular debt collection for which he was retained. He allegedly breached that right in two ways, but it nevertheless remained a single right.

The Bay Cities court articulated a public policy rationale for its holding by examining its effect on deductibles and available policy limits, explaining:

By parity of reasoning, the artificial multiplication of claims should not result in increased coverage. To construe a policy provision narrowly so as to find only one claim and thus limit the deductible, but to construe the same language expansively so as to find multiple claims and thereby increase coverage, would be a result-oriented approach we decline to follow.

The California Court of Appeal has reaffirmed that the test for “relatedness” under

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7 Bay Cities, 5 Cal. 4th at 859.
8 Bay Cities, 5 Cal. 4th at 860 (internal quotations, citations and footnote omitted).
9 Bay Cities, 5 Cal. 4th at 862.

We note that generally, most jurisdictions that have considered the issue of “relatedness” and have concluded that where a logical or causal connection between two or more claims exists, they are “related.” See, e.g., Cont’l Cas. Co. v. Wendt, 205 F.3d 1258, 1263 (11th Cir. 2000) (per curiam) (where insured attorney’s course of conduct was designed to promote investment in client’s notes, two suits by investors were “related” even though attorney’s “acts resulted in a number of different harms to different persons, who may have different types of causes of action against” attorney, because attorney’s acts “were aimed at a single particular goal.”) (Florida law); Nat’l State Bank, Elizabeth, N.J. v. American Home Assurance Co., 492 F. Supp. 393, 397 (S.D.N.Y. 1980) (five suits arising out of insured’s continuous provision of professional accounting services constituted separate claims, because under policy provisions, “the word ‘claim’ means an individual demand by the insured under the policy regarding a single assertion of a right by a third-party. Thus, each such demand by the insured is a separate ‘claim’ because it involves the same continuous provision of professional service to a particular client.”) (New York and New Jersey law); Giant Eagle, Inc. v. Federal Ins. Co., 884 F. Supp. 979, 987–991 (W.D. Pa. 1995) (holding that policy endorsement exclusion “[w]here all or part of such claim is, directly or indirectly based on, attributable to, arising out of, resulting from or in any manner related to the INSURED’S WRONGFUL ACT(S) committed, attempted or allegedly committed or attempted after January 14, 1992” did exclude coverage for claims against insured’s directors and officers based on “‘common claims or common wrongful acts relating to [subsidiary] Phar-Mor.’ ”); but see City of Idaho Falls v. Home Indem. Co., 126 Idaho 604, 608–609, 888 P.2d 383 (Idaho 1995) (“[S]imply because the same types or categories of wrongful acts are alleged over an interval spanning both the Prior Acts Endorsement period and the first policy year does not mean that all wrongful acts were in fact the same or related.”); Beale v. American National Lawyers Ins. Reciprocal, 379 Md. 643, 666–667, 843 A.2d 78, 92–93 (Md. Ct. App. 2004) (claims of each of five children for legal malpractice based on attorney’s failure to properly pursue lead paint claims were not
errors and omissions policies is whether “a claim is either logically or causally related to another claim.”\footnote{Friedman Professional Mgmt. Co., Inc., v. Norcal Mut. Ins. Co., 120 Cal. App. 4th 17, 21–22 (2004) (emphasis in original) (medical malpractice claims held related where first episode of malpractice caused need for second surgery, which gave rise to claim for battery). See also Lipton v. Superior Court, 48 Cal. App. 4th 1599, 1607, 1610 n.13 (1996) (claims for attorney malpractice for (1) improper settlement, (2) failure to bring product liability claim, and (3) misrepresentations of fact to clients were related because each related to attorney’s representation of claimants to recover for injuries sustained in a single accident); Cont’l Ins. Co. v. Metro-Goldwyn-Mayer, Inc., 107 F.3d 1344, 1346, 1348 (9th Cir. 1997) (where insured provided documents to insurer describing dates and nature of wrongful acts in connection with merger that could result in claims against directors and officers, suit based on same merger was “related,” even though suit was tendered after policy expired).} In the context of a prior knowledge exclusion analysis, the “related claims” analysis can be significant since an initial claim may be made before a relevant insurance policy incepts and may be “related” to a subsequent claim made against an insured during the relevant policy period.

VI. INTERPRETATION OF EXCLUSIONARY CLAUSES

Using California law as a general example, coverage clauses tend to be interpreted broadly, while exclusionary clauses tend to be interpreted narrowly, so as to protect the insured’s reasonable expectations.\footnote{AIU Ins. Co. v. Superior Court, 51 Cal. 3d 807, 822 (1990).} Moreover, where a coverage question arises, the burden is on the insured initially to demonstrate that the claim is within the coverage provided by the policy’s insuring clause. If the insured satisfies this burden, the burden then shifts to the insurer to come forth with proof that a policy exclusion applies.\footnote{See Royal Globe Ins. Co. v. Whitaker, 181 Cal. App. 3d 532, 537 (1986).}

In general, it is recognized in California that when examining language within an insurance policy, California law requires that “any ambiguities or uncertainties in insurance contracts are construed against the insurance company.”\footnote{Hanson v. Prudential Ins. Co. of Am., 783 F.2d 762, 764 (9th Cir. 1985).} However, it is also well settled in California that “[a]n insurer may select the risks it will insure and those it will not and a clear exclusion will be respected.”\footnote{Legarra v. Federated Mut. Ins. Co., 35 Cal. App. 4th 1472, 1479 (1995) (citing Howell v. State Farm Fire & Cas. Co., 218 Cal. App. 3d 1446, 1467 (1990)).} Additionally, “[c]ourts may not rewrite the insurance contract or force a conclusion to exact liability where none was contemplated.”\footnote{Id. (quoting Blumberg v. Guarantee Ins. Co., 192 Cal. App. 3d 1286 (1987)).} Further, when a policy clearly excludes coverage, the court “will not indulge in tortured constructions to divine some theoretical ambiguity in order to find coverage.”\footnote{Titan Corp. v. Aetna Cas. & Sur. Co., 22 Cal. App. 4th 457, 469 (1994).} An insurer is thus entitled to limit its coverage to defined risks and as long as it does so in clear language, “the court will not impose coverage where none was intended.”\footnote{Id.} Thus, exclusions “must be clearly stated to apprise the insured of the effect of those exceptions.”\footnote{Franceschi v. American Motorists Ins. Co., 852 F.2d 1217, 1219 (9th Cir. 1988) (citing State Farm Mut. Auto. Ins. Co. v. Partridge, 10 Cal. 3d 94, 101–102 (1973)).}

In the event an insurer contends that a policy exclusion precludes a duty to defend, in
order for the insurer to obtain summary judgment on that issue, it must present undisputed facts that eliminate any possibility of coverage. Accordingly, the insurer may not rely on policy exclusions to obtain summary judgment where a factual dispute exists as to the applicability of the exclusion.

VII. THE PRIOR KNOWLEDGE EXCLUSION

A. Example of a Prior Knowledge Exclusion
Prior knowledge exclusions are found primarily in claims made professional liability policies and, more specifically, in E&O or D&O policies. While policy language may vary among insurers and may be modified over time, an example of such language is:

THIS POLICY DOES NOT APPLY:

(D) to any CLAIM arising out of any act, error, or omission occurring prior to the effective date of this policy if any INSURED at the effective date knew or could have reasonably foreseen that such act, error or omission might be expected to be the basis of a CLAIM or suit.

B. Such Exclusions Have Been Found to Be Clear and Unambiguous
In Coregis Ins. Co. v. Camico Mut. Ins. Co., the court held that because the insured could have reasonably foreseen a claim or suit on the date the policy incepted, the prior notice exclusion barred coverage. In determining whether the prior notice exclusion operated to bar coverage, the court first concluded that the prior notice exclusion within the policy was “clear and unambiguous.” In following the holding of Phoenix Ins. Co. v. Sukut Constr. Co., which held that the phrase “might be expected to be the basis of a claim or suit” was “perfectly clear” and unambiguous, the Coregis court reasoned as follows:

First, the Court notes that none of Camico’s papers filed in connection with this matter even raise the possibility that the Prior Notice Exclusion is ambiguous. Second, the Court on its own reading of the exclusion, finds that the language is perfectly clear as to what is excluded. And third, the Court notes that the same policy language appearing as a condition precedent for coverage has been deemed to be unambiguous by a California court.

In fact, the majority of cases construing prior knowledge exclusions across the nation have determined that the provision is clear and unambiguous. These cases are referenced in the

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21 Id.
24 Id.
26 Id.
C. Applying the Exclusion to a Set of Facts

After concluding that the exclusion was unambiguous, the Coregis court then looked at whether the exclusion precluded coverage. In order to answer this question, the court looked at the specific facts of the case. On or about January 1, 1984, Edward London (“London”) began providing accounting services to Jack Gindi and his various partnerships. At this time, London was working through the accounting offices of London & Heisman. In 1988, London & Heisman dissolved and London joined the firm of UKW. On July 9, 1993, Gindi filed an action against London alleging causes of action for negligence, intentional misrepresentation, fraudulent concealment, breach of fiduciary duty, conspiracy and negligent misrepresentation. Mt. Airy Insurance Company (“Mt. Airy”) had issued an Accountant’s Liability Insurance Policy to UKW for the period between November 1, 1994, and November 1, 1995. On April 5, 1995, Gindi filed an amended complaint. In response, London tendered the amended complaint to Mt. Airy. Coregis Insurance Company (“Coregis”), the successor to Mt. Airy denied coverage on the basis of, among other things, the prior notice exclusion since London knew of the claims asserted against him in the Gindi action prior to inception of the Mt. Airy Policy on November 1, 1994.

The Coregis court concluded that “it is inconceivable to the Court how London, on November 1, 1994, could not have known or reasonably foreseen that his alleged acts... in his capacity as an accountant in his dealings with Gindi might be the basis of a claim or suit.” In support of this conclusion the court noted that Gindi’s complaint was filed and served on London in July 1993, which was more than a year before the Mt. Airy policy incepted. At that point, London was obviously aware that the acts alleged in the complaint were the basis of a claim or suit. The court further stated that even if London did not actually know that the allegations against him might form the basis for a claim or suit, “a reasonable person would have foreseen that the conduct alleged in the Amended Gindi Complaint might form the basis of a claim or suit.” Additionally, the court found that “London, more so than any other party involved in this matter, was aware on November 1, 1994 of any and all of his conduct prior to November 1, 1994 and the potential effect any of his actions may have had on Gindi.” Accordingly, the court concluded that “on November 1, 1994, London could have reasonably foreseen that the alleged

27 Id. at 1214.
28 Id. at 1214–1215.
29 Id. at 1215.
30 Id.
31 Id. at 1216.
32 Id.
33 Id. at 1217.
34 Id.
35 Id. at 1222.
36 Id.
37 Id.
38 Id.
39 Id. at 1223.
1991 conduct might form the basis of a claim or suit.”

D. The Third Circuit “Two-Step” Analysis

Some courts have separated an analysis of the exclusion into a determination of (a) when the insured possessed “knowledge” of prior acts or circumstances that might lead to a claim; or (b) when an insured “could reasonably have foreseen” that such prior actions or circumstances might result in a claim. A determination of whether an insured “knew” that a claim would be made against it is relatively straightforward and is often proven in the form of letters, memoranda, admissions, or concessions. However, the second circumstance to which the prior knowledge exclusion may apply, i.e., when the insured “could reasonably have foreseen” that its actions would lead to a claim against it is not as easily determined and often leads to a debate as to whether such an analysis should be subjective or objective.

The Third Circuit Court of Appeals adopted a “mixed” two-step analysis for circumstances in which an insured “could reasonably have foreseen” that its prior acts could lead to a claim against it. In *Selko v. Home Ins. Co.*, the Third Circuit was asked to determine whether an attorney could have reasonably foreseen that his conduct of investing client funds in real estate ventures in which he was personally involved, without appropriate disclosures to the client and in violation of fiduciary and legal duties, could result in a claim against him. The evaluation, as articulated by the Third Circuit, was as follows:

First, it must be shown that the insured knew of certain facts. Second, in order to determine whether the knowledge actually possessed by the insured was sufficient to create a “basis to believe,” it must be determined that a reasonable lawyer in possession of such facts would have had a basis to believe that the insured had breached a professional duty.

Relying on this analysis, another court reasoned that “under this test, the attorney must have known of an act, error, incident, or omission, and … could have expected it would result in a malpractice claim.”

The *Selko* court used this analysis to preclude coverage for the claim against the insured attorney. The court held that the first step of the analysis was satisfied because the attorney clearly had knowledge of the facts concerning the investments. Under the second step of the analysis, the court adopted an “objective” analysis standard to assess what a reasonable attorney would have concluded in light of the facts of which the attorney had actual knowledge and held that under such an objective standard the insured could have foreseen that a claim against him would be made. Based on this analysis, the court found that the claim was not covered under the policy.

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40 *Id.*
42 139 F.3d 146 (3d Cir. 1998).
43 *Id.*, 139 F.3d at 152. See also Appleman on Insurance 2d § 146.6.
Of note, the court also expressly rejected the insured’s argument for the application of a subjective standard under the second prong of the analysis and, in particular, his argument that he did not have subjective knowledge concerning the breach of fiduciary duty. The court reasoned that “the insured may not successfully defend on the ground that he was uniquely unaware of ethical and fiduciary principles that all lawyers would know or that he did not understand the implications of conduct and events that any reasonable lawyer would have grasped.”

E. Variations on a Theme

Since Selko, many courts have adopted the Third Circuit’s two-step analysis or have placed their own variations on this two-step theme. Many of these decisions are referenced in the Appendix, below.

1. Condition Precedent to Coverage

In the Coregis decision, the court discusses that a “reasonable person” standard applies to the assessment of whether an insured knew or should have known something, or some action, would eventually result in a claim such that disclosure to the insurance carrier would be required. Additionally, the Coregis court impliedly adopts the holding of one California state court decision that holds that disclosure of any known or reasonably foreseeable fact or circumstance that may give rise to a claim is a “condition precedent” to coverage.

The “condition precedent” case the Coregis court relies upon is Phoenix Ins. Co. v. Sukut Constr. Co., Inc. In Sukut, Phoenix filed a declaratory relief action against a construction company and another carrier seeking a declaration that it did not owe an obligation to defend its insured, an attorney that had represented the construction company in the filing of a lien and who was later sued for malpractice by the construction company.

The court found that the prior notice language in the policy amounted to a “condition precedent” to coverage: “As a condition precedent for coverage, the Phoenix policy requires that the insured ‘at the effective date of the insurance did not know or could not have reasonably foreseen that such acts or omissions might be expected to the basis of a claim or suit.’”

The underlying malpractice action involved the attorney’s execution of a mechanic’s lien and subsequent events pertaining to that lien. In short, the attorney executed a lien for his client, the construction company, but during a foreclosure action, the company discovered that the lien could be inadequate to protect its interests. Subsequently, the company met with the attorney and asked him to work without pay to correct the problem with the lien. The attorney agreed, subject to a few conditions, including that the company grant a liability waiver relative to the defective lien; but the company would not accept any conditions. As a consequence, the attorney did nothing. Subsequently, by letter, the company advised the attorney that it was holding him responsible for damages resulting from the defective lien and then later filed a malpractice action against the attorney.

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45 Selko, 139 F.3d at 146.
47 Id. at 676.
48 Id. at 675.
49 Id.
50 Id. at 676.
The meeting between the company and the attorney took place before the Phoenix policy incepted but the letter was sent during the term of Phoenix’s policy and suit was also filed during the term of its policy. Phoenix defended the action, however, and raised the issue of application of the prior notice exclusion as part of a subsequently filed declaratory relief action.

In applying the prior notice language to preclude coverage the court first found such language to be unambiguous and then also found the following:

[The attorney] was aware that the lien could prove inadequate unless the proper arguments were made at the foreclosure trial. More importantly, he knew that the client held him responsible for the lien’s inadequacy since [the company] refused to give a liability waiver as a condition for [the attorney’s] work on the foreclosure case. The trial court therefore did not err in denying coverage under the Phoenix policy.51

Of note, the court applied the prior knowledge “condition precedent” to preclude coverage even where the first written notification of a possible claim was given during the policy period. However, it is also worth noting that in Sukut, the carrier first defended then brought a declaratory relief action on the issue of applying the prior knowledge condition. The court does not address this issue in the opinion. Nor does the Sukut court mandate providing a defense before filing a declaratory relief action as the only course.

2. Absence of Knowledge

Similar to Coregis, the Ninth Circuit Court of Appeals in National Steel Corp. v. Golden Eagle Ins. Co.52 examined the applicability of the insured’s prior knowledge when such knowledge is called into question. National Steel involved an insurance broker who obtained a performance bond for National Steel’s subcontractor.53 The broker placed the bond with an off-shore carrier and the broker requested, but never received financial statements from the carrier. When National Steel attempted to make a claim on the bond, it was unable to locate the carrier and eventually discovered that the carrier was a “defunct, nonexistent, or assetless surety company.”54 In July 1990, Golden Eagle Insurance Company (“Golden Eagle”) issued a professional errors and omissions insurance policy to the insurance broker. The policy covered claims against the insureds from August 1990 until August 1991 as long as “the claim was not reasonably foreseeable to the insureds at the time the policy was executed.”55 In April 1991, National Steel filed a complaint against the insurance broker.56

Prior to the inception of the Golden Eagle policy in June 1989, a letter from National Steel, which was copied to the insurance broker, stated that National Steel intended to pursue a claim on the bond. The broker testified that he did not recall this letter even though it was sent

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51 Id. at 677.  
52 121 F.3d 496 (9th Cir. 1997).  
53 Id. at 498.  
54 Id.  
55 Id.  
56 Id.
certified and was signed by his secretary. Additionally, in December 1989, a letter from National Steel informed the broker that the carrier was bankrupt and that National Steel intended to pursue claims against the broker. The broker again testified that he did not receive the letter.  

On the basis of the above facts, Golden Eagle informed the broker that it would “not defend or indemnify against National Steel’s claim because they should reasonably have foreseen the claim at the time the insurance policy was executed, and therefore the claim was not covered by the insurance policy.”  

The court disagreed with Golden Eagle’s denial. Specifically, the court held that although the facts would create an inference that something was wrong with the bond, “they do not establish definitively that [the broker] should have reasonably foreseen that National Steel would bring a claim against them for negligence in placing the bond. There was still a possibility that the claim would be covered by the Golden Eagle Insurance policy. Golden Eagle breached its duty to defend.”

The *National* case is distinguishable from cases applying the prior knowledge exclusion in that the insured in *National* disavowed any knowledge of any of the letters that purportedly gave the insured notice of the claim.

3. Insured’s Knowledge Does Not Usually Require Specific Complaint or Threatened Claim

Another instructive, albeit unpublished, decision is *Grayson, Givner, Booke, Silver, Wolfe v. Old Republic Ins. Co.* In this case, appellant Grayson, a law firm, appealed the district court’s granting of summary judgment in favor of Old Republic. Grayson claimed that Old Republic had a duty to defend and indemnify Grayson against an action brought by the former client of the firm, Marshall Redman. In relevant part, the policy issued to Grayson specifically excluded from coverage any claim arising out of an act, error, or omission committed by the insured if the insured knew or could reasonably foresee that such act, error, or omission might be the basis for a claim against it.

Old Republic had initially defended Grayson against a suit filed by Redman, but later withdrew such defense on the basis of operation of the policy’s prior notice exclusion and because of certain pre-policy knowledge of Grayson. Old Republic also rescinded its policy on the basis of material misrepresentations in the application for coverage. The court found that both actions were justified and upheld the trial court’s ruling in this regard.

In relevant part, the court first held that prior to applying for the policy, Grayson had drafted a memorandum detailing its knowledge that certain legal advice it had given to Redman was “improper” and “could have severe consequences for Redman.” Prior to the policy, Grayson also had knowledge concerning problems with a sale rescission it handled for Redman and that certain property buyers involved in other real estate transactions with Redman were complaining about the transactions and at least one buyer had hired counsel. Additionally,

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57 Id.
58 Id. at 499.
59 Id. at 500.
61 Id. at *3.
62 Id. at *4.
Grayson was also aware that at least one of the buyers had trouble obtaining a building permit. In sum, Grayson had pre-policy knowledge that “its improper advice was being used and that Redman was experiencing multiple problems as a result of that advice.” The court rejected Grayson’s argument that it was reasonable to believe that Redman would not bring a claim against it because Redman had not complained to Grayson about its services:

California case law does not establish that an insured has reason to suspect a claim might be brought against it only if it receives a specific complaint or threat of litigation. While such communications provide strong evidence that an insured knew of a potential claim, see, e.g., Sukut … a specific complaint or threat is not necessary to such a finding. Rather, looking at the totality of the circumstances, the issue is whether a reasonable insured would have reason to suspect that a claim might be brought against it. Here, Grayson had a memorandum from one of its own attorneys in the firm that warned that the firm may have given Redman erroneous advice. The memorandum spelled out the severe consequences for Redman if he acted on that advice, and the firm knew, from its continued representation of Redman, that Redman had indeed acted on that advice, was experiencing difficulty with buyers, and was being investigated by local planning agencies.

In justifying the rescission of the policy, Old Republic contended that Grayson withheld material information, related to: the Redman matter; a prior malpractice action against Grayson, and a prior cancellation of insurance—the court did not discuss the malpractice action or the prior cancellation, but instead focused on issues and facts pertaining to Redman. In this regard, the court noted that:

Grayson contends that there are material questions of fact regarding whether it concealed information related to any of the issues in contention. Grayson further avers that even if it did conceal such information, there is a real dispute as to the materiality of such concealment. We hold that, looking only at the Redman issue, there is undisputed evidence that Grayson withheld material information.

The undisputed evidence—the Fried memorandum, the fact that Grayson handled at least once rescission for Redman, the fact that Grayson was aware of the problems Redman’s buyers were having obtaining building permits, and the fact that Grayson was communicating with the Los Angeles County Planning Department regarding Redman’s violations—establishes that Grayson concealed information regarding the Redman matter. Grayson responded ‘no’ in its application when asked whether it was aware, after inquiry, of any fact, error, or omission that

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63 Id. at *6.
64 Id. at *6–7.
65 Id. at *9.
“could reasonably give rise to” a claim, and submitted a
declaration that Grayson “was not aware of any circumstance
which may reasonably give rise to a claim.”

We reject Grayson’s claim that the cumulative information it had
did not put it on notice that it had committed a previous error
that might lead to a claim against it. We also reject Grayson’s
claim that it “did not appreciate the significance” of the
information before it.66

In Grayson, the carrier defended, but then withdrew and rescinded its policy. This is a
dramatic course of action and one that the court ultimately upheld as justified based entirely on
what the insured knew about the possibility of a claim to be made by Redman before the Old
Republic incepted but failed to disclose as part of the application process.

Low v. Golden Eagle Ins. Co. ("City of Palm Springs"),67 is similarly instructive. In City
of Palm Springs, in January of 1995, Golden Eagle issued a professional liability policy to Brown
& Diven and the policy was renewed in January of 1996 and expired on January of 1997.68 The
policy issued by Golden Eagle contained “an exclusion for acts or omissions occurring prior to
the inception date of the policy, where ‘any Insured knew or could have reasonably foreseen that
such an act or omission could lead to a claim or suit.’”69 Brown & Diven acted as bond counsel
for the city, but after doing nothing to preserve the leasehold estates to protect the bondholders,
Allstate Insurance Company (“Allstate”) threatened to file an action against the city and Brown
& Diven in April of 1996. On August 14, 1997, Golden Eagle denied the claim on the basis that
before the policy incepted, Brown & Diven possessed facts that indicated the firm’s acts or
omissions could lead to a claim.70 In February 1999, the city and the underwriters filed an action
against Brown & Diven and in turn, Brown & Diven again tendered the matter to Golden Eagle
on May 10, 1999.71

In analyzing the applicability of the exclusion, the City of Palm Springs court found the
following facts particularly relevant:

In its role as bond counsel, Brown & Diven knew the following
facts about the bond issuance prior to inception of the Golden
Eagle policy:

1. The firm’s memo of March 31, 1998 specifically identified what needed to be done;

2. Almost 50 percent of the assessments were secured by leasehold interests on Agua
   Caliente land;

66 Id. at *9–10.
68 Id. at *7.
69 Id. at *8.
70 Id. at *8.
71 Id. at *8–9.
3. The relevant leases should have been reviewed prior to the issuance of the bonds but apparently were not;

4. The City could not foreclose on the land;

5. Both large leaseholders defaulted and the BIA promptly cancelled their leases.

6. Lease assignments perfecting the City’s security interest in the leaseholds had not been prepared, executed or recorded;

7. The BIA refused to cooperate with the City in imposing the assessments against subsequent lessees;

8. The bond disclosure documents did not address the risk of lease cancellation without recourse by the City;

9. The 1994 press release, reviewed by Brown & Diven, stated that the City would foreclose on terminated leasehold interests, even though Brown & Diven knew the City could not foreclose;

10. Allstate complained to the City, demanded that it exercise its foreclosure remedy and blamed defective disclosure documents for not revealing the risk to the bonds it held;

11. Allstate strongly urged the City to pursue all of its remedies to prevent losses to the bondholders.72

On the basis of the above facts, the City of Palm Springs court concluded that:

    Brown & Diven possessed more than sufficient knowledge prior to inception of the Golden Eagle policy to realize that its actions in connection with the bond issuance had been seriously questioned, that its client was at risk for a loss as a result, and that Allstate, through its letters to the City, blamed its losses on the acts and omissions of Brown & Diven.73

The court concluded by stating that “[i]t is not necessary that an actual lawsuit be filed prior to the policy’s inception. A claim is merely a demand for something as a right.”74 Thus, after advising the city on the issuance of the bonds and assisting in the response to the unhappy bondholders and the public, “Brown & Diven should have known that a claim against it was reasonably likely to occur when it learned of the facts listed above, including Allstate’s strong

72 Id. at *18–20.
73 Id. at *20.
74 Id. at *20 (citing Phoenix Ins. Co. v. Sukut Constr. Co., 136 Cal. App. 3d 673, 677 (1982)).
questioning of the adequacy of the bond disclosure statements.”

Similarly, the main issue in *Low v. Golden Eagle Ins. Co.* (“Dickson”), was whether based on the facts known prior to the inception of the policy, the law firm should have reasonably expected that its acts or omissions might lead to a claim for purposes of the prior knowledge exclusion. In *Dickson*, when Brenda Dickson was fired from her job, she hired a law firm to file an action against her employer. Michael Shelley was the attorney who handled Dickson’s case. On May 1, 1991, Dickson wrote to Shelley and discharged him as her attorney. Specifically, Dickson stated in her letter that she was “going to have a fair trial or you’ve got a lawsuit … You are no longer my attorney of record on this case that you’ve tried so hard to lose.”

On May 7, 1992, Dickson’s new counsel filed a malpractice action against the law firm. *Id.* After investigating the claim, Golden Eagle, the insurer for the law firm, denied coverage on the basis that the law firm had knowledge of the potential claim prior to the inception of the policy and failed to disclose the potential claim. The two Golden Eagle policies issued to the law firm incepted on June 27, 1991, and June 27, 1992.

The Golden Eagle policies provided coverage for “an act or omission arising out of the rendering of professional services prior to the policy period only if: ‘the Insured had no basis to believe that any such act, omission or Personal Injury might reasonably be expected to give rise to a Claim.’ ” Further, a “warranty statement issued in connection with the 1992 policy renewal provided that there was no coverage for prior acts if the firm had knowledge of any circumstances that could give rise to a claim.”

In distinguishing its facts from those in *National Steel*, the *Dickson* court held that the facts in the case were more than adequate to conclude that the law firm knew that its acts or omissions “might reasonably be expected to give rise to a claim,” under the terms of the policy’s prior acts exclusion. The court reasoned that “[w]hen the law firm received notice that its client was dissatisfied with its representation in the Columbia matter, coupled with an explicit threat of a lawsuit, the firm should have reasonably expected that the client’s dissatisfaction would give rise to a claim. The evidence available to Golden Eagle at the time it rejected the claim conclusively eliminated any possibility that Dickson’s claim fell within the scope of coverage.” Accordingly, the court concluded that based on the facts known to the law firm prior to the inception of the policy, the law firm should have reasonably expected that its acts or omissions could potentially lead to a claim or suit.

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75 *Id.* at *20–21.
76 No. A094961, 2002 Cal. App. Unpub. LEXIS 4549 (Cal. Ct. App. Jan. 25, 2002) (unpublished). Both cases have the same name as “Low” was the California insurance commissioner at the time the suits were filed.
77 *Id.* at *1–3.
78 *Id.* at *1–3.
79 *Id.* at *6.
80 *Id.* at *7.
81 *Id.* at *11.
82 *Id.* at *11.
83 *Id.* at *11.
4. Subjective Belief as to Viability of a Claim or as to Relevant Facts

A common insured defense to an insurer’s denial of coverage based upon its application of a prior knowledge exclusion is that while the insured may have known of facts that could lead to a claim, it did not have a belief that any such claim was viable or would ever be brought and, consequently, did not have a reasonable expectation that facts that existed prior to the policy’s inception could result in a claim during the relevant policy period.

In *Colliers Lanard & Axilbund v. Lloyds of London*,84 Colliers, Lanard & Axilbund (“Colliers”), a real estate lending broker prepared leases for tenants, but essential terms of the leases were entered incorrectly. After noticing the mistake in July of 2000, Colliers sent letters to the tenants stating that there had been a mutual mistake. But the tenants denied there was a mutual mistake and indicated that any future discussions regarding the matter should be directed at their attorneys.85

On August 29, 2000, Lloyds of London (“Lloyds”) provided a claims made professional liability insurance policy to Colliers with a retroactive date of November 4, 1992.86 The policy provided Colliers with retroactive coverage for claims as long as “the insured had no knowledge of any suit, or any act or error or omission, which might reasonably be expected to result in a claim or suit as of the date of signing the application for this insurance.”87

On January 10, 2001, Colliers was sued relative to the mistakes it made in preparing the leases and Colliers informed its insurance broker as a result.88 Lloyds denied the claim on the basis that Colliers was “aware of issues or circumstances which ‘might reasonably be expected to result in a claim or suit as of the date of signing the application for this insurance.’”89 Colliers eventually sued Lloyds seeking to recover costs it incurred in defending and settling the prior suit.90

In applying New Jersey law, the court in *Colliers* held that the plain meaning of the policy exclusion is “clear and unambiguous” and “its plain language mandates a subjective test for the first part of the necessary inquiry and an objective test for the second part of the inquiry.”91 In the first step, the court asks whether the insured “had knowledge of the relevant suit, act, error or omission” and this step depends on the insured’s “actual knowledge, or subjective awareness.”92 The second step asks whether “the suit, act, error, or omission might reasonably be expected to result in a claim or suit.”93 In other words, the second step asks “whether a reasonable professional in the insured’s position might expect a claim or suit to result.”94

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84 458 F.3d 231, 234 (3d Cir. 2006).
85 Id.
86 Id.
87 Id. at 233.
88 Id. at 234.
89 Id.
90 Id. at 235.
91 Id. at 237.
92 Id.
93 Id.
94 Id.
The court noted that this combined inquiry limits the moral hazard for those who attempt to disingenuously convince a court that they were not aware that a claim could result from their errors. The court predicted that the New Jersey Supreme Court would hold that this mixed subjective-objective test arising from the clear and unambiguous policy language would not violate either New Jersey public policy or the reasonable expectations of an insured.

In *Liberty Surplus Insurance Corp. v. Nowell Amoroso, P.A.*, the professional liability insurer brought an action against its insured for a declaratory judgment that the insured was aware of a possible claim when applying for the policy and thus the policy did not provide coverage for the malpractice suit. Specifically, one of the questions on the insurance application asked the insured whether “any lawyer to be insured under this policy [had] knowledge of any circumstance, act, error or omission that could result in a professional liability claim.” In response to this question, the insured answered “no.”

The *Liberty* court applied a subjective standard in determining the insured’s knowledge when it applied for malpractice insurance. In applying this standard, the court determined that “the trial court would have had to ignore reality to conclude that [the insured] did not have knowledge that a claim might be filed against it when faced with a trial court and two Appellate Division decisions that [its client] had missed the statute of limitations for its claim.” Accordingly, the court held that “because the evidence in the record ‘is so one-sided,’ Liberty must prevail as a matter of law.”

Applying the test from the *Colliers* decision, noted above, in the first step, the inquiry is whether the insured “had knowledge of the relevant suit, act, error or omission.” This step depends on the insured’s “actual knowledge, or subjective awareness.” The second step asks whether “the suit, act, error, or omission might reasonably be expected to result in a claim or suit.” In other words, the second step asks “whether a reasonable professional in the insured’s position might expect a claim or suit to result.”

Other courts using a two-part test similar to the one used in *Selko v. Home Ins. Co.* (discussed above), have relied upon the prior knowledge exclusion to disclaim coverage under myriad circumstances. For example, courts have precluded coverage:

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95 *Id.* at 240.
96 The court vacated a district court judgment in favor of the insured and remanded the case for further proceedings consistent with its opinion.
97 916 A.2d 440 (2007).
98 *Id.* at 444.
99 *Id.*
100 *Id.* at 446.
101 *Id.* at 448.
102 *Id.*
103 139 F.3d 146 (3d Cir. 1998). This decision is discussed above in the text accompanying note 42 *et seq.*
• When an insured attorney knowingly fails to respond to the opposition’s preliminary objections;\textsuperscript{104}

• When an insured attorney receives a copy of a motion for post-verdict relief alleging ineffective assistance of counsel;\textsuperscript{105}

• When an insured attorney receives a letter from a client stating dissatisfaction with the attorney’s representation;\textsuperscript{106} or

• When an insured received a copy of a letter of complaint sent to bar counsel.\textsuperscript{107}

However, courts may be unwilling to apply the exclusion to preclude coverage when the insured’s knowledge cannot be shown. For example, when an insured under a malpractice policy issued to a title company did not disclose that an employee was secretly diverting money from funds intended to pay off mortgages for personal benefit, the court in \textit{American Guar. & Liab. Ins. Co. v. Perrone},\textsuperscript{108} found that the relevant exclusion was not applicable because the insured lacked knowledge of the relevant act.\textsuperscript{109}

A minority of jurisdictions have used a purely subjective test to determine whether an insured could have reasonably foreseen a claim would result. Such a subjective approach examines what facts the insured knew and whether the insured subjectively believed a claim would result. In \textit{American Guar. & Liab. Ins. Co. v. Fojanini},\textsuperscript{110} for example, in evaluating a directors and officers policy, the federal district court applied a “purely subjective standard of proof, requiring evidence of actual knowledge on the part of a company official that a claim or lawsuit could arise.”\textsuperscript{111} Based on that standard, the court held that even though the corporate official had received a letter accusing his company of making misrepresentations and breaching agreements, because there was no indication that a lawsuit would be filed, the insurer was not

\textsuperscript{109} See also Appleman on Insurance 2d § 146.6.
\textsuperscript{110} In Sharp v. Trans Union LLC, 845 N.E.2d 719, 724 (Ill. App. Ct. 2006), a standard provision precluding coverage for claims that the Chief Financial Officer could reasonably have foreseen was changed to exclude any claims arising out of prior conduct that the General Counsel knew about on the effective date of the policy. When the insured sought coverage for lawsuits filed against it, the insurer requested documents that the insured refused to produce due to the attorney-client privilege. The court ordered production reasoning that since the policy defined an excluded claim in terms of the general counsel’s knowledge, the insurer was entitled to the documents so as to be able to determine what counsel knew on the effective date of the policy. \textit{Id. at 727.}
\textsuperscript{111} 90 F. Supp. 2d 615, 620 (E.D. Pa. 2000).
\textit{Id. at 620.}
entitled to summary judgment. However, *Fojanini* is distinguishable from many prior knowledge exclusion cases as the court was construing policy language that did not include the “reasonably have foreseen” language commonly found in prior knowledge exclusions.

In this respect, a New Mexico court in *General Ins. Co. of America v. Rhoades*, has also determined that specific facts must be known to an insured in order for an insurer to preclude coverage based on the insured’s knowledge of facts prior to the effective date of a policy that could result in a claim during the policy. As a practical matter, the court acknowledged and approved of the reasoning of such decisions as *Selko v. Home Ins. Co.*, and *Ehrgood v. Coregis Ins. Co.*, both of which applied the prior knowledge exclusion where it was undisputed that the insured was aware of facts that could lead to a potential claim. However, the court declined to follow such an approach if the insured attorney was not aware of specific facts that would form the basis for such a claim:

The court rejects Plaintiff’s approach, which would exclude coverage whenever an insured has been threatened with a claim, no matter how idly. An attorney who has no idea he or she has done anything wrong, and knows no facts indicating any performance has been substandard, is generally not expected to anticipate that a disappointed client will actually file a malpractice claim. *Cf. Hoyt v. St. Paul Fire and Marine Ins. Co.*, 607 F.2d 864, 866 (9th Cir. 1979) (letter pointing out that attorney’s actions had caused substantial tax liability for estate, and asking for explanation, did not constitute a “claim” under malpractice policy). If the client has alleged no specifics, and the attorney has no knowledge of any deficient performance of his or her duties, the attorney would be justified in assuming the client’s threats are mere mutterings not likely to come to fruition.

5. Fraud

In *James River Ins. Co. v. Hebert Schenk, P.C.*, the defendant submitted an application for professional liability insurance coverage to James River Insurance Company (“James River”) on April 19, 2004. In the application, there was a question that asked the defendant to identify “any circumstances, allegations, Tolling Agreements or contentions as to any incident which may result in a claim being made against the Applicant.” In answering this question, the defendant identified nine potential claims and submitted information relative to those claims. On April 27, 2004, after submitting the application, but before the policy was executed, one of the defendant’s clients, David Nolan, sent a letter to a Hebert Schenk attorney indicating that he intended to end

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112 *Id. at 620–621.*
113 *See also* Appleman on Insurance 2d § 146.6, nn.384–386.
115 139 F. 3d 146 (3d Cir. 1998).
119 *Id.* at *2.*
the defendant’s representation of his interests. The letter also provided that the client was requesting a return of all of his files and a write-off of all his bills due to the attorney’s failure to communicate with him. Subsequently, on June 7, 2004, the defendant received an insurance quote setting forth certain conditions and requiring an update of the application and a statement indicating that the defendant did not know of any other incidents that might result in claims against the firm. The defendant responded by stating that “[t]his confirms that the law firm of Hebert Schenk has no known claims and no known incidents since the time of the application.”

After James River issued the policy, the defendant received a letter on October 7, 2004, from David Nolan indicating that they were filing a claim related to allegations in his prior letter.

The issue presented before the James River court was whether “James River can deny insurance coverage on the Nolan Claim due to defendant’s failure to disclose receipt of the Nolan Letter and the incidents related thereto in response to Question 10C in the application or to the June 7th fax requesting updated information.” The court first noted that legal fraud can be found “where a question on an insurance application seeks facts which are presumably within the personal knowledge of the insured and are such that the insurer would naturally have contemplated that the answer represented the actual facts, and the answer is false.” In following this definition, the court held that the application elicited a statement of fact and the question on the application “broadly required the disclosure of facts which, objectively considered, might give rise to a claim, without respect to the insured’s subjective belief.” Additionally, the court concluded that “[n]o reasonable person would deny that the Nolan Letter and related circumstances ‘may result in a claim.’” Thus, the court found that the defendant’s failure to include this information in response to James River’s request for additional information constituted legal fraud. As a result, James River was entitled to deny coverage.

VIII. RESCISSION

Risk management type activities are often detailed in an insurance application and often include questions regarding “claims management,” “incident reporting,” “tracking and trending of incidents at the facility level.” As part of this process many insurers include a question in the application for insurance that expressly asks whether the applicant is aware of any fact, circumstance or situation that gives the applicant reason to believe that it might result in any future claim under the insurance for which this application is made. If so the application requires that the applicant provide the insurer with details regarding the facts and circumstances involved.

For example, California allows for the rescission of a policy when the insured has made

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120 Id. at *4.
121 Id. at *5.
122 Id. at *6.
123 Id. at *9.
124 Id. at *9.
125 Id. at *9.
126 Id. at *10.
127 See, e.g., Liberty Surplus Ins. Corp. v. Nowell Amoroso, P.A., 916 A.2d 440 (N.J. 2007) (the professional liability insurer questions on the insurance application included a question whether “any lawyer to be insured under this policy [had] knowledge of any circumstance, act, error or omission that could result in a professional liability claim.” Id. at 444.
A survey review of cases addressing the application of prior knowledge exclusions reveals that insurers relying on such exclusions in denying coverage often either rescind the policy, reserve the right to rescind the policy, or pursue rescission in the appropriate venue.

IX. CONCLUSION

Insurers extending coverage for professional liability claims made against insureds have implemented “prior knowledge” exclusions in an effort to preclude insureds from applying for coverage without disclosing facts or circumstances known to them that a like-situated insured at the effective date of the policy knew or could have reasonably foreseen that such act, error or omission might be expected to be the basis of a claim or suit against the insured. A large majority of courts that have construed such provisions have found them to be clear and unambiguous. Where facts are undisputed and evidence that an insured was clearly aware of facts and could have reasonably foreseen that its error could be the basis for a claim against it, courts are generally willing to make a determination that coverage is precluded. More often than not, what is deemed to be a claim that is “reasonably foreseeable” is based upon an objective, reasonableness standard rather than the subjective impressions and opinions an individual insured may have. Nevertheless, a minority of courts have conducted such policy interpretation using a subjective standard. Under such a standard, courts often find that the prior knowledge exclusion does not apply or that issues of material fact exist that prevent the court from granting an insurer summary judgment. Overall, however, the prior knowledge exclusion and related policy application questions remain effective tools for both insured and insurer to use as a means of identifying and assessing risk, underwriting coverage, and identifying specific categories of risk that will—or will not—be included in the relevant policy.

APPENDIX MULTI-STATE PRIOR KNOWLEDGE EXCLUSION CHART

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133 Imperial Casualty, 198 Cal. App. 3d at 182.
This chart addresses the narrow issue of whether courts have addressed, directly or indirectly, the application of the prior knowledge exclusion (or similarly worded exclusions such as prior notice exclusions) in determining whether an insured’s awareness of facts or circumstances prior to the inception of a policy could lead to a future claim against the insured under the policy issued and, consequently, be precluded from coverage. Relevant law is identified from 21 of the 50 United States.

In the “EXCLUSION” column of the chart, “YES” indicates specific case law upholding such an exclusion, and “NO” indicates rulings where courts have been unwilling to apply the exclusion. Note that the majority of cases that have not applied the exclusion have done so on the basis that there were questions of fact regarding whether the insured had knowledge of facts that would reasonably lead it to believe such facts could result in a claim against it, rather than based on any question regarding whether the policy exclusion is plain and unambiguous. Several other states appear not to have addressed such exclusions in their appellate courts.

This survey is not intended to be, and does not constitute legal advice as to a particular case or claim. The survey provides an overview, but is not an exhaustive list of all cases. While the survey does contain brief summaries of the cases, each case presents a unique factual and legal scenario. Coverage determinations should be made by the claims professional based upon the analysis of the relevant policy language, review of relevant claim-specific facts, and a detailed and specific review and application of each individual case and controlling law.

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<thead>
<tr>
<th>State</th>
<th>Exclusion Applies</th>
<th>Case Law</th>
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</thead>
<tbody>
<tr>
<td>California</td>
<td>Yes</td>
<td><strong>Coregis Ins. Co. v. Camico Mut. Ins.Co.,</strong> 959 F. Supp. 1213 (C.D. Cal. 1997) (in suit between prior and successive insurer, court held insured could have reasonably foreseen claim or suit on effective date of second policy period and, consequently, prior notice exclusion precluded coverage).</td>
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<td></td>
<td>No</td>
<td><strong>M.D. Sass Investors Services, Inc. v. Reliance Ins. Co. of Ill.</strong> 810 F.Supp. 1082 (N.D. Cal.1992) (issues of fact existed as to whether prior knowledge exclusion applied given questions about scope of investment advisor’s knowledge of any</td>
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<td>State</td>
<td>Exclusion Applies</td>
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<td></td>
<td>Yes</td>
<td><em>Phoenix Ins. Co. v. Sukut Constr. Co.</em> 136 Cal. App. 3d 673 (1982) (court finds prior knowledge exclusion is a condition precedent to coverage and precludes coverage where insured knew or reasonably could have foreseen client’s claim).</td>
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<tr>
<td>Delaware</td>
<td>No</td>
<td><em>National Steel Corp. v. Golden Eagle Ins. Co.</em>, 121 F.3d 496 (9th Cir. 1997) (prior knowledge exclusion did not apply where insured disavowed any knowledge of facts prior to inception of policy that could give rise to claim under policy).</td>
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<tr>
<td>Florida</td>
<td>Yes / No</td>
<td><em>Grayson, Givner, Booke, Silver &amp; Wolfe v. Old Republic Ins. Co.</em>, 152 F.3d 925 (9th Cir. 1998) (unpublished) (exclusion applied because, <em>inter alia</em>, insured’s memorandum demonstrated that it had potentially given improper advice to its client).</td>
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<tr>
<td>Connecticut</td>
<td>Yes</td>
<td><em>Napolitano v. Coregis Ins. Co.</em>, No. 3:01-CV-34 EBB (D. Conn. Aug. 27, 2002) (prior knowledge exclusion applies where insured failed to advise of facts or circumstances to could result in claim).</td>
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<tr>
<td>Delaware</td>
<td>No</td>
<td><em>Alstrin v. St. Paul Mercury Ins. Co.</em>, 179 F. Supp. 2d 376 (2002) (prior notice exclusion did not apply since it was only applicable where policy was a renewal, replacement, or successor policy and excess policy did not qualify as either).</td>
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<tr>
<td>Florida</td>
<td>Yes</td>
<td><em>Illinois Union Ins. Co. v. Berry, Inc.</em>, 2006 U.S. Dist. LEXIS 84505 (S.D. Fla. Nov. 17, 2006) (prior knowledge exclusion is plain and unambiguous and applies to acts that took place before the continuity date; however, since there are allegations of misconduct after continuity date insurer policy covering indemnity of legal expenses and costs must periodically pay such expense).</td>
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<tr>
<td>Illinois</td>
<td>No</td>
<td><em>Lawyers Professional Liability Ins. Co. v. Dolan, Fertig &amp; Curtis</em>, 524 So. 2d 677 (Fla. App. 4 Dist. 1988) (where claim of malpractice was received prior to inception of policy, prior knowledge exclusion precluded coverage and entitled insurer to summary judgment).</td>
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<tr>
<td>State</td>
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<td>Case Law</td>
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<td>Yes</td>
<td>(2002) (prior notice exclusion did not apply since it was only applicable where policy was a renewal, replacement, or successor policy and excess policy did not qualify as either).</td>
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<td>Yes</td>
<td><em>Evanston Ins. Co. v. Security Assurance Co.</em>, 715 F. Supp. 1405 (Ill. 1989) (application for policy stated objective or reasonableness standard for determining whether insured was required to disclose its knowledge of potential claim against it and insured should have disclosed facts that ultimately erupted as claim against it; thus, claim not covered).</td>
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<td>Yes</td>
<td><em>Continental Cas. Co. v. Coregis Ins. Co.</em>, 316 Ill. App. 3d 1052, 738 N.E.2d 509, 250 Ill. Dec. 293 (2000) (successor insurer entitled to summary judgment against prior insurer where facts showed notice letter to insured during prior policy sufficiently provided insured with facts that could reasonably lead it to conclude such facts could result in a claim).</td>
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<tr>
<td>Maine</td>
<td>No</td>
<td><em>Westport Ins. Corp. v. Lilley</em>, 292 F. Supp. 2d 165 (D. Me. 2003) (inconclusive and confusing jury verdict in medical malpractice action was not sufficient to place insured on notice of facts sufficient to lead it to reasonably believe such facts could form basis for future malpractice claim and, thus, precluded application of prior knowledge exclusion).</td>
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<tr>
<td>Maryland</td>
<td>Yes</td>
<td><em>Culver v. Cont’l Ins. Co.</em>, 11 Fed. Appx. 42 (4th Cir. 1999) (unpublished) (summary judgment for insurer affirmed based upon prior knowledge exclusion where letters sent to insured provided an objectively reasonable basis for insured to determine foreseeability of claims for purposes of disclosure in application for policy).</td>
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<td>Yes</td>
<td><em>Westport Insurance Corp. v. Albert</em>, 208 Fed. Appx. 222 (4th Cir. 2006) (unpublished) (allegations made in petition to remove accountant as personal representative of client would have put a reasonable accountant on notice that a malpractice suit was forthcoming; prior knowledge exclusion precludes coverage).</td>
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|            | Yes               | *Maynard v. Westport Ins. Corp.*, 208 F. Supp. 2d 568 (D. Md. 2002) (objectively reasonable attorney knew or should have...
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<td>Yes</td>
<td><em>Comerica Bank v. Lexington Ins. Co.</em>, 3 F.3d 939 (6th Cir. 1993) (prior knowledge and prior litigation exclusions entitle insurer to summary judgment where bank could have reasonably foreseen at time wrongful acts committed in its mishandling of estate would ultimately result in claim being filed against bank by estate beneficiary).</td>
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<td>Missouri</td>
<td>Yes</td>
<td><em>North American Specialty Ins. Co. v. Correctional Med. Services, Inc.</em>, No. 4:04CV798 CDP (E.D. Mo. Jan. 26, 2006) (prior notice, prior litigation, and prior demand exclusions all preclude coverage for claim arising from medical treatment where provided with notice of circumstances leading to multiple suits before effective date of policy).</td>
</tr>
<tr>
<td>Nebraska</td>
<td>No</td>
<td><em>Petersen v. TIG Ins Co.</em>, 2002 U.S. Dist. LEXIS 20801 (D. Neb. Oct. 28, 2002) (court declined to impute knowledge of non-lawyer employee to professionals insured under policy and, consequently, prior knowledge exclusion did not apply—“the argument made by TIG that her status as an employee makes her an agent of the Law Firm and therefore her receipt of the letter is imputed to the professional staff so as to deny coverage, requires more leaps and jumps than I am willing to make”).</td>
</tr>
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</table>
|             | No                | *Rod Rehm v. Tamarack American*, 261 Neb. 520, 623 N.W.2d 690 (2001) (whether insured had reasonable basis to foresee, prior to insurance policy’s effective date, that client intended to bring a malpractice claim against him and whether insured had a reasonable basis to believe he had breached
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<td>New Hampshire</td>
<td>No</td>
<td><em>Stratford School Dist. v. Employers Reinsurance Corp.</em>, 105 F.3d 45 (1st Cir. 1997) (insured’s receipt of subpoena from teacher who had been employed ten years earlier and who was being investigated for sexual misconduct in another school district was not sufficient to put insured on notice of probability of claim against insured; thus, exclusion that eliminated coverage if insured was aware of event that could result in claim against the insured did not preclude coverage).</td>
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<tr>
<td>New Mexico</td>
<td>No</td>
<td><em>General Ins. Co. of America v. Rhoades</em>, 196 F.R.D. 620 (D.N.M. 2000) (court declines to apply exclusion if client’s complaints against attorney do not provide attorney with any specifics of wrongdoing and attorney has no knowledge of deficient performance of his or her duties).</td>
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<td>No</td>
<td><em>M.D. Sass Investors Services, Inc. v. Reliance Ins. Co. of Illinois</em>, 810 F. Supp. 1082 (N.D. Cal. 1992) (issues of fact existed as to whether prior knowledge exclusion applied given questions about scope of investment advisor’s knowledge of any wrongdoing prior to policy inception; consequently, insurer obligated to defend under either CA or NY law.)</td>
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|              | Yes               | *Zahler v. Twin City Fire Ins. Co.*, 2006 U.S. Dist. LEXIS 14263 (S.D.N.Y. Mar. 30, 2006) (prior notice exclusion precludes coverage under second insurer’s policy where there are successive, related claims to which interrelated wrongful
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<td>Zunenshine v. Executive Risk Indem., Inc., 182 F.3d 902 (2d Cir. 1999) (prior notice exclusion unambiguously precludes coverage for noteholders’ lawsuit that was similar to shareholder’s lawsuit, which was filed prior to effective date of relevant policy).</td>
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<tr>
<td>Oklahoma</td>
<td>Yes / No</td>
<td>Roesler v. TIG Ins. Co., No. 05-7055 (10th Cir. 2007) (unpublished) (approves objective standard for applying prior knowledge exclusion, but finds insured’s responses to insurance application present fact questions for jury).</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>Yes</td>
<td>Bogatin v. Fed. Ins. Co., No. 99-4441 (E.D. Pa. June 21, 2000) (personal knowledge exclusion precludes coverage where insured was aware of circumstances prior to policy inception that a reasonable person would have supposed “might give rise to a future claim that would fall within the scope of proposed coverage”).</td>
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<td>No</td>
<td>Coregis Ins. Co. v. City of Harrisburg v. St. Paul Fire and Marine Ins. Co., 2005 U.S. Dist. LEXIS 29738 (M.D. Pa. Sept. 9, 2005) (court adopts analysis of Third Circuit Court of Appeals in Selko v. Home Ins. Co., 139 F.3d 146 (3d Cir. 1998), but finds that facts and circumstances that county official may have been aware of prior to policy inception regarding alleged law enforcement malfeasance were not sufficient to have caused a reasonable attorney to believe they would result in an action against the county).</td>
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<td>Yes</td>
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<td><strong>Selko v. Home Ins. Co.</strong>, 139 F.3d 146 (3d Cir. 1998) (insured attorney would have “basis to believe” he had breached professional duty, precluding coverage under professional liability policy, for act, error, or omission occurring prior to policy period if he was subjectively aware of facts that would have led reasonable attorney to believe that he had breached professional duty; summary judgment for insurer affirmed.).</td>
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<td>Yes</td>
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<td><strong>Westport Ins. Corp. v. Mirsky</strong>, 2002 U.S. Dist. LEXIS 16967 (E.D. Pa. Aep't. 10, 2002) (prior knowledge exclusion is clear and unambiguous and precludes coverage where insured was alleged to have personal prior knowledge of legal malpractice prior to inception of policy).</td>
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<td>Yes</td>
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<td><strong>Coregis Ins. Co. v. Baratta &amp; Fenerty, Ltd.</strong>, 264 F.3d 302 (3d Cir. 2001) (prior knowledge exclusion applied to preclude coverage notwithstanding insured’s belief that limitations period had expired for malpractice action prior to effective date of policy).</td>
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<td>Yes</td>
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<td><strong>Brownstein &amp; Washko v. Westport Insurance Corp.</strong>, 2002 U.S. Dist. LEXIS 13822 (E.D. Pa. July 24, 2002) (prior knowledge exclusion applies to preclude coverage notwithstanding insured attorney’s subjective believe that as of the date of the policy inception he had been cleared of the client’s ineffectiveness claim).</td>
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<td>Yes</td>
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<td><strong>Coregis Ins. Co. v. Wheeler v. Bertholon-Rowland, Inc.</strong>, 24 F. Supp. 2d 475 (E.D. Pa. 1998) (policy provided no coverage for malpractice action since insured could have foreseen it when applying for the policy; insurer entitled to summary judgment).</td>
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<td>No</td>
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<td><strong>American Guar. and Liab. Ins. Co. v. Fojanini</strong>, 99 F. Supp. 2d 558 (E.D. Pa. 2000) (evaluating a directors and officers policy, the court applied a “purely subjective standard of proof, requiring evidence of actual knowledge on the part of a company official that a claim or lawsuit could arise.” Based on that standard, the court held that even though the corporate official had received a letter accusing his company of making misrepresentations and breaching agreements, because there...</td>
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<td>was no indication that a lawsuit would be filed, the insurer was not entitled to summary judgment. <em>Id. at 620–621</em>. Of note, the court was construing policy language that did not include the “reasonably have foreseen” language commonly found in many prior knowledge exclusions.</td>
<td><em>Murphy v. Coregis Ins. Co.,</em> 1999 U.S. Dist. LEXIS 12617 (E.D. Pa. Aug. 17, 1999) (court finds only plausible interpretation of record is that reasonable attorneys in position of insured attorneys would have realized before effective date of policy that it had committed acts, errors, or omissions that might be the basis of a claim; however court declines to grant insurer summary judgment since issues of material fact existed regarding the reasonable expectations of the insured).</td>
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<td>Yes / No</td>
<td><em>Westport Ins. Corp. v. Hanft &amp; Knight, P.C.,</em> 523 F. Supp. 2d 444 (M.D. Pa. 2007) (prior knowledge exclusion barred coverage for lender-client’s professional malpractice and breach of fiduciary duty claims against firm arising from insured attorney’s obtaining loans through false representations; as of policy’s effective date, according to lenders’ complaint, attorney already had secured all loans at issue through fraudulent representations, had used money to gamble and satisfy gambling debts, and had prepared promissory note to evidence debt he never intended to repay and failed to adequately secure).</td>
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<td>Yes</td>
<td><em>Westport Ins. Corp. v. Law Offices of Marvin Lundy,</em> 2004 U.S. Dist. LEXIS 4839 (E.D. Pa. Mar. 19, 2004) (court notes probable application of prior knowledge exclusion where insured received demand letter prior to policy inception, but advises issue is moot since letter qualified as a claim under the policy and the claim was made before the policy incepted).</td>
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<tr>
<td>Texas</td>
<td><em>Coregis Ins. Co. v. Lyford,</em> 21 F. Supp. 2d 695 (S.D. Tex. 1998) (policy provided no coverage to law firm or lawyer since lawyer knew of impending lawsuit before firm applied for the policy; insurer entitled to summary judgment).</td>
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<tr>
<td>No</td>
<td><em>Westport Ins. Corp. v. Atchley, Russell, Waldrop &amp; Hlavinka, L.L.P.,</em> 267 F. Supp. 2d 601 (E.D. Tex., 2003) (court declined to look beyond the “eight corners” of the pleadings and policy in evaluating whether insured had prior knowledge sufficient to apply exclusion; consequently, insurer required to defend insured; court could not make a determination on any duty to indemnify insured before conclusion of underlying litigation against insured).</td>
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<td>Washington</td>
<td>Yes</td>
<td><em>Tewell, Thorpe &amp; Findlay, Inc., P.S. v. Cont’l Cas. Co.</em>, 64 Wash. App. 571, 825 P.2d 724 (1992) (prior knowledge exclusion is unambiguous and barred coverage where reasonable person would have known, prior to effective date of malpractice policy, that attorney’s acts or omissions in handling real estate transaction might be basis for malpractice claim where attorney had been informed by title insurer prior to policy’s effective date that insurer would contest its obligation to pay client’s claim under title policy; insurer entitled to summary judgment).*</td>
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