



HOW TO KNOW WHAT YOU DON'T KNOW

SAFEGUARDING COVERAGE LIMITATIONS
BASED ON THE INSURED'S PRIOR
KNOWLEDGE OF POTENTIAL CLAIMS

Handling claims where the insured may have withheld prior knowledge of potential claims during the underwriting process

- Defending under a reservation of rights letter or non-waiver agreement
 - The Choice: reservation of rights or non-waiver agreement?
 - When to provide either to the insured?
 - Is there a conflict of interest for the insured's counsel?
- Pursuit of a declaratory judgment
 - Extrinsic evidence can be considered
- Rescission of the insurance policy

Types of policy provisions at issue:

Claims made Policies

- Claims made policies – grant of coverage for claims first made during policy period unless any insured had knowledge of facts that could reasonably give rise to a claim
 - Coverage is triggered when the insured first became aware of the *possibility* of a claim and notified the insurer of such knowledge
 - Covers claims made today stemming from actions/events occurring on or after the retroactive date
 - Claims usually must be reported during the policy period or an extended-reporting period

Types of Policy Provisions at issue:

CGL Provisions

- **Coverage A** - covers bodily injury (BI) or property damage (PD) that “occurs during the policy period”
 - “Deemer” clauses provide that if the insured knew of BI or PD prior to the policy period then any continuation or resumption will be deemed to have occurred prior to the policy period

Types of Policy Provisions at issue:

CGL Provisions

- **Coverage B** - covers personal and advertising injury (PAI) caused by an “offense” committed during the policy period – exclusion for material first published before the policy period
- **Variations**
 - Identification of who had to have prior knowledge
 - Knowledge prior to successive periods of coverage
 - Carve-outs for “innocent insureds”

The Prior Knowledge

Subjective-Objective Standard

- Whether the lawyer has actual knowledge of certain facts or circumstances...
 - Subjective Component
- ... that would put a reasonable lawyer on notice that a claim may be made established on those facts.
 - Objective component
- Lawyer's subjective belief that he won't be sued or that the claim lacks any merit is irrelevant
 - Cannot assume that a claim will not be brought against you

The Prior Knowledge Subjective-Objective Standard

- “As a matter of public policy, courts cannot allow the insured to perform this risk analysis function instead of the insurer”
 - *Mt. Airy Ins. Co. V Thomas*, 954 F. Supp. 1073, 1079 (W.D. Pa. 1997).

Mt. Airy Ins. Co. v. Thomas

- In finding that, while there is a subjective standard as to the attorney's knowledge, an objective standard applies to notice that a claim may be made, the Court stated that it will:
 - “[W]e distinguish between *facts* which are known to an attorney, which facts, when viewed by a reasonable person, could give rise to a claim of malpractice, and *impressions* which lead the attorney to believe that the client will not pursue a claim for malpractice. . . . The subjective impression or belief of the attorney, based on his perceived relationship with his client or otherwise, as to whether the client will actually pursue a malpractice claim against him falls into the second category.”

Scenario 1

- David Driver is injured in a car accident and consults with Larry Lawyer.
- Lawyer advises Driver that he will need to look into the facts of the case but does not get back to him.
- Had Lawyer looked into the case, he would have realized that the limitations period was about to expire.
- Meanwhile, Lawyer applies for claims-made coverage from ABC Insurance Company stating that he has no knowledge of circumstances that could give rise to a claim.
- After the policy is issued, Lawyer receives a letter from Driver demanding compensation for Lawyer's failure to advise him before the limitations period expired.

Questions re: Scenario 1

- Was Lawyer aware of facts before the policy period that could give rise to a claim?
- Does Lawyer need to have subjective knowledge that the limitations period was lapsing or simply knowledge of facts that would objectively inform one that a claim could arise?
- Defense counsel advises the strongest defense is that an attorney-client relationship was not created because Lawyer simply stated he would need to look into the facts. Does this impact whether to seek declaratory relief?

Scenario 2

- Connie Contractor, Inc. is the general contractor for a tract of 20 residences. He uses the same subcontractors for all the residences, which are constructed in two phases: Phase I houses are located adjacent to a lake and Phase II will be across the street.
- A city inspector observes leaks around windows in two of the Phase I homes and brings it to the attention of a subcontractor who is present.
- The subcontractor re-seals the windows and sends the invoice to Connie Contractor, Inc.'s billing clerk who pays the amount invoiced.
- Shortly afterwards, Connie Contractor, Inc. begins Phase II and also *switches his coverage to ABC Insurance Company.*
- By the time Phase II is complete, more leaks are observed around the Phase I windows, at which point Connie Contractor, Inc. turns the claims in to ABC Insurance Company.
- Upon investigation, ABC finds that the windows in both Phase I and Phase II residences were installed improperly, causing water intrusion that damaged personal property of the residents.

Questions re: Scenario 2

- When did Connie Contractor, Inc. have knowledge of leaks around the window frames?
- Were the leaks in the Phase I homes a continuation or resumption of PD found in the first two homes?
- Were the leaks in the Phase II homes a continuation or resumption of PD found in the Phase I homes?
 - Would it matter if different window subcontractors were used for the different construction phases?

Scenario 3

- Veronica Victim has been employed by Manly Man Company for many years. She informs Manly Man's risk manager that her boss, Callous Cowboy, has been making inappropriate comments that she considers to be harassment. She also confided in the risk manager that she has an anxiety condition that has been getting worse as a result but that she otherwise likes and needs her job.
- The risk manager talks to Cowboy who said his behavior was nothing more than innocent flirtations but agreed to stop.
- The risk manager tells Victim that Cowboy has agreed to stop his behavior and that no further action would be needed.
- Victim seems satisfied by risk manager's action, and admits her reactions may be related to her anxiety condition.
- Shortly afterwards, Victim was laid off, ostensibly due to a shortage of work, after which she claims is retaliation and seeks compensation for the emotional distress she sustained while an employee of the company and after she was laid off.
- After she is laid off but before she makes her claim, Manly Man changes its coverage to ABC Insurance Company.

Questions re: Scenario 3

- Assuming Manly Man has claims-made coverage, was it aware of facts before the policy period that could reasonably give rise to a claim?
 - Does it matter that Victim had an anxiety condition?
- Assuming Manly Man had CGL coverage with a “deemer” clause, and that BI includes emotional distress, when did her BI occur?
- Was Victim’s emotional distress after she left the company a continuation or resumption of the stress she sustained during her employment?
- What might the risk manager have done to make sure Manly Man had insurance coverage for a potential claim by Victim?

Concluding remarks...