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November 3, 2020

Insurance Coverage Update

Prior Knowledge and Notice Provisions Apply to Bar Coverage for Legal Malpractice Suit, and Insurer Obtains Reimbursement of Defense Costs

The U.S. District Court for the District of North Dakota recently found that an insured attorney's knowledge of a judgment entered against his client following his failure to appear at trial, among other things, triggered a professional liability policy's "prior knowledge" provision. Applying that provision, as well as a separate notice-related policy provision, the court determined the insurer had no duty to defend or indemnify the insured for a subsequent malpractice suit and further found the insurer was entitled to reimbursement of defense costs the insurer incurred in defense of that suit. *ALPS Property & Casualty Insurance Company v. Bredahl & Associates, P.C. et al.*, No. 19 CV 00195 (D.N.D., October 23, 2020).

The insured attorney accepted a fee to perform legal services for a contractor and two individuals associated with the contractor (the "Clients"), who were defendants in a construction dispute lawsuit. Despite never actually entering the lawsuit as an attorney of record, the insured attorney appeared at two court hearings and was listed as the Clients' attorney on the opposing party's court filings and service documents. The court included the insured in an order granting the opposing party's motion to compel discovery and listed him as counsel for the Clients in a notice of Trial. When trial was set, the insured received electronic notice of the trial date. The insured then assisted in preparing and filing a motion to continue the trial, which the court denied. The case proceeded to trial, the insured and the Clients did not appear, and the court entered a monetary judgment against the Clients. The insured

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claimed to have promptly advised the Clients of the judgment and to retain new counsel to vacate it, although the Clients disputed that assertion.

In an insurance policy renewal submitted several months later, the insured answered "no" to a question asking whether he or any member of his firm had any "knowledge of any fact, circumstance, act, error, or omission that could reasonably be expected to be the basis of a claim…." Three months after the policy renewal, the insurer became aware of a potential claim relating to the insured's alleged malpractice in connection with the construction dispute litigation. When the Clients subsequently filed suit against the insured attorney for legal malpractice, the insurer defended the action under reservation of rights and filed a declaratory judgment action.

Applying North Dakota law, the court in the coverage action granted the insurer's motion for summary judgment. Noting a dearth of North Dakota case law construing similar policy language, the court applied the two-prong "subjective-objective" test applied in many other jurisdictions when courts consider application of "prior knowledge" provisions. The court found the circumstances present in the case – where the insured accepted a fee to perform legal services, made two informal court appearances, received electronic court filings, consistently was listed as the attorney on court filings, was aware of and assisted in attempting to continue the trial, learned of a substantial monetary judgment against his clients, etc. – indicated the insured's subjective knowledge of the underlying events that lead to the Clients' damages. Declining to consider the insured's own beliefs about the likelihood of a claim, the court further found that the circumstances met the "objective" prong of the two-prong test in that a reasonable attorney would have known of the potential for a malpractice claim arising from those events.

The court also based its decision on a notice provision in the policy. Pursuant to that provision, the policy would not apply to any act or error if, prior to the policy's effective date, the insured *should have* given notice to any insurer of a potential claim arising from the act or error. Finding that the insured should have given notice of the potential claim when applying for the policy and answering the question regarding knowledge of potential claims, the court relied on this additional basis for its decision.

Finally, the court found that a reimbursement provision in the policy obligated the insured to reimburse the insurer for all defense costs it incurred in defending the underlying malpractice case. The court noted that there was no North Dakota law on the issue of reimbursement. The court predicted, though, that the state Supreme Court would hold that, where the policy includes an express reimbursement condition and the insurer is defending under a reservation of rights, the insurer has a right to reimbursement if the terms of the condition are met.

Comment

The *Bredahl* decision exemplifies an application of the often-used "subjective-objective" approach to "prior knowledge" provisions found in E&O, D&O and various other types of policies. Under this approach, the court first determines whether the insured had subjective knowledge of the events, acts or errors underlying the claim. In addressing the second prong

– the "objective" aspect of the test – the court evaluates whether a reasonable person in the insured's position would have known a claim could follow from the known circumstances. And here, the court followed the lead of courts in other jurisdictions in disregarding the insured's own subjective belief as to whether a claim would be made.

If you have any questions about this Update, please contact the author listed below or the Aronberg Goldgehn attorney with whom you normally consult:

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