

Seventh Circuit Determines Law Firm's Prior Knowledge Bars Coverage for Malpractice Claim
Koransky, Bouwer & Poracky, P.C. v. The Bar Plan Mut. Ins. Co.
(U.S. Court of Appeals, Seventh Circuit)

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Addressing an issue that professional liability insurers often face, the U.S. Court of Appeals for the Seventh Circuit recently found that a law firm's professional liability policy did not cover a malpractice claim because the insured had prior knowledge of a potential claim. Applying Indiana law, the Court in *Koransky, Bouwer & Poracky, P.C. v. The Bar Plan Mut. Ins. Co.*, 712 F.3d 336 (7th Cir. 2013) held that prior to the relevant policy period, the law firm had a basis to believe it had committed an act or omission which may give rise to a malpractice claim, which triggered a policy exclusion.

The coverage dispute arose from a real estate transaction in which the law firm represented the buyer. The firm obtained its client's signature on the sales contract, but it did not deliver an executed copy of the contract to the seller. The seller rescinded the sales contract and declared the agreement null and void. One of the firm's attorneys then sent an email to the seller's counsel in which he acknowledged responsibility for the situation and apologized for the error. He also requested that the seller withdraw its cancellation notice, but the seller refused.

While the buyer and seller litigated the validity of the sales contract in Alabama and Ohio state courts, the law firm obtained a renewal of the claims-made professional liability policy in effect at the time. According to the Seventh Circuit opinion, during the renewal process, the law firm did not notify the insurer of any potential malpractice claims, despite the pending litigation and the fact that the seller was refusing to go through with the real estate deal.

The firm's client gave the firm formal notice of the malpractice claim during the renewal policy period, and the firm then tendered the claim to its insurer. But the insurer contended that the firm knew, or should have known, before the renewal policy became effective, of acts or omissions that could give rise to a claim. The insurer relied on a policy exclusion barring coverage for unreported acts and omissions predating the policy where "before the Policy effective date," the firm "knew or should reasonably have known, of any circumstance, act or omission that might reasonably be expected to be the basis of that Claim." 712 F.3d at

340. The firm took the position that it did not need to notify the insurer of anything prior to receiving formal notice of a claim from its client because, among other things, it had no reason to think that the deal was truly doomed.

The Seventh Circuit rejected the firm's position, concluding that "it [was] clear that a reasonable attorney would have recognized that his failure to deliver the contract, in light of the communications and legal activity that quickly followed, was an omission that could reasonably be expected to be the basis of a malpractice claim." *Id.* at 344. The Court affirmed the trial court's summary judgment ruling in the insurer's favor, finding that coverage was barred because the law firm had prior knowledge of a potential claim.

The Court also addressed whether the law firm had an obligation to provide notice to the insurer of *potential* claims under the firm's initial claims-made policy. The Court held that the policy provisions "make clear that the obligation to notify [the insurer] arose, not when the law firm has received an actual claim, but when it became aware of an "act or omission" which "may give rise to a Claim." *Id.* at 339. The Court therefore ruled that the firm was obligated to notify the insurer of the potential claim during the initial claims-made policy period.

Comment: The Seventh Circuit has reaffirmed the importance of timely reporting potential claims under claims-made professional liability policies, and the risk of having no coverage when a claim eventually is made in a later policy period. Moreover, this case highlights the application of "prior knowledge" provisions to preclude coverage even in situations where the insured is continually insured by the same insurer both when the claim is made and when the insured is found to have had knowledge of a potential claim.

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

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