

No Coverage for Class Actions Based on Prior Acts that Were the Subject of Other Class Actions that Predated the Policy

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The Eighth Circuit, applying Missouri law, has affirmed a district court's grant of summary judgment to an insurer in a declaratory judgment action, holding that the policyholder was not entitled to coverage under a claims-made professional liability policy for certain class action suits alleging fraud and unfair or deceptive acts and practices in connection with its Refund Anticipation Loan (RAL) program because they were based upon the same wrongful acts that had been the subject of prior class action suits and were therefore barred by a prior knowledge exclusion. *H & R Block, Inc. v. American Int'l Specialty Lines Ins. Co.*, 2008 WL 4889807 (8th Cir. Nov. 14, 2008).

During the 1980s, the insured developed and promoted its RAL program, which provided short term loans to its tax clients who did not want to wait for their refund from the government. The RAL's were processed by the insured, funded by third-party banks and repaid with the borrower's refund proceeds. Between 1990 and 1996, the insured was named in eleven state and federal class action lawsuits asserting that it had failed adequately to disclose finance charges, charged usurious and unconscionable interest rates and breached its fiduciary duty to its RAL recipients.

In May 1996, the insured purchased second- and third-layer excess policies from two insurers. Between May 1996 and August 1998, eleven more class action suits were filed against the insured. The excess insurers denied coverage based in part on the primary policy's prior knowledge provision, which afforded coverage for claims based on a wrongful act that occurred before the policy's effective date provided that the insured "had no knowledge of the prior wrongful act on the effective date of [the] Policy, nor any reasonable way to foresee that a claim might be brought." The insured filed a declaratory judgment action seeking coverage. The district court granted summary judgment for the insurers on the grounds that the prior knowledge provision barred coverage for those claims made after May 1996 that were based on wrongful acts that were the subject of the class action suits filed before May 1996. The insured appealed.

The Eighth Circuit noted that this was "an insurance coverage issue of first impression: whether class actions filed against [a policyholder] . . . are excluded from 'prior acts' coverage under professional liability 'claims

made' insurance policies because other class actions asserting similar claims were filed prior to the policy periods." The insured argued that the language of the prior knowledge provision should be interpreted to provide coverage for prior acts unless the policyholder could reasonably foresee "a specific claimant making a claim based on a specific alleged wrongful act known to [the policyholder] before the inception of the policy." The insurers argued that the class actions filed after May 1996 alleged the same facts and legal theories as the earlier suits, and thus the insured had knowledge of its wrongful acts and a reasonable basis to foresee that additional class action suits might be brought.

The court upheld the grant of summary judgment on behalf of the insurers. The court began by observing the basic principle that "insurance is to protect against the risk of unknown but not unexpected loss." The "difficult question," the court noted, "is how to apply this principle to class actions." The court noted that, in a modern class action, the plaintiffs must allege and prove that each class member was injured by the same wrongful act or acts. The court reasoned that, when a company sells a product or service nationwide, claims based on "uniform aspects" of the product or service and alleging common causes of action put the company on notice that other contemporaneous clients are likely to assert similar claims alleging harm based on the same wrongful acts.

The court also rejected the insured's argument that construing the prior knowledge provision to permit a denial of coverage for the class actions filed after May 1996 would render coverage illusory or create an unconscionable gap in coverage. The court held that the doctrine of illusory coverage applies only when part of an insurance premium is specifically allocated to a particular type or period of coverage and that coverage turns out to be functionally nonexistent. Here, the policies provided some prior acts coverage. The court further held that, because the policyholder failed to report the earlier class actions under its then-current policies, it had no basis for claiming that the denial of coverage for subsequent actions constituted an unconscionable gap in coverage.