

D.C. Circuit Holds that Prior Knowledge of Potential Malpractice Claim Precludes Coverage Under LPL Policy

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The United States Court of Appeals for the District of Columbia Circuit, applying District of Columbia law, has held that a prior knowledge provision in a lawyers professional liability policy barred coverage where, prior to the insurer issuing its first policy to the insured law firm, the insured attorney had reason to believe that a malpractice claim might be filed because he had failed to file a timely answer, resulting in a default judgment against his client. *Ross v. Cont'l Cas. Co.*, No. 09-7166 (D.C. Cir. Sept. 22, 2010), *aff'g Ross v. Cont'l Cas. Co.*, 420 B.R. 43, 49-50 (D.D.C. 2009). Wiley Rein LLP represented the insurer in the case.

The insured attorney, a member of the insured law firm, represented a restaurant equipment supply company in a civil action brought against the company. After the insured attorney failed to file a timely answer, to the complaint, the court entered default judgment for more than \$800,000 against the restaurant equipment supply company. The default judgment was affirmed on appeal.

While the appeal of the default judgment was pending, the insurer issued a lawyers professional liability policy to the insured law firm. The policy provided, in part, that the insurer would

pay on behalf of the Insured all sums in excess of the deductible that the Insured shall become legally obligated to pay as damages and claim expenses because of a claim that is both first made against the Insured and reported in writing to the Company during the policy period . . . provided that . . . prior to . . . the inception date of the first policy issued by the Company . . . no Insured had a basis to believe that any such act or omission, or related act or omission, might reasonably be expected to be the basis of a claim.

The insured first provided notice of a malpractice claim by the trustee of the now-bankrupt client during the policy's extended reporting period. The insurer denied coverage for the claim on the basis that the insured had reason to know, prior to the inception date of the first policy issued to the insured firm, that a malpractice claim might be brought against it as a result of the default judgment.

The appellate court held that the policy's prior knowledge condition unambiguously required the court to apply a two-part subjective/objective analysis that looked at the facts of which the insured was aware (*i.e.*, that his failure to file a timely answer had led to a default judgment against his client) and then determined that a reasonable lawyer would have believed those facts could form the basis of a malpractice claim.

The appellate court also addressed D.C. Code § 31-4314, which provides that an insurer may not rescind or deny coverage under a policy based on an insured's false statement on an application unless "such false statement was made with intent to deceive or unless it materially affected the acceptance of the risk or the hazard assumed" by the insurer. The district court held that the statute did not apply in this case because the insurer denied coverage based on the prior knowledge condition and not on any false statement in an application. The appellate court held that, even if this statutory provision applied, the plain language of the statute would permit the insurer to deny coverage because a false statement about an insured's negligence leading to a \$900,000 default judgment plainly would satisfy the statute's materiality standard.