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Va. District Court Shelters Insurers From Prior Acts

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The United States District Court for the Eastern District of Virginia, applying Virginia law, recently held that a lawyer's professional liability insurer had limited liability for an underlying judgment because the underlying action arose out of acts, errors or omissions occurring on or before a prior acts date specified in the policy. Minnesota Lawyers Mutual Insurance Co. v. Protostorm LLC, (E.D.Va. June 22, 2016). The court interpreted the term "claim" through the lens of the insurer's duty to indemnify the insured. This case also adds to a line of authority enforcing prior acts dates in legal malpractice policies by looking to the acts that gave rise to the liability, rather than to acts continuing the attorney-client relationship after the client's cause of action had already accrued.

The insurer issued a malpractice policy to a law firm. The policy included a split limit of liability, providing $5 million in coverage for any claim arising out of any acts, errors or omissions which occurred on or before Oct. 25, 2006, and a $10 million limit for any acts occurring after that date.

An internet game company retained the law firm in 2000 to prepare and prosecute patent applications. The law firm properly filed a provisional application in 2001, but allegedly made a mistake in a later filing, jeopardizing the company's ability to receive patent protection. The error could have been corrected as late as February 2003; however, the firm abandoned the patent application without informing the company. When the company did not hear from the firm for five years, it investigated and learned in 2008 that the law firm had abandoned the application. The company filed a legal malpractice suit. The jury found for the company, awarding

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compensatory damages of nearly $7 million.

The insurer sought a declaratory judgment that the policy's $5 million limit of liability applied, rather than the $10 million limit, because the underlying judgment arose out of acts, errors or omissions occurring before Oct. 25, 2006.

The court agreed with the insurer and determined that the lower limit of liability applied. The court reasoned that because the relevant endorsement addressed the insurer's duty to indemnify for claims resulting from the rendering of professional services, the term "claim" should be read in context to mean "the cause of action within a lawsuit that obligates [the insurer] to pay damages covered by the policy." In interpreting the phrase "arising out of," the court examined whether where there was a "causal connection between a particular fact or source of law and an essential element of the cause of action alleged." The court determined that the law firm's liability arose from its failure to prosecute the applications, which could not be corrected after February 2003. Thus, the court reasoned that "all of the elements necessary for the accrual of the malpractice cause of action were present by early 2003 at the latest," and the action could not have been a claim arising out of an act, error or omission occurring after October 2006.

The court rejected the law firm's theory that the claim at issue comprised the entire malpractice lawsuit and that the success of that lawsuit depended on some post-October 2006 acts to toll the statute of limitations. The court determined that, "[a]s a factual matter, no post-October 2006 act, error or omission was necessary to the tolling of the statute of limitations," and "[a]s a legal matter, it is clear that under the New York law that governed the malpractice lawsuit that acts tolling the statute of limitations do not affect the date of accrual of the cause of action itself."

Significantly, given the context of the dispute, the court interpreted "claim" through the lens of the insurer's duty to indemnify. The court observed that the term "claim" appeared in an endorsement discussing the insurer's duty to indemnify the insured and that the policy only covered claims that resulted from rendering or failing to render professional services. From these other provisions in the policy, the court determined that "claim" in this context was narrower than a lawsuit for compensatory damages, even though the policy defined "claim" to mean a "lawsuit served upon the insured seeking damages." Instead, the court reasoned that a claim must mean a cause of action obligating the insurer to pay damages covered by the policy. The court determined that if it applied the policy's definition of "claim" literally and in isolation from the rest of the policy's provisions, such a broad definition would "sweep in all theories of recovery alleged within a lawsuit, even if some of those theories were clearly outside of the policy's coverage and would have no effect on [the insurer's] indemnification liability."

This case also adds to a line of authority holding that when examining whether a claim arose out of an act error, or omission after a specified prior acts date, the critical inquiry concerns when the elements "necessary for accrual of the ... cause of action were present." The court rejected the defendants' argument that the continuation of the attorney-client relationship after the point at which the firm's errors could not be rectified meant that the claim arose out of a post-October 2006 act. The court instead held that it was "completely tangential" that the existence of an ongoing attorney-client relationship or the law firm's concealment of the

error might have tolled the statute of limitations. Instead, the coverage analysis turned on whether the elements needed to create the cause of action were present before the prior acts date.

Interestingly, the court noted in passing its view that the policy was "ambiguous as to which liability limitation applies to a claim that arises out of acts occurring both before and after Oct. 25, 2006." The court suggested that the insurer might have written the policy "to exclude the higher coverage for claims falling into both periods," but that it did not do so. While it was not relevant here because the court found that the claim arose solely out of acts, errors and omissions occurring before the prior acts date, the court's observation serves as a reminder that distinctions in policy language can be material.

Finally, this case provided the Eastern District the opportunity to apply a recent Virginia Supreme Court interpretation of the phrase "arising out of." The court observed that the parties had each relied on federal district court authority applying Virginia law that had defined the phrase to mean "originating from," "having its origin in," "growing out of," "flowing from," or "incident to or having connection with." However, the court looked instead to subsequent Virginia Supreme Court authority holding that liability "does not arise out of something 'incidental' to the cause of action." In light of that authority, the Protostorm court required a "causal connection between a particular fact or source of law and an essential element of the cause of action alleged." Thus, while "arising out of" continues to have a "broad meaning" under Virginia law, courts will likely ask, as the court did in Protostorm, whether there is a "sufficient nexus" between an insured's liability and excluded conduct to limit coverage. The Doctors Co. v. Women's Healthcare Associates Inc., 740 S.E.2d 523, 527 (Va. 2013).