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ALERT

Prior Knowledge Exclusions in E&O Insurance Policies: What Does 'Knowledge' Really Mean?

By Diana Shafter Gliedman and Nicholas Maxwell

Errors and omissions (E&O) professional liability insurance exists to protect against malpractice claims. But when such a claim lands, policyholders sometimes get a rude surprise when the insurance company's coverage determination arrives. Nearly all E&O policies and applications include a condition or exclusion barring coverage for claims arising from facts the policyholder knew of prior to the inception of the policy, but did not disclose.

The patchwork of case law around the country concerning what triggers a prior knowledge condition demonstrates that assessing what the policyholder "knew" is more nuanced than it might seem. In some cases, a policyholder might have known of the facts that eventually gave rise to a claim, but may still be able to show that a reasonable person would not have expected those facts to lead to a claim. In other cases, a policyholder does not have actual knowledge of the facts that led to a claim, but loses coverage anyway on the basis that any reasonable person would have discovered the facts and understood that they could lead to a claim.

Recent Development in New Jersey

On May 1, 2018, the New Jersey Appellate Division weighed in on this issue in *Ironshore Indemnity, Inc. v. Pappas & Wolf, LLC*, an insurance coverage action arising from an underlying legal malpractice suit.[1] The policyholder law firm stated in its insurance application that it was unaware of any potential claims against it, but the firm was subsequently sued based on pre-policy conduct arising from its representation of a client accused of securities fraud. The partner in question claimed he did not realize the representation in question could lead to a claim and therefore New Jersey's "subjective standard" for assessing prior knowledge protected him against Ironshore's prior knowledge coverage denial.

The Appellate Division disagreed and affirmed the trial court's award of summary judgment to Ironshore, clarifying that the "subjective intent" emphasized in prior New Jersey cases "may not be controlling when the undisputed facts reveal otherwise." In so doing, the Appellate Division has clarified that rather than being purely focused on the policyholder's subjective knowledge, New Jersey law is more akin to — and

ANDERSON KILL
1251 Avenue of the Americas
New York, NY 10020
(212) 278-1000

ANDERSON KILL
1760 Market Street, Suite 600
Philadelphia, PA 19103
(267) 216-2700

ANDERSON KILL
1055 Washington Boulevard, Suite 510
Stamford, CT 06901
(203) 388-7950

ANDERSON KILL
1717 Pennsylvania Avenue, Suite 200
Washington, DC 20006
(202) 416-6500

ANDERSON KILL
One Gateway Center, Suite 1510
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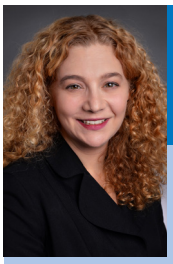
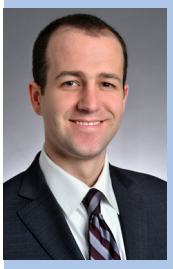
Los Angeles, CA 90071
(213) 943-1444

www.andersonkill.com



who's who

Diana Shafter Gliedman is a shareholder in Anderson Kill's New York office. Ms. Gliedman represents policyholders in actions ranging from small insurance coverage disputes to multi-party, multi-issue insurance coverage litigations. Ms. Gliedman often counsels professional firms and organizations seeking to analyze potential sources of insurance coverage and maximize insurance recovery when faced with liabilities arising from professional practice. She is chair of the firm's professional liability group and co-chair of the firm's hospitality group.
dgliedman@andersonkill.com
(212) 278-1036



Nicholas R. Maxwell is an attorney at Anderson Kill whose practice concentrates in corporate and commercial litigation, insurance recovery, exclusively on behalf of policyholders, and in environmental and employment law. He is admitted to the New York and New Jersey Bars. He is co-chair of the firm's Professional Liability Group.
nmaxwell@andersonkill.com
(212) 278-1161

possibly stricter than — the hybrid subjective-objective standard for analyzing prior knowledge used in many other states, including New York and Pennsylvania.[2] Under these hybrid standards, courts typically ask whether the policyholder had subjective knowledge of particular facts and, if it did, whether a reasonable person would have anticipated that those facts could lead to a claim. The *Pappas & Wolf* court, quoting an earlier case, explained that the policyholder's recitation of its subjective intent may be "less than controlling," and that a judge may "conclude, from the circumstances of the act," what the policyholder really intended. In the future, insurance companies may use this language to suggest that the subjective first prong in the subjective-objective test can be overridden.

Conclusion

As the *Pappas & Wolf* case should make clear, prior knowledge conditions can be a minefield for law firms and other unwary E&O policyholders. Since there is always the possibility of evidence suggesting that attorneys knew or *should have known* of key facts that could potentially lead to a malpractice claim, E&O insurance companies frequently raise the prior knowledge condition or exclusion. Policyholders should negotiate for clear and narrow policy language and ensure that their attorneys are regularly required to identify and disclose any facts that might lead to a claim down the road.

ENDNOTES

1 *No. A-0959-16T1, 2018 N.J. Super. Unpub. LEXIS 1010 (Super. Ct. App. Div. May 1, 2018).*

2 Liberty Ins. Underwriters Inc. v. Corpina Piergrossi Overzat & Klar LLP, *78 A.D.3d 602 (N.Y. App. Div. 1st Dep't 2010) (Court "must first consider the subjective knowledge of the insured and then the objective understanding of a reasonable attorney with that knowledge");* Selko v. Home Ins. Co., *139 F.3d 146, 151 (3d Cir. 1998) (Court must determine "whether the insured was subjectively aware of facts that would have led a reasonable attorney to believe that he had breached a professional duty.").*