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Don't Get Second Guessed:
The Known Prior Acts Exclusion

William G. Passannante
John P. Gaisor

Like many conditions and exclusions buried in the fine print of a liability insurance policy, the Known Prior Acts exclusion is a provision most policyholders probably know nothing about until their insurance company uses it to deny a claim. With the Known Prior Acts exclusion, this situation is even more likely given that the exclusion has little to do with knowledge of prior "acts."

One version of the exclusion states:

> **Known prior acts.** The insurance company will not cover claims or suits:
> - made or brought against the policyholder;
> - that the policyholder knew about; or
> - that the policyholder could have foreseen or discovered in a reasonable way;
> - prior to the effective date of this agreement.
>
> And, if this agreement is a renewal, the effective date is that of the earliest preceding agreement from which we have continuously provided the protection provided by this agreement.

Curiously, it is a "claim or suit" which is addressed in the Known Prior Acts exclusion, not the act which leads to a claim or suit.

The "Post-Loss Underwriting" Exclusion

Aside from its misleading title, insurance companies argue that the exclusion has a stealth-like capacity to destroy coverage. Consider the situation where one company acquires another and asks to have the new company added to its current insurance program. The acquiring company performs what it considers to be a thorough due diligence inquiry and, satisfied that the new company is not hiding any potential claims or suits, buys the new company. The acquiring company then asks its insurance company to add the new company to its existing, claims-made insurance policy. The insurance company might, with nonexistent or minimal underwriting, add the new company.

When, however, a significant claim comes in, the insurance company claims adjuster can search far and wide to find *any* facts which indicate that the newly acquired company could have foreseen the claim would be made prior to the date of acquisition. The insurance company, with the benefit of hindsight, might try to add its own spin to the facts to convince itself—the policyholder and a jury—that the claim was "bound" to be made. The exclusion almost is an open invitation for insurance companies to engage in "post-loss underwriting," that is, the practice of foregoing any serious underwriting investigation of a policyholder or its acquisitions until after a claim has been made.

Trumping The Known Prior Acts Exclusion—Continuous Coverage To The Rescue

One policyholder recently persuaded a Minnesota federal district court that this game of "who knew what, and when did they know it" was not necessary under the Known Prior Acts exclusion. Recently, in *St. Paul Fire & Marine v. MetPath*, the policyholder relied upon the final clause of the exclusion to save coverage for an entity newly added to its insurance policy. MetPath first bought insurance from St. Paul in 1989. Approximately five years later, MetPath merged with a Maryland laboratory. Shortly after the merger, in 1994, three malpractice lawsuits were started naming MetPath and the Maryland lab as defendants. The suits were based on

alleged misdiagnoses made by the Maryland lab in the early 1990's, several years before the acquisition by MetPath.

St. Paul initially agreed to defend the claims. Some time later, after gathering facts about the claims, St. Paul denied coverage and bought a declaratory judgment action, based on the Known Prior Acts exclusion. St. Paul asserted that the Maryland lab knew or should have known, before it was included as an insured under the insurance policy sold to MetPath, that the three suits would be brought.

Policyholder's Common Sense Versus Insurance Company View

MetPath countered that the exclusion only addresses claims that a policyholder knows about "*prior* to the *effective date* of *this agreement*." The exclusion also says that, "if this agreement is a *renewal*, the *effective date* is that of the earliest preceding agreement from which we have continuously provided the protection provided by this agreement."

Having purchased and renewed insurance coverage from St. Paul continuously since 1989, MetPath asserted that the exclusion plainly could not apply to claims based on diagnoses which were made several years later.

St. Paul did not agree with MetPath's common sense reading of the exclusion. St. Paul asserted that the policy in effect in 1994 was not a "renewal" of coverage as far as the Maryland lab was concerned. According to St. Paul, the first time that the Maryland lab obtained the benefits of "the protection provided by this agreement" was on the date in 1994 when St. Paul sold an endorsement adding the Maryland lab to the MetPath insurance policy. It was this "agreement," the Policy Change Endorsement adding the Maryland lab, that St. Paul argued must be referred to when considering the Known Prior Acts exclusion. Under this interpretation, each time MetPath acquired a new laboratory, that new laboratory would have a different "effective date" under the St. Paul insurance policy. In effect, each entity under the MetPath insurance program would have a different "agreement" with St. Paul for the purpose of the Known Prior Acts.

Insurance Company Faces Consequences

When the issue was presented to the Minnesota United States District Court, the court found that the Known Prior Acts exclusion did not provide for or anticipate the situation where a policyholder which had received continuous insurance protection adds another entity to the policy coverage. Observing that none of the relevant terms in exclusion are defined, the court reasoned as follows:

> Under St. Paul's definition, the Known Prior Acts exclusion has different "effective dates" for every new entity that was added to the Policy, and the term "this agreement" in the exclusion refers to the individual endorsements adding each of these entities to the Policy. Nothing in the language of either the Policy as a whole, the Policy Change Endorsement, or the Known Prior Acts exclusion, however, would lead an insured to believe that these terms have different meanings for each company on the Policy. The Known Prior Acts exclusion speaks of "this Agreement," not "these Agreements." Moreover, the term "this Agreement" appears numerous times throughout the Policy, and there is no indication that it has multiple meanings, at times referring to the Policy itself and at other times referring to the Policy Change Endorsement.

The court went on to declare that MetPath was entitled to coverage because the insurance company "had a duty to define [the terms 'this agreement'] if it intended for them to have multiple meanings." Quoting from another Minnesota decision, "[t]he insurer drafted this policy. It had the opportunity to clearly identify coverage and exclusions. It did not do so. Thus, it must bear the consequences."

Conclusion

Policyholders are well advised to find out if their claims-made insurance policy contains a Known Prior Acts exclusion. Even if you have purchased "retroactive" or "tail" coverage by means of a costly endorsement, insurance companies may attempt to deny coverage for suits arising from earlier acts by means of the Known Prior Acts exclusion. MetPath managed to persuade one court that the exclusion was ambiguous in the context of a merger or acquisition. Ask your broker or insurance company what you can do to guarantee that the seamless coverage you look for when your company merges with or

acquires another company is not lost by means of the stealthy Known Prior Acts exclusion. ■

WILLIAM G. PASSANNANTE AND JOHN P. GASIOR ARE PARTNERS IN ANDERSON KILL & OLICK'S NEW YORK OFFICE, AND REPRESENTED THE POLICYHOLDER IN THE METPATH CASE. MR. PASSANNANTE CAN BE REACHED AT (212) 278-1328 OR AT **wpassannante@andersonkill.com** MR. GAISOR CAN BE REACHED AT (212) 278-1368 OR AT **jgasior@andersonkill.com**