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ALERT

Prior Knowledge Condition Not Met Where Law Firm Had Pre-Policy-Inception Knowledge that its Failure to Appear Resulted in an Adverse Judgment

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Applying Ohio law, the United States Court of Appeals for the Sixth Circuit has held that the prior knowledge provision in a professional liability policy was not met where the insured law firm knew, before the policy's inception, that the firm's failure to appear at a trial had resulted in an adverse judgment against its client and therefore could "reasonably foresee" that its error "might reasonably be expected" to be the basis of a claim. *Schwartz Manes Ruby & Slovin, L.P.A. v. Monitor Liab. Mgrs., LLC*, 2012 WL 2161640 (6th Cir. June 15, 2012).

The underlying action arose from the law firm's alleged negligence in connection with its representation of a client in a property dispute, particularly its failure to appear at a 2005 trial, which resulted in the entry of an adverse judgment in 2006. On June 15, 2008, the client's new counsel informed the law firm that its file for the matter contained documentation that it had been notified of the 2005 trial date. After undertaking an internal investigation, the law firm notified its insurance agent on July 10, 2008 that the client might assert a malpractice claim. On July 24, 2008, the law firm obtained a professional liability policy from the insurer for the policy period of June 29, 2008 to June 29, 2009. After the client filed suit in January 2009, the insurer initially provided a defense under a reservation of rights but later denied coverage based on the policy's prior knowledge provision. This provision made it a condition precedent to coverage that the law firm, prior to the policy's inception, "did not know, or could not reasonably foresee that [the Wrongful Act giving rise to the Claim] might reasonably be expected to be the basis of a

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Claim." In the ensuing coverage litigation, the district court granted summary judgment in favor of the insurer, holding that the prior knowledge provision unambiguously bars coverage.

On appeal, the Sixth Circuit affirmed. The court noted that the "plain language" of the policy "employs a mixed subjective-objective analysis" to determine whether the prior knowledge provision has been met, looking first to the law firm's subjective knowledge of the facts giving rise to the claim and then objectively determining whether a reasonable law firm could "reasonably foresee" that these facts might "reasonably be expected" to give rise to a claim. The court acknowledged the holding of a federal district court applying Ohio law that the "reasonably be expected" language is ambiguous as to whether it requires an insured to report *any possibility* of a claim or only those claims that are *reasonably probable*. Based on the facts here, however, the court declined to reach the issue of ambiguity because, even under the interpretation more favorable to the law firm, "a reasonable insured would have expected a malpractice claim . . . to be reasonably probable" given that the law firm knew that (i) it was counsel of record for its client in the property dispute; (ii) it had failed to appear at a scheduled trial; (iii) its failure to appear resulted in an adverse judgment; and (iv) the client had retained new counsel.

The court also rejected the law firm's alternative argument that the policy affords coverage for the client's claims involving the law firm's failure to research and to perform work on the client's behalf because it could not have reasonably foreseen anything other than those claims related to its failure to appear. The court held that the other claims cannot "be divorced" from the firm's alleged failure to appear and therefore fall squarely within the broad definition of "Related Wrongful Acts," such that there is no coverage for the entirety of the client's lawsuit.

The opinion is available here.