

## **Seventh Circuit Decision in *Koransky Bower* Enforces Professional Liability Reporting Requirements**

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Earlier this month, the 7th Circuit affirmed a district court order that held an insurer properly denied coverage to the insured law firm based on its failure to comply with the reporting requirements under its claims-made professional liability policy. *Koransky, Bower & Poracky, P.C. v. The Bar Plan Mutual Insurance Co.*, No. 12-1579, 2013 U.S. App. LEXIS 6558 (7<sup>th</sup> Cir. Apr. 2, 2013). This decision cautions lawyers to consider carefully the circumstances in which the provision of legal services may give rise to a claim for legal malpractice.

The underlying litigation arose out of the law firm's representation of a potential buyer in the purchase of a Rite Aid drugstore in Ohio. The law firm of Koransky Bower drafted and executed a sales contract on behalf of the buyer and sent the seller's counsel a copy of the agreed-upon contract. The seller executed and returned the contract on January 31, 2007, and the buyer executed the contract on February 9, 2007. On February 11, 2007, the seller's counsel inquired about the status of the contract. The law firm advised that the contract was executed. In fact, Koransky Bower had inadvertently misfiled the contract and failed to deliver it to the seller.

Shortly thereafter, counsel for the seller advised the law firm that the contract was not properly executed and the seller had decided to rescind its signature and declare the contract null and void. On February 23, 2007, an associate at Koransky Bower sent an email to the seller's counsel advising of the error and apologizing, stating "[t]his whole situation is my fault and not the fault of my client." Despite the law firm's request that the seller withdraw the cancellation, the seller confirmed its decision to rescind the offer. In March 2007, the seller and the buyer filed competing actions in different venues seeking declarations regarding the validity of the contract. An Alabama

court ultimately ruled in favor of the seller and held that the contract was never formed.

Meanwhile, on March 10, 2007, Koransky Bower submitted its application for renewal of its professional liability coverage. In relevant part, the application inquired: "Does the firm or any attorney or employee in the firm have knowledge of any incident, circumstance, act or omission, which may give rise to a claim not previously reported to us?" The law firm answered in the negative. Koransky Bower also affirmed that its representations were true and agreed to notify the insurer of material changes prior to the renewal policy's April 15, 2007 inception date. In reliance on the representations in the application, the insurer issued a renewal policy. The policy required the insured to provide notice during the policy period in which the insured first became aware of any act or omission that may give rise to a claim. The policy also contained a prior knowledge exclusion. Koransky Bower did not disclose its knowledge of its error or the pending lawsuit between the buyer and seller that could (and ultimately did) give rise to a malpractice action against the law firm.

Koransky Bower tendered the suit to its insurer after it received a formal notice of claim on August 28, 2007. The insurer sought rescission based on the fact that Koransky Bower did not disclose the incident on the application for insurance. In the alternative, the insurer denied coverage on the basis that the insured failed to comply with the policy's reporting requirements. The insurer claimed that Koransky Bower became aware of the facts underlying the claim during the prior policy period, in February 2007. The insurer further claimed that the policy's prior knowledge exclusion applied to bar coverage.

In the ensuing coverage litigation, Koransky Bower argued it was entitled to coverage because it provided notice when the claim was made and notified the insurer as soon as it had reason to believe its error might result in a claim. Koransky Bower further noted that even if its notice was untimely, the insurer did not suffer any prejudice. In response, the insurer sought rescission and a declaration that it had no duty to defend or indemnify.

The district court granted summary judgment in favor of the insurer. The 7th Circuit affirmed on appeal and held that the obligation to provide notice under a claims-made policy arises not when the claim is filed, but when the insured becomes aware of an act or omission that “may give rise to a claim” under the policy. The court further stated that under a claims-made policy, the notice requirement operates as a condition precedent to coverage that “defines the limits of the insurer’s obligation.” *Id.* at \*14 (internal citations omitted).

The court held that prior to the policy period, Koransky Bower had knowledge of an act or omission that may be the basis of a malpractice claim. The court explained it was immaterial whether such knowledge arose in February, when Koransky Bower acknowledged the error, or in March, when the buyer and seller sought declarations regarding the validity of the contract. Insofar as the court held that the coverage defenses

barred coverage, the court declined to address the merits of the rescission argument and confirmed that prejudice is not required in the claims-made context.

The court acknowledged the risk – as set forth by the law firm – that its holding would impose a burdensome notice requirement because it will encourage any insured law firm to report every error, no matter how trivial, in order to avoid jeopardizing its professional liability coverage. Despite the potential broad application of its decision, the court explained that this “case is not a close one” and a “reasonable attorney in Koransky & Bower’s position would realize that his client might bring a malpractice claim against him because, as a result of the attorney’s mistake, Seller was refusing to complete the negotiated sale.” *Id.* at \*17-18. In an environment that is litigious by nature, this case highlights the need for lawyers and law firms to identify and evaluate potential risks and determine the point at which notice to an insurer is necessary.

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*To discuss any questions you may have regarding the issues discussed in this Alert, or how they may apply to your particular circumstances, please contact Abby J. Sher at 215.665.2761 or [asher@cozen.com](mailto:asher@cozen.com).*