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BEWARE OF THE PRIOR KNOWLEDGE PROVISION: A COMMENT ON *BRYAN BROTHERS, INC. V. CONTINENTAL CASUALTY CO.*

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In the hope of spreading the risk of loss, insurance has become a must for today's businesses. This is no less true for professionals, such as medical practitioners, attorneys, and accountants. Thus, many businesses today will acquire what is known as a professional liability policy to protect against unknown claims. However, imagine if someone employed by such a business, even a lower level employee, had knowledge of prior acts that might give rise to a claim under a professional liability policy. Would this completely preclude coverage under the policy and leave the insured to bear the costs of defending the action and paying a judgment? The United States Court of Appeals for the Fourth Circuit has recently addressed this question.

Last year, in *Bryan Brothers, Inc. v. Continental Casualty Co.*,[1] the United States Court of Appeals for the Fourth Circuit upheld a Virginia district court's decision that the prior knowledge provision in a professional liability insurance policy was an unambiguous condition precedent to coverage.[2] In that case, after third parties brought claims against Bryan Brothers, Inc. (Bryan Brothers) based on allegations of theft by an account clerk, Bryan Brothers sought coverage under a professional liability insurance policy issued by Continental Casualty Company (Continental).[3] After Continental denied coverage based on a prior knowledge provision included in the policy, Bryan Brothers brought a lawsuit that eventually led to this Fourth Circuit appeal.[4]

As with most insurance coverage disputes, this case begins and ends with the insurance policy and the provisions included therein. Here, Continental issued a professional liability insurance policy with effective dates of July 1, 2008, to July 1, 2009 to Bryan Brothers, an accounting firm.[5] Among others, the policy contained three provisions that later became the center of the Fourth Circuit's decision in the case: a prior knowledge provision,[6] bad acts

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1. 660 F.3d 827 (4th Cir. 2011).

2. *Id.* at 829–30, 832–33 (citing Bryan Bros., Inc. v. Cont'l Cas. Co., 704 F. Supp. 2d 537, 542 (E.D. Va. 2010)).

3. *Id.* at 829.

4. *Id.*

5. *Id.* at 828.

6. *Id.* at 828. The prior knowledge provision stated that coverage will be triggered "provided that . . . prior to the effective date of this policy, none of you had a basis to believe that any such act or omission . . . might reasonably be expected to be the basis of a claim." *Id.* Additionally, it is important to note that the policy broadly defined "you" as the named insured and "any person who is or becomes a partner, officer, director, associate, or employee of the named insured." *Id.* at 829 (internal quotation marks omitted).

exclusion,[7] and an innocent insureds provision.[8] After Continental issued the policy, Bryan Brothers discovered that one of its account clerks, Deborah Whitworth, had stolen funds from multiple client accounts.[9] The theft began in 2002 and ended sometime after Continental issued the policy.[10]

As a result of the theft, the victim-clients brought suit against Bryan Brothers.[11] When Bryan Brothers sought coverage under its professional liability policy, Continental denied Bryan Brothers' claim "under the prior knowledge provision because Whitworth had reason to believe, before the effective date of the policy, that her thefts might become the basis for claims."[12] Bryan Brothers subsequently settled with the victim-clients and brought suit against Continental for coverage under the policy.[13]

While in district court, the parties filed cross-motions for summary judgment.[14] Continental "argued that the prior knowledge provision was a condition precedent that precluded coverage if unfulfilled."[15] Conversely, Bryan Brothers argued that the prior knowledge provision was merely an exclusion and that "the innocent insureds provision saved coverage for any insured other than Whitworth."[16] The district court granted Continental's motion for summary judgment based on the account clerk's knowledge, and Bryan Brothers appealed the decision to the Fourth Circuit.[17]

On appeal, both parties maintained the same arguments that they put forth in the district court.[18] The Fourth Circuit reached the same conclusion as the district court, holding that the prior knowledge provision conditioned policy coverage.[19]

In its opinion, the Fourth Circuit adhered to the basics of contract interpretation. After an analysis of the plain language of the policy, the court

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7. *Id.* at 828. The bad acts exclusion was located under the heading "Exclusions" and stated that the policy did not apply to "any claim based on or arising out of a dishonest, illegal, fraudulent, criminal or malicious act by any of you." *Id.*

8. *Id.* at 828–29. The innocent insureds provision stated that:

> If coverage under this Policy would be excluded as a result of any criminal, dishonest, illegal, fraudulent, or malicious acts of any of you, we agree that the insurance coverage that would otherwise be afforded under this Policy will continue to apply to any of you who did not personally commit, have knowledge of, or participate in such criminal, dishonest, illegal, fraudulent or malicious acts or in the concealment thereof from us.

Id. at 829.

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.* (citing Bryan Bros., Inc. v. Cont'l Cas. Co., 704 F. Supp. 2d 537, 540 (E.D. Va. 2010)).

16. *Id.* (citing *Bryan Bros.*, 704 F. Supp. 2d at 540).

17. *Id.* at 829–30.

18. *See id.* at 830.

19. *Id.* at 832.

found that the language and structure of the policy was evidence "that the prior knowledge provision [was] a condition precedent to coverage."[20] Furthermore, the court noted that their interpretation comports "with the concept of fortuity, a fundamental premise of insurance law."[21] Specifically, the court stated that "[i]nsurers do not usually contract to cover preexisting risks and liabilities known by the insured."[22] Thus, in this policy, "the prior knowledge provision essentially [made] fortuity a condition of coverage."[23]

The court then took up Bryan Brothers' argument that coverage existed for all but Whitworth because the innocent insureds provision was an exception to the prior knowledge provision.[24] To address this point of view, the court looked to yet another basic of policy interpretation, stating that "it is elemental that exclusions and exceptions in an insurance policy cannot expand the scope of agreed coverage . . . . Therefore, the innocent insureds provision [could not] provide coverage that [was] precluded by the plain language of the prior knowledge provision."[25]

Based on this reasoning, the Fourth Circuit held "that the prior knowledge provision is a clear and unambiguous condition precedent to recovery on the policy" and that "[b]ecause Whitworth had prior knowledge of her thefts, a condition precedent was unfulfilled, and the coverage agreement was not triggered."[26] In short, there was no coverage under the policy, extinguishing Bryan Brothers' hope of spreading the loss.

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20. *Id.* at 830. Specifically, the court discussed the fact that Continental's agreement to provide coverage and the prior knowledge provision were linked by the phrase "provided that." *Id.* at 830–31 (internal quotation marks omitted). The court further stated that the language may be rephrased to state that "if any defined 'you' knew prior to the effective date of the policy that an act or omission might become the basis for a claim, any claims arising from such acts or omissions are not covered." *Id.* at 831.

21. *Id.* "Fortuitous has been defined as 'occurring by chance without evident causal need or relation or without deliberate intention.'" Ins. Co. of N. Am. v. U.S. Gypsum Co., 678 F. Supp. 138, 141 (W.D. Va. 1988) (quoting WEBSTER'S THIRD INTERNATIONAL DICTIONARY, 895 (1961)), *aff'd*, 870 F.2d 148 (4th Cir. 1989); *see also* BLACK'S LAW DICTIONARY 725 (9th ed. 2009) ("Occurring by chance."). "The underlying principle of the fortuity doctrine is public policy: it would encourage fraud to allow recovery on an insurance loss which is certain to occur." *Gypsum*, 678 F. Supp. at 141 (citing Compagnie des Bauxites de Guinee v. Ins. Co. of N. Am., 554 F. Supp. 1080, 1085 (W.D. Pa.), *rev'd*, 724 F.2d 369 (3d Cir. 1983)).

22. *Bryan Bros.*, 660 F.3d at 831.

23. *Id.*

24. *See id.*

25. *Id.* Furthermore, the court explains that the innocent insureds provision was not implicated because it is an exception to the bad acts exclusion and coverage was not denied on that basis. *Id.*

26. *Id.* at 832. To further support this holding, the court cites to case law with a very similar fact pattern. *Id.* ("[C]overage exists only if this [prior knowledge] *precondition* is met, and is denied if *anyone* meeting the definition of 'you' has knowledge of what reasonably might be a potential claim." (second alteration in original) (quoting Prof'l Asset Strategies, LLC v. Cont'l Cas. Co., No. 2:09-cv-1238-AKK, 2010 WL 4284991, at *5 (N.D. Ala. Aug. 27, 2010), *aff'd*, 447 F.App'x. 97 (11th Cir. 2011)) (internal quotation marks omitted)).

In *Bryan Brothers*, it was not a unique legal theory or convoluted set of facts that led to the Fourth Circuit's ruling. Instead, this case exhibits both facts and law that are fairly simplistic and the court treats it as so. Indeed, with the Fourth Circuit's use of such basic principles as conditions precedent and fortuity, it was the basics of insurance law that cost Bryan Brothers dearly.

Furthermore, not only did the case involve the application of established legal theories, but the prior knowledge decision that the Fourth Circuit faced was far from a novel issue. It is not out of the ordinary to see prior knowledge exclusions in professional liability policies; in fact, that type of provision is quite commonplace.[27] The reasoning is simple—insurance carriers don't enjoy paying for a loss known by the insured prior to contracting for coverage.[28]

As a result of the basic legal canons used in this case, and the lack of a unique issue, a reader may not find much value in such a straightforward opinion. However, even though this case was decided on core legal principles, it is important not to brush this opinion aside as merely inconsequential. Instead, this case must be remembered for its pragmatic value. Specifically, *Bryan Brothers* should serve as a wakeup call to those who claim the protection of their professional liability insurance policies. Those policyholders must realize that this prior knowledge issue has been litigated in the past, resulting in business owners facing lawsuits without the benefit of coverage.

In fact, as a result of insurance carriers blanket use of such provisions, litigation involving prior knowledge exclusions is prevalent throughout the United States, and has been for some time.[29] The Fourth Circuit itself has decided such a case as recently as 2006.[30] Not surprisingly, these cases come to the same seemingly obvious conclusion: if you knew prior to the effective date of the policy that an act or omission might become the basis for a claim, any claims arising from such acts or omissions are not covered.[31]

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27. Cohen-Esrey Real Estate Servs. v. Twin City Fire Ins. Co., 636 F.3d 1300, 1303 (10th Cir. 2011) ("[P]rior-knowledge conditions are common in claims-made policies because they 'ensure that only risks of unknown loss are potentially incurred' and prevent an insured from 'obtain[ing] coverage for the risk of a known loss,' which would be unfair to the insurer." (quoting Am. Special Risk Mgmt. Corp. v. Cahow, 192 P.3d 614, 621–22 (Kan. 2008))).

28. The often stated reason for inclusion of such a provision is fortuity, a concept addressed directly by the Fourth Circuit. *See supra* notes 21–23 and accompanying text.

29. *See, e.g.*, Prof'l Asset Strategies, LLC v. Cont'l Cas. Co., 447 F. App'x 97, 98–99 (11th Cir. 2011) (case involving a prior knowledge provision in a professional liability insurance policy); Axis Ins. Co. v. Farah & Farah, P.A., No. 3:10 cv 393 J 37JBT, 2011 WL 5510063, at *5 (M.D. Fla. Nov. 10, 2011) (same); Cont'l Cas. Co. v. Jones, No. 3:09 cv 1004 JFA, 2011 WL 3880963, at *6 (D.S.C. Sept. 2, 2011) (same); Lawyers Prof'l Liability Ins. Co. v. Dolan, Fertig & Curtis, 524 So. 2d 677, 678 (Fla. Dist. Ct. App. 1988) (same).

30. Westport Ins. Corp. v. Albert, 208 F. App'x 222, 226 (4th Cir. 2006) (holding that the prior knowledge exclusion included in the policy prohibited coverage for the malpractice action filed where an "accountant [was] on notice that a malpractice suit was forthcoming").

31. *E.g.*, *Axis*, 2011 WL 5510063, at *8 ("Courts routinely affirm the denial of coverage where an insurance policy contains an unambiguous prior knowledge provision and where an insured has knowledge, prior to the effective date of the policy, of acts or omissions that might reasonably provide the basis for a claim.").

One may question why litigation is so rampant when precedent is against the insured and when the inclusion of a prior knowledge provision in the policy seems equitable on the part of the insurance carrier. Indeed, it seems axiomatic that an insurer carrier should not pay for a loss that was known to the insured prior to him or her signing the policy.[32] However, when one looks more closely at professional liability claim statistics, the reason for going through a lengthy litigation process becomes clear: the stakes are high. Indeed, two things are apparent about professional liability claims: (1) they are expensive, and (2) the amount of claims filed is on the rise.

Today, "[p]rofessional liability insurance claims can turn disastrous and be very expensive, especially when there is conduct that involves fraud, conversion, or intentional acts that draw a negative reaction."[33] For example, in the nursing profession, according to a study by insurance carrier CNA, "[t]he average total paid per claim is generally over $200,000."[34] However, the amount that carriers must pay out for professional liability claims is eclipsed only by the amount of claims asserted each year. In 2011 alone, professional liability claims were up by as much as 20 percent at some of the leading insurance companies providing coverage for this type of exposure.[35] Although caused by a myriad of factors, the recent economic recession and prolonged real estate market slump could be primarily to blame for the rise in the number of professional liability claims, especially those asserted against law firms.[36]

So with a rise in the amount of claims asserted and average payout on each claim, it becomes easier to understand why a policyholder would want to fight for coverage, even in the face of established case law against him or her. However, with the opinions issued after *Bryan Brothers* reaching the same

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32. *Prof'l Asset Strategies*, 447 F. App'x at 100 (stating that the carrier "had the right to so limit its liability" through a prior knowledge provision).

33. Denise Johnson, *Issues in Handling Professional Liability Claims*, CLAIMS JOURNAL (Nov. 14, 2011), http://www.claimsjournal.com/news/national/2011/11/14/195001.htm.

34. *Nursing Claims Costs Rise Again After Falling*, CLAIMS JOURNAL (Dec. 20, 2011), http://www.claimsjournal.com/news/national/2011/12/20/197299.htm. This number had dropped to $150,000 in 2009, but is quickly rising to its highest ever. *Id.*

35. *Survey: Law Firms Face Rising Number of Malpractice Claims*, INSURANCE JOURNAL (June 30, 2011), http://www.insurancejournal.com/news/national/2011/06/30/204635.htm; *see also* Pat Speer, *Hospital Injury Commercial Claims Up*, INSURANCE NETWORKING NEWS (Jan. 13, 2012), http://www.insurancenetworking.com/news/Claims-zurich-hopsital-frequency-severity-29725-1.html ("There has been a rise in the hospital industry's professional liability claims frequency and severity, according to a new benchmarking report on professional liability claims trends in the hospital industry."). It is important to note that not all claims result in damage payments. For example, commentators suggest that about 43% of malpractice claims result in payment of some compensation to the patient. FRANK G. FEELEY & WENDY K. MARINER, BOSTON UNIVERSITY SCHOOL OF HEALTH, BASIC ELEMENTS OF THE LEGAL SYSTEM OF PHYSICIAN LIABILITY FOR NEGLIGENT PATIENT INJURY IN THE UNITED STATES WITH COMPARISONS TO ENGLAND AND CANADA 6 (2000).

36. *See Survey: Law Firms Face Rising Number of Malpractice Claims*, *supra* note 35.

conclusion as the Fourth Circuit,[37] it appears as though the policyholders' battle against the prior knowledge provision is far from over.

In conclusion, *Bryan Brothers, Inc. v. Continental Casualty Co.* is a case to remember. Not because of a unique legal theory or landmark holding, but for the reminder that professionals everywhere may be on the hook for actions they personally did not take, but their employee did. In short, *Bryan Brothers* shows every professional that coverage may not be presumed. Thus, attorneys, physicians, and other professionals everywhere need to ask themselves one vital question: Am I covered? Because once the safety net of that professional liability coverage is gone, it is the professional's wallet that will clearly take the hit.

37. *See, e.g., Prof'l Asset Strategies*, 447 F. App'x at 100 (denying coverage based on prior knowledge provision included in the policy); Axis Ins. Co. v. Farah & Farah, P.A., No. 3:10 cv 393 J 37JBT, 2011 WL 5510063, at *9 (M.D. Fla. Nov. 10, 2011) (same); Cont'l Cas. Co. v. Jones, No. 3:09 cv 1004 JFA, 2011 WL 3880963, at *7 (D.S.C. Sept. 2, 2011) (same).