

April 2, 2007

*Donaldson*, the court held that poisoning caused by the accumulation of carbon dioxide did not fall within the pollution exclusion. Any thought that *Langone* might come out differently simply because the offending substance had one fewer oxygen molecule was wishful thinking in the extreme. In that sense, one would be hard pressed to disagree with the result, given prior controlling Wisconsin case law.

Whether the logic underlying *Donaldson*, *Peace* and *Langone* withstands scrutiny, however, is a different question. According to those decisions, carbon monoxide and carbon dioxide are not pollutants because they appear normally in the air in small quantities. Lead paint is a pollutant, by contrast, because its dangers are well known. These are all *non sequiturs*. Cigarette smoke, motor vehicle exhaust and industrial smog all appear in the atmosphere in small (and sometimes large) quantities, yet no one would dispute that they are pollutants. By contrast, the dangers of liquor and gambling are well known, but no one would call them "pollutants." Furthermore, the dangers of carbon monoxide and carbon dioxide have also been well known for a century or more: why are they then not pollutants?

What these mixed messages illustrate is that the courts are still grappling with the scope of the pollution exclusion twenty years after it supposedly became "absolute." The *Langone* case may be true to Wisconsin law, but it provides little guidance for future cases involving different types of poisonous substances. // Barnes

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## Professional Liability Insurance

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**Since the Insured Attorneys Knew of a Possible Claim When They Applied for Coverage, the Claims-Made Policy They Obtained Did Not Cover the Predictable Malpractice Suit**

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*The Insureds' Knowledge Should Be Judged under a Subjective Standard*

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*Liberty Surplus Insurance Corporation, Inc. v Nowell Amoroso, P.A.*, 189 N.J. 436, 916 A.2d 440 (N.J. 2007)

### Case at a Glance

Under New Jersey law, affidavits in which law firm's former and current attorneys merely denied their professional liability insurer's assertions about the law firm's "knowledge of any circumstance, act, error or omission that *could* result in a professional liability claim" when applying for policy did not create a genuine issue of material fact precluding summary judgment that law firm, when applying for the policy, had subjective knowledge of the dismissal of a client's case on statute of limitations grounds.

### Summary of Decision

This is an insurance declaratory relief action. It grew out of a legal malpractice action based on the insured's law firm's failure to file a case within the applicable statute of limitations. Consequently, dates are important in understanding what happened. The various cases stretch out over more than 15 years.

*Underlying Case.* A man owned a bar in East Orange New Jersey. It changed its name to "Scandals" and expanded its clientele. Scandals became a thriving club, and it posed an economic threat to a competitor club that the Director of Property Maintenance for East Orange owned in part. Its owner believed that his public-official/competitor had "used his influence to encourage the police to harass Scandals." The owner of Scandals also claimed that his competitor had persuaded yet other city agencies

to engage in "numerous unannounced inspections of his club during peak hours[.]" thereby interfering with the operation of the club. There was a substantial decline in business at Scandals over several months. The owner filed a complaint with the Internal Affairs Unit of the East Orange Policy Department. He also filed a Notice of Claim against East Orange. In the fall of 1992, Scandals closed.

At this point, the defendant-appellant law firm came on the scene. It took the Scandal's case on a contingency fee. However, it did not file a complaint against the East Orange defendants until May 23, 1994. During the discovery period of the lawsuit, the defendants failed to provide discovery. Consequently, the superior court struck their answers and defenses. There was a proof hearing, after which the trial court awarded the owners of Scandals damages of \$400,000.

The East Orange defendants appealed. Unfortunately, the plaintiffs' pleadings and proof in the underlying case might be read to mean that the causes of action "arose prior to May 22, 1992[.]" Hence, the filing of the lawsuit may have occurred outside the statute of limitations. Consequently, the appellate court reversed and remanded for judicial determination as to whether there was compliance with the limitation period. *Kolczycki v. City of E. Orange*, 722 A.2d 603 (N. J. App. 1999).

On remand, the trial court ruled that the plaintiff failed to establish any wrongful conduct after May 22, 1992. As a result, the trial court entered judgment in favor of the defendants, and it dismissed the Scandals suit, "because it was not timely filed." The owner of Scandals appealed this time, but the Appellate Division affirmed the trial court decision on June 12, 2002.

**Malpractice Insurance.** Less than one month after the Appellate Division's second decision, the law firm submitted an application for insurance to Liberty. The application was for claims-made coverage, and was made on July 15, 2002. One of the questions in the application asked whether "any lawyer to be insured under the policy [had] knowledge of any circumstance, act, error or omission that *could result* in a professional liability claim?" (Italic added.) The firm answered in the negative, and Liberty issued the firm the usual "claims-made and reported" policy. It was effective from July 21, 2002 to July 21, 2003, other things being equal.

**Law Firm Sued.** The malpractice action was filed

in June of 2003. The firm claimed coverage, but Liberty disclaimed coverage on July 21, 2003. It asserted that the firm "had a reasonable basis to believe that [it] had breached a professional duty or to foresee that a claim would be made against' it when it completed the application for claims-made insurance."

**Declaratory Relief Action.** Liberty soon filed the present declaratory judgment action. In November 2003, the parties filed cross-motions for summary judgment. In opposition to Liberty's summary judgment cross-motion, the individual attorneys at the firm filed affidavits to the effect that they had no reason to believe that there might be a malpractice action brought against them arising out of the scandal case.

**Summary Judgment Decision.** The trial court held that the first of the two appellate decisions "told" the firm that there was an error or omission that *could result* in a professional liability claim against the firm and/or some of its attorneys. The fact that the case was going back to the trial court was irrelevant. The decision of the court of appeals unequivocally indicated a danger. The subsequent decision of the trial court—that it was indeed an actual limitations problem—made the matter even clearer to the firm. The second decision of the court of appeals on June 12, 2002, hammered the point home: a claim really could result. The fact that there was a request for review going to the state supreme court was irrelevant as to whether (1) there was an error or omission that *could result* in a professional liability claim and (2) whether sensible lawyers would know this off the bat, as it were.

**Appellate Division.** The intermediate appellate court affirmed the decision of the trial court. It held that "under the unique circumstances of this case, the law firm could not have conceived that there was no reasonable basis to believe a professional duty had been breached. When there is a single, unavoidable resolution of a factual dispute, summary judgment is appropriate." In support of this view, the court of appeals had reasoned as follows:

Coverage, under the policy, was conditioned not only on foreseeing a possible malpractice claim, but also on the insured having no reasonable basis to believe that any deviation from a pertinent standard of legal care had

occurred. When a trial court and two appellate division decisions indicate that a statute of limitations has been missed, no reasonable fact-finder could conclude the firm honestly conceived that there was no plausible basis to believe that [it] had breached a professional duty.

Remember: the question in the application is not whether there actually had been any breach of a professional duty. The question was whether anyone at the firm had knowledge of anything which, roughly speaking, might result in a professional liability claim.

*New Jersey Supreme Court.* Interestingly, the New Jersey Supreme Court observed that the application question was not really the only issue. It also thought a policy condition was significant. Here is what the supreme court said: "One of those conditions was that 'the Insured had no reasonable basis to believe that the Insured had breached a professional duty or to foresee that a claim would be made against the insured.'" The court then observed, "If the insured could not satisfy that condition, the policy did not provide coverage for any claims arising from acts, errors or omissions prior to the policy."

Interestingly, the court said that subjective standards governed the issue created by the question asked in the application, but that objective standards probably governed the policy condition. Undoubtedly, it was right about this. The supreme court ignores reasoning on both sides of the difference, however, since both parties before it reasoned on the basis of the subjective standard only.

The reasoning of the supreme court regarding the subjective standard was interesting. It started from the proposition that a subjective standard was more rigorous for the insurer and therefore more difficult for it to meet. It is therefore natural that an insurer would have to use it, where there is a choice between two standards. It is also the honorable way for an insurer to proceed, since it is then taking the hard way out. In this case, however, as already mentioned, the court said, "because both parties erred that a subjective standard governs, we apply a subjective standard concerning [the law firm's] knowledge when it applied for malpractice insurance." In addition, the court "also appl[ied] the subjective standard in the application on the well-settled principle that insurance policy interpretation should

either be construed against the insurer[,] and hence in favor of the insured.

So what makes the subjective standard harder? Its difficulty arises particularly in the summary judgment context, where there is no cross-examination. Often, when a subjective standard applies, if the person whose mental state is at issue swears that his mental state was other than the law requires for the other side to win, there would be a fact issue to be decided by the jury, so summary judgment would fail. Would it not, therefore, always be extremely difficult for an insurer to win summary judgment under circumstances like this one? The answer is *No! Not always.* Sometimes, the character of an act or omissions, about which there needs to be some inferential knowledge in order to trigger non-coverage, is such that it provides the basis of a logically inevitable inference that the insured intended the injury, no matter what the insured says. When this principle applies, an actor's testimony about his subjective intent will be less than controlling. This principle was established in a now famous New Jersey case. *Morton Int'l, Inc. v. Gen. Accident Ins. Co. Am.*, 629 A.2d 895 (N.J. Super. 1991), *aff'd*, 629 A.2d 831 (N.J. 1993), *cert. denied sub. nom. Ins. Co. N. Am. v. Morton Int'l, Inc.*, 512 U.S. 1245 (1994).

That principle—or a "sibling principle"—applies to cases like this. Here it is. Sometimes the character of an act or omission performed (or not performed) by a lawyer, or the way in which the judiciary has characterized that act or omission, is such that there exists an indisputable basis for the logically inevitable and obvious inference that the insured lawyer knew he was facing a potential malpractice complaint. When evidence is strikingly "one-sided" with respect to a matter like this, an insurer should prevail as a matter of law. See *Liebling v. Garden State Indem.*, 767 A.2d 515 (App. Div.), *certif. denied*, 782 A.2d 424 (N.J. 2001) (a factually similar case).

Basically, the supreme court affirmed the courts below because "the trial court would have to ignore reality to conclude that [the law firm] did not have knowledge that a claim *might* be filed against it when faced with a trial court and two Appellate Division Decisions that [the firm] had missed the statute of limitations for [Scandal's] claim against the East Orange defendants." (Italics added.) Hence, the New Jersey Supreme Court "conclude[d] that because the evidence in the record 'is so one-sided[,] Liberty

must prevail as a matter of law.”

Under the circumstances of this case, the supreme court did not think that the granting of the motion was premature. No discovery could possibly have undone the evidentiary situation. In addition, the appellate court did not misuse its discretion by refusing to receive evidence that was not before the court below. Does the supreme court impliedly say that at least one of the lawyers who signed the affidavits under review was lying?

### Comment

The decision of the court was unanimous. Every judge who considered the matter agreed, although one judge did not participate. Clearly, the New Jersey Supreme Court has adopted at least the following as a rule of law: If there is substantial, judicial authority that a lawyer has a blown a statute of limitations, then any lawyer who knows about this situation also knows that a malpractice action against the breaching lawyer is quite possible. There is not a chance in the world that not anyone who has passed the bar will know this.

This is a strikingly sensible rule. At the same time, shouldn't a law firm be able to buy coverage for a possible claim even when it knows that there *might* well be a claim? Of course, it should. Then again, the insurer should be able to charge for this kind of coverage.

The practitioner should keep in mind at least some of the following distinctions:

What do you know will happen?

What do you believe will happen?

What do you think will happen?

What do you conjecture will happen?

What do you guess will happen?”

What do you know is likely to happen?

What do you believe is likely to happen?

What do you think is likely to happen?

What do you conjecture/guess is likely to happen?

What do you suppose/assume is likely to happen?

What do you know might happen?

What do you believe might happen?

What do you think might happen?

What do you conjecture/guess might happen?

What do you suppose/assume might happen?

What event do you know to be logically possible, i.e., conceivable without contradiction?

What event do you believe to be logically possible?

What event do you think is logically possible?

What even do you conjecture or guess to be logically possible?

In this range, what is the real meaning of the word “could”? Is there any chance that it is ambiguous? If it is, how should the policy be interpreted? // Quinn