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Tenth Circuit Applies Broad Interpretation of "Interrelated Acts" to Preclude Policyholder's Access to Aggregate Limits

Saxe Doernberger & Vita, P.C.

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The Tenth Circuit's recent broad application of Oklahoma law on "interrelated acts" creates concerning precedent for policyholders seeking to maximize coverage under a professional liability policy with per claim limits. In this regard, careful pre-loss planning and policy modifications may prevent unexpected coverage gaps and avoid surprise exposure. In addition, post-loss strategic planning may prove critical to help maximize recovery depending on the applicable state law. Affected insureds may consider retaining knowledgeable coverage counsel where their carrier is seeking to deprive them of policy limits based on interrelated acts and/or interrelated claims.

Multiple Audits, Multiple Years – Interrelated Acts?

In *American Southwest Mortgage Corp. v. Continental Casualty Co.*[1] two lending companies lost millions after relying on inaccurate reporting from an auditing company (the insured), which failed to detect that the borrower falsely represented that it had collateralized loans. The court held that the auditor's three separate audit reports of the borrower mortgage company's finances in 2014, 2015, and 2016 predicated on a failure to review source documentation to detect company fraud and amounted to "interrelated acts" under a professional liability policy. As such, the court found that only $1 million in per claim limits were available under the auditor's policy, since interrelated acts could support only one claim, notwithstanding that the policy had up to $3 million in aggregate limits and the audits were conducted in three separate years.

The court further held that multiple claims arising from any single audit year were "interrelated claims" to also limit per claim recovery to a single limit, irrespective of the number or type of claimants (here, two different lenders).

The Policy Language

The Continental Casualty policy language at issue defined "[i]nterrelated acts or omissions" as "all acts or omissions in the rendering of professional services that are logically *or* causally connected by any common fact, circumstance, situation, transaction, event, advice or decision." (Emphasis added). In looking solely at whether the audits were "logically" connected (as this was, to the court, a dispositive analysis), the court held that each audit report was logically related because the same common facts and circumstances tied the recurring negligent acts together. Namely, "[t]here was one Auditor – one who performed the same service for the same clients three times."[2] Each time, the auditor made the same error and perpetuated the same fraud scheme. The court distinguished seemingly applicable prior authority authored by now Supreme Court Justice Neil Gorsuch, where the Tenth Circuit held that an insured's negligence in structuring a corporate stock sale was not interrelated with its misrepresentations as to the release of a deed of trust.[3]

Meanwhile, the policy defined “interrelated claims” as “all claims arising out of a single act or omission or arising out of interrelated acts or omissions in the rendering of professional services.” Therefore, the court found that the claims all arose out of the same audit for each given year and were thus interrelated as well, even though there were two separate lending companies relying on the audits. The court was unconvinced that because each lender was owed a separate duty of care, this had any bearing on the fact that the conduct at issue related to the same audit.

The court determined that despite the $3 million in aggregate limits, only $1 million in per claim limits were available.

The Takeaway

This decision is concerning for policyholders insofar as one would think that an auditor performing discrete audits in separate years would constitute separate and unrelated acts. The court could easily have made available multiple per claim limits either within a single audit year and/or, at a minimum, across multiple audit years. Given this decision, companies with a similar exposure seeking to maximize per claim limits may want to explore options to incorporate manuscript policy language to limit the application of an “interrelated acts” provision. However, considerations should also be taken into account in terms of how such policy modifications could impact other aspects of coverage, such as applicable per claim self-insured retentions. Notably, the lack of potential for interrelated acts relative to a per claim self-insured retention could increase an insured’s out of pocket expenses in accessing coverage. Alternatively, policyholders should always consider a thorough examination of choice of law issues to determine if another, more favorable state’s law may apply. Retention of experienced coverage counsel may be warranted under such circumstances..

Saxe Doernberger & Vita, P.C. - Michael A. Stockalper