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Ky. Ruling Shows Need For Consistent Insurer Claim Replies

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In a recent decision the Kentucky Supreme Court ruled that a policyholder's tender of a government subpoena to its directors and officers liability insurer a few years before it was named as a defendant in related civil litigation did not trigger a prior-notice exclusion in its professional liability policy.

Although it is a general rule that known liabilities are not insurable, on Oct. 20, the Kentucky Supreme Court in Ashland Hospital Corp. v. Darwin Select Insurance Co.[1] **found** this rule inoperable where the insurer previously advised the policyholder that its notice of a government investigation did not constitute adequate notice of circumstance that might give rise to a claim; and the insurer failed to inform the policyholder upon renewal that any claims related to the investigation would be precluded by the policy's prior-notice exclusion.

The court emphasized that insurers cannot have it both ways. If an insurer advises a policyholder that a subpoena is inadequate to constitute a notice of circumstances that might give rise to a claim, then it must be inadequate to constitute notice under "any policy of insurance" for the purpose of triggering a prior-notice exclusion.

Background

In 2011, the U.S. Department of Justice served a subpoena duces tecum on a Kentucky medical center, Ashland Hospital, doing business as King's Daughters Medical Center, seeking a host of documents generally pertaining to all medical records, files and communications relating to cardiac patients in order to investigate potential federal health care offenses.

The medical center submitted the subpoena to its D&O insurer, Darwin National Insurance, which agreed to cover the costs incurred by the medical center in complying with the subpoena.

The medical center alerted its professional liability insurer, Darwin Select, an affiliate of Darwin National Insurance known as Allied, and excess liability insurer, Homeland Insurance Co. of New York, of the existence of the subpoena during its renewal negotiations in 2012. Still, both Allied and Homeland issued renewed policies to the medical center for the 2012-2013 policy period.

Beginning in May 2013, the medical center submitted formal notice letters to Allied concerning the subpoena and ongoing DOJ investigation, as well as a litigation hold letter it received from counsel purporting to represent hundreds of potential claimants regarding the medical center's cardiac procedures. Allied responded that the letters did not constitute proper "notice of circumstances that might give rise to a claim" because they failed to include certain specific details required under the policy.

In addition, Allied claimed that coverage was barred by the prior-notice exclusion in the policy, which applied to claims "based on, arising out of, directly or indirectly resulting from, or in consequence of, or in any way involving ... any facts, matters, events, suits or demands notified or reported to, or in accordance with, any policy of insurance ... in effect prior to October 16, 2012."

Allied asserted that the prior-notice exclusion applied because the medical center previously submitted the subpoena to its D&O insurer for coverage in 2011.

Thereafter, the first medical malpractice claims generally alleging unnecessary cardiac operations and lack of informed consent were filed against the medical center in Boyd Circuit Court. Allied agreed to defend the suit under a reservation of rights based on its position that the prior-notice exclusion, as well as two other exclusions in the policy relating to intentional acts and government-related claims, precluded coverage for the medical center's claims.

In May 2014, the DOJ investigation concluded with a private settlement in which the medical center did not concede liability but agreed to pay approximately $40 million in fines.

Procedural History

The medical center filed a declaratory judgment action seeking a ruling as to its rights under the policies issued by Allied and Homeland with respect to the civil suit. The circuit court granted summary judgment in favor of the medical center, finding that neither the prior-notice exclusion nor the two other exclusions raised by the insurers barred coverage.

The circuit court reasoned that "the insurers are attempting to label the letter and the subpoena as something that they are not. There is nothing contained therein that describes any supposed wrongful conduct, let alone any allegation of performing unnecessary cardiac procedures."

The insurers appealed and the Kentucky Court of Appeals, in a unanimous opinion, reversed. The court held that the prior-notice exclusion did in fact apply to bar coverage because:

> [The medical center] had previously secured coverage under its D&O policy with National [Darwin] regarding the DOJ investigation. [The medical center's] D&O policy qualified as 'any policy of insurance in effect prior to the inception Date' of [the medical center's] Umbrella Policies with Darwin [Allied]. And, judging from the allegations set forth above in the various complaints filed in In re: Cardiac Litigation, the claims asserted in that mass of litigation unavoidably fell within the remaining ambit of this exclusion.

The court of appeals further held that the insurers were entitled to recoupment of their expenses paid in defending the civil suit, even though that issue was not before the court.

The Kentucky Supreme Court granted review.

The Kentucky Supreme Court's Decision

The Kentucky Supreme Court held that the prior-notice exclusion did not apply because the subpoena did not constitute adequate notice of circumstances giving rise to a claim in 2011. In particular, the subpoena failed to specify the "time, date and place" of the claim or "a description of the injury or damage which has allegedly resulted."

The court explained that while subsequent events that unfolded over the following two years ultimately indicated that the DOJ investigation and the civil litigation arose from the same set of facts and events, that conclusion was not evident in 2011, when the medical center sought coverage for the subpoena from its D&O insurer. The court stated:

> [H]indsight is 20/20. And looking at this case from the perspective of 2022, the DOJ inarguably was investigating facts, matters, and circumstances shared by the Cardiac Litigation. But in this instance, hindsight is obscuring the reasonable interpretation of the language by a lay reader which sensibly supports the interpretation that the policy contemplates a great deal of specificity to constitute notice of circumstances giving rise to a claim that is absent from the subpoena.

The court acknowledged that in some instances, notification might require supplementary communications within a reasonable period of time, but rejected the court of appeals' conclusion that "notice could be gathered over multiple years."

As the Kentucky Supreme Court emphasized, Allied's own position in 2013 that the subpoena was insufficient to constitute a notice of circumstances that might give rise to a claim was fatal to its later contention that the subpoena constituted notice of a claim to another insurer for the purpose of the prior-notice exclusion.

In addition, the court further found that Allied created an expectation of coverage by issuing the 2012-2013 policy even after it was explicitly made aware of the DOJ subpoena and pending federal investigation.

Although Allied argued that it issued the policy only because it believed the prior-notice exclusion would bar coverage for any claims related to the investigation, the court found this argument unavailing as Allied failed to point to any evidence demonstrating that this was in fact its understanding at the time it issued the 2012-2013 policy or that such an understanding was ever communicated to the medical center.

Rather, the court directed that to avoid the implication of coverage here: "It was incumbent on the insurers to clearly state in the policy that they would not insure any potential claims related to the DOJ investigation."

Finally, the court reversed the Court of Appeals ruling on recoupment, finding that the appellate court lacked subject-matter jurisdiction over the issue because the circuit court had not made any final order as to recoupment.

Implications

Policyholders will likely continue to argue that years-long governmental investigations, especially those initiated by broad document subpoenas, do not trigger prior-notice exclusions to preclude coverage of related civil litigations filed after the investigation is initiated. Policyholders are also likely to seek similar rulings in other states.

The Kentucky Supreme Court's decision also provides a stark warning to insurers of the unintended consequences that may result from rejecting a policyholder's notice of circumstances that may give rise to a claim where a prior-notice exclusion based on the very same set of facts may be implicated. Indeed, by adopting inconsistent positions with respect to whether a policy's notice requirements have been meet, an insurer's admissions may support a finding of latent ambiguity arising from the application of the policy language.

Moreover, the decision further suggests that insurers should expressly reserve the right to deny coverage based on a prior-notice exclusion as soon as the insurer becomes aware of any facts that may trigger the exclusion, especially where an insurer is provided notice of such facts during the underwriting process for the next policy period.

Indeed, if the insurer is aware of a prior notice to another insurer before issuing a new policy, the decision strongly implies that the insurer should clearly state within the policy itself that the prior-notice exclusion precludes coverage for any claims related to the prior notice. The failure to do so may result in a finding that the insurer lured the policyholder into reasonably believing it had obtained coverage for potential claims arising from the circumstances already known by the insurer.

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[1] Ashland Hosp. Corp. v. Darwin Select Ins. Co. , No. 2020-SC-0260-DG, 2022 Ky. LEXIS 331 (Oct. 20, 2022).