

District Court Denies Summary Judgment on Late Notice and Fraudulent Conduct Exclusion

March 2006

The United States District Court for the Northern District of Illinois, applying Illinois and South Carolina law on separate issues, denied summary judgment to an excess insurer, holding that genuine issues of material fact remained as to whether, under South Carolina law, an insurance broker was the agent of the excess insurer for purposes of notice and whether, under Illinois law, coverage for punitive damages based on the direct liability of the insured is barred by public policy or under a fraudulent conduct exclusion. *Old Republic Ins. Co. v. Ness, Motley, Loadholt, Richardson & Poole, P.A.*, 2006 WL 88666 (N.D. Ill. Jan. 11, 2006).

The court also rejected each of the policyholder's affirmative defenses to the excess insurer's late notice claim, including assertions of estoppel, wrongful prevention, unclean hands, waiver, and laches as well as arguments contending that the insurer failed to provide a reservation of rights letter and thereby extended the time period for reporting under the renewal policy.

The excess insurer issued two "claims made and reported" excess professional liability policies to a law firm and its individual attorneys with effective dates of August 15, 2000 to August 15, 2001 and August 15, 2001 to August 15, 2002. Both policies required that

[t]he Insured shall as a condition precedent to their rights under this Policy, give to the Company written notice of any Claim made against the Insured as soon as practicable but in no event later than sixty (60) days after the end of the Policy Period or the Extended Period (if exercised) in which such Claim was made.

The policies further required that "all notices . . . shall be in writing and be mailed or delivered to the appropriate party." The policies barred coverage of punitive damages for claims involving "actual dishonest, fraudulent, criminal, or malicious" conduct; however, the policies included a "Waiver of Exclusions," providing that, whenever coverage is barred by the fraudulent conduct exclusion, the insurer will still provide coverage "to each and every insured who did not personally commit or personally participate in committing one (1) or more of the acts, errors, or omissions described in any such exclusion."

In the underlying action, the insured law firm was sued in December 2000 on allegations that "it engaged in

wrongdoing in connection with its representation in the prosecution of certain class action claims." A jury found that the law firm had breached its fiduciary duty and awarded compensatory and punitive damages. On appeal, the law firm's primary insurer, which had issued a \$20 million professional liability policy, settled the underlying claim for an amount in excess of \$20 million. The excess insurer sought a determination that it had no duty to defend, indemnify or reimburse defense costs or indemnify the law firm, its individual attorneys or the primary insurer.

The excess insurer first sought summary judgment on the basis that the law firm had failed to provide timely written notice of the claim when it was made during the first policy period. The law firm argued that the excess insurer had actual notice of the claim because it was orally reported. Relying on Federal Rule of Evidence 406, the court admitted testimony of habit evidence from two employees of the law firm, who testified that the firm "had a specific procedure in place by which it would notify its insurance carriers of any claims filed against it" and thus had provided timely oral notice to the insurance broker. Applying South Carolina law, the court then determined that genuine issues of material fact remained as to whether the broker was the insurer's "agent for purposes of notification of a claim under the Policies." The court noted that South Carolina law recognizes that "[g]enerally, an insurance broker is the agent of the insured, not the insurer" but also holds that "[u]nder certain circumstances, a broker may be an agent for an insurance company."

The court then rejected the law firm's affirmative defenses to its insurer's claims of late notice as a matter of law. The law firm contended that the excess insurer was estopped from disclaiming on late notice because, while its binder expired on October 15, 2000, it did not deliver the policy until January 2001; thus, according to the law firm, the excess insurer was at fault for not providing the insured with evidence that coverage existed at the time of the claim in December 2000. The court rejected the argument, emphasizing that the original binder provided the dates of the first policy period and that the insured still failed to provide notice before the expiration of the policy period in August 2001, eight months after the law firm finally received the policy. The court rejected the law firm's unclean hands defense as well because the law firm failed to provide evidence of fraud or bad faith on the part of the excess insurer in failing to extend the binder, which the court held to be a requirement for this defense under Illinois law. As to the law firm's defenses under the doctrines of waiver and laches, the court determined that the law firm provided no evidence that the excess insurer in any way relinquished a right as required by the waiver doctrine and that it failed even to submit a basis for a laches defense. The court also concluded that the excess insurer issued an appropriate and timely reservation of rights letter in April 2002 since, as an excess insurer, its duty to issue a reservation of rights was not triggered until judgment in the underlying lawsuit was entered in July 2003 and since the letter properly put the law firm on notice that its excess insurer might attempt to avoid liability under the policy.

The court also rejected the law firm's argument that the requisite time period for reporting claims against it under the policy was extended since the excess policy was extended for a second year. The law firm relied on the extension of the primary policy, which "embraced claims reported within the two year time frame," as well as the excess policy's adoption of the definition of "Loss" from the primary policy as being "to the extent

for which coverage would be provided under the Primary Policy." Therefore, according to the law firm, the extension of the excess policy also "embraced claimed reported within the two year time frame." The court, relying on *Executive Risk Indemnity, Inc. v. Chartered Benefit Services, Inc.*, 2005 WL 1838433 (N.D. Ill. July 29, 2005) and *National Union Fire Insurance Co. of Pittsburgh, Pa. v. Bauman*, 1992 WL 1738 (N.D. Ill. Jan. 2, 1992), confirmed that case law rejects the conclusion that "renewal of the policy creates a single policy period for claims reporting purposes." Moreover, the court recognized that the excess policies "expressly state that they do not adopt or follow [the primary insurer's] limits of liability or policy period."

The court also denied the excess insurer's motion for summary judgment on its argument that, under Illinois law, coverage for punitive damages was prohibited by public policy because the law firm was found directly rather than vicariously liable. The law firm argued that the underlying judgment did not specify whether the law firm was directly or vicariously liable, but the court concluded that, as a matter of law, the punitive damage award was based on the law firm's direct liability. Nonetheless, relying on *Strzelczyk v. State Farm Automobile Insurance Co.*, 497 N.E.2d 1170 (Ill. 1986), the court determined that "given the apparent overriding interest articulated by Illinois courts in having an insurance company provide coverage that is contracted for, the court cannot state as a matter of law that [the excess insurer] should be granted summary judgment on the asserted ground."

The court also denied the insurer's summary judgment motion based on its claim that coverage for punitive damages was barred because the law firm's liability under breach of contract or breach of fiduciary duty required a showing of fraud, dishonesty or malice, which triggered the policy's intentional dishonesty exclusion. The court determined that even if it were to find the exclusion applicable, genuine issues of material fact remained because the excess insurer did not address the applicability of the "Waiver of Exclusions" provision in the policy and did not point to any evidence that the exclusion should apply to the law firm rather than the specific individuals involved.