

Policy Provides Coverage for Claim Made During Extended Reporting Period

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A federal district court, applying New York law, has held that an extended reporting period endorsement to a claims-made policy extended the time period during which a claim could be made against the insured and still be subject to coverage. *Liberty Surplus Ins. Corp. v. Segal Co.*, 2004 WL 2102090 (S.D.N.Y. Sept. 21, 2004). The court also held, however, that the policyholder was not entitled to attorneys' fees incurred in defending itself against the insurer's declaratory action.

An insurer issued a claims-made excess insurance policy to a company. The insurer subsequently issued an extended reporting period (ERP) endorsement to the company. The first paragraph of the ERP endorsement provided that the excess policy "is hereby extended to apply to Claims first made against the Insured during thirty-six (36) calendar months immediately following...the effective date of nonrenewal of this Policy." The second paragraph provided that the ERP applied "only to Claims which arise out of any act, error or omission of the Insured prior to [the effective date of nonrenewal] and which would otherwise be covered hereunder."

During the extended reporting period, a municipality filed suit against the insured company based on the company's actions prior to the nonrenewal date. The insurer instituted this declaratory action to determine whether the policy covered claims first made during the extended reporting period. The insurer argued that because the endorsement applied only to claims "which would otherwise be covered hereunder," the policy provided coverage only for claims first made against the insured company during the original policy period. The ERP endorsement, the insurer argued, merely expanded the period during which the company could report such claims to its insurer.

The court ruled in favor of the company, holding that the ERP endorsement extended the policy to claims first made against the company during the ERP and that arose out of alleged acts, errors or omissions of the company occurring prior to the nonrenewal date. The court reasoned that the ERP endorsement was unambiguous and clearly stated that the endorsement applied to claims brought against the company during the ERP. The court found that the plain meaning of the phrase "which would otherwise be covered hereunder" in the second paragraph simply limited coverage to those claims that exhausted the company's underlying insurance. The court concluded that the insurer's interpretation of the ERP would eviscerate the first paragraph and granted judgment in favor of the company.

The court also determined that its grant of declaratory judgment to the insured company on the ERP endorsement did not entitle the company to recover attorneys' fees from the insurer. Under New York law, a court may impose extracontractual liability for attorneys' fees on an insurer 1) upon a showing of "such bad faith in...denying coverage that no reasonable carrier would, under the given facts, be expected to assert it" or 2) where an insured "has been cast in a defense posture by the legal steps an insurer takes in an effort to free itself from its policy obligations." The court rejected the first theory of liability because the company's counterclaim alleged no facts to support a finding of bad faith. The court observed that the second theory, if taken out of context, "would seem to state a broad proposition requiring the award of such fees in every action for declaratory judgment in which the insured prevails." The court explained that the second theory was potentially applicable only where the insurer's duty to defend its insured was implicated. Because the excess policy issued by the insurer did not impose a duty to defend the company, the court concluded that an award of attorneys' fees would be inappropriate.

The court also concluded that the insurer's filing of this declaratory judgment did not constitute an anticipatory breach of the ERP endorsement because contract "is not breached until the time set for performance has expired." The court noted that the company had presented no evidence to establish that the event triggering the insurer's performance—the exhaustion of the company's underlying insurance—had occurred. Furthermore, the insurer had not indicated that it would refuse to provide coverage should it be found liable to indemnify the company in this action.

Finally, the court rejected the company's argument that the insurer had acted fraudulently by not disclosing its interpretation of the ERP endorsement at the time of contracting. The court explained that the company had not alleged that the insurer had intended to "defraud" the company, as opposed to intending to limit coverage. The court also expressed its agreement with the holding by the U.S. Court of Appeals for the Ninth Circuit in *Hartford Accident & Indemnity Co. v. J.L.R.A. Compliance, Inc.*, 1990 WL74859 at 6 (9th Cir. June 5, 1990), that "the failure to disclose these varying interpretations at the beginning of a contractual relationship does not provide a predicate for a later fraud action."

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