

Insured Must Show Prejudice from Insurer's Unreasonable Delay in Disclaiming Coverage

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In an unpublished decision, the Second Circuit, applying New York law, recently held that an eight-month delay in disclaiming coverage for a valid reason is unreasonable as a matter of law, but that the insurer would not be required to provide indemnification and a defense absent a showing of prejudice. *Adams v. Chicago Ins. Co.*, No. 02-7179, 2002 WL 31398801 (2d Cir. Oct. 23, 2002).

The insurer issued a professional liability policy to the insured, an attorney. After the attorney received notification of a potential malpractice lawsuit, he informed his insurer. The insurer accepted notice of the claim under a reservation of rights, noting that the claim may not have been timely reported. The insurer then engaged in negotiations in attempts to settle the malpractice claim, although there is a dispute about how vigorously it did so. After unsuccessful communications between the insurer and the injured party, the client filed a malpractice suit against the attorney. Two weeks later, the insurer disclaimed coverage based on the untimely notice of the claim. The attorney did not dispute that the insurer had a valid coverage defense based on untimely notice. He argued, however, that the insurer was estopped claiming coverage based on its eight-month delay.

The appellate court held that the eight-month delay in asserting the late notice defense was "unreasonable as a matter of law," but remanded because the district court failed to determine whether the lawyer had been prejudiced as a result of the insurer's delay, a requisite component to establishing estoppel. The court stated that prejudice could be presumed where an insurer assumes control of the defense from the insured without reserving its rights to later assert policy defenses. Where the insurer has reserved its rights, however, the court said actual prejudice must be demonstrated. The court remanded to the district court to determine whether the lawyer had actually been prejudiced based on, among other things, the attorney's assertion that he was forced to spend time litigating issues that might have been forwarded to ADR as well as that the insurer failed to settle while there was a "residue of good will" among the parties.

For more information, please contact one of WRF's Professional Liability Attorneys at 202.719.7130