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NEWSLETTER

Claims-Made Policy with Limited Retroactive Coverage Does Not Violate Public Policy

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A New Jersey appellate court, applying New Jersey law, held that a professional liability claims-made policy with limited retroactive coverage does not violate public policy where factual circumstances render such limited coverage reasonable and expected. *President v. Jenkins*, 814 A.2d 1173 (N.J. Super. Ct. App. Div. 2003).

A physician had purchased a series of one-year occurrencebased medical malpractice policies from an insurer. After repeated nonpayment of premiums, the insurer, in a letter dated January 9, 1998, canceled the policy effective October 26, 1997 even though the policy would otherwise have been effective until February 1, 1998. The physician, through a broker, then purchased a claims-made policy from a second insurer. The new policy was issued to a physician's alliance created by the broker, and individual doctors were added to the policy through endorsements. The physician in this case negotiated an endorsement that had both an effective and a retroactive date of February 1, 1998 because he told the broker that was the date on which his prior policy would expire. The endorsement provided that "[w]e will pay on behalf of a physician, damages that the physician shall become legally obligated to pay because of a claim first made during the policy period arising out of a medical incident which occurred on or after the retroactive date and which is reported to us during the policy period." The physician was subsequently sued for malpractice allegedly committed in early January 1998, during the coverage gap. The insurer denied coverage, and litigation ensued.

The court rejected the physician's contention that a policy limiting claims-made coverage to claims for wrongful acts during the policy period violates public policy. The court initially noted that, under the holding of *Sparks v. St. Paul Fire Insurance Co.*, 495 A.2d 406 (N.J. 1985), "provisions of a policy limiting coverage to claims brought for negligence committed during the policy term and providing only limited retroactive coverage were unenforceable as violating public policy *absent* factual circumstances that would render such limited retroactive coverage both reasonable and expected." In this case, however, the court concluded that the limited retroactive coverage was reasonable and expected because the claims-made policy "immediately followed a prior period of 'occurrence' coverage, thus obviating the need for any greater retroactive coverage than was bargained for and obtained by [the policyholder]." The court noted that "occurrence plus" policies characteristically provide coverage for acts occurring within the policy period and "claims-made" policies provide coverage for claims made and noticed to the insurer during the policy period. Had there been no

cancellation of coverage, "there would have been seamless, uninterrupted coverage provided." The court also rejected the physician's argument that the policy was vague. The court reasoned that the endorsement clearly indicated that the retroactive date was February 1, 1998, and the physician had purposefully bargained for the February retroactive date because, had the occurrence policy been in effect, it would have expired on that date.

The physician also brought a claim against the broker, alleging that the broker was negligent for failing to procure coverage to bridge the gap between the two policies. The court rejected this contention, noting that the policyholder never informed the broker of any lapse in coverage, and stating that "absent notice or a specific initiating inquiry from the [policyholder]...an insurance broker has no affirmative duty to advise an insured of gaps in [the policyholder's] insurance coverage."

The malpractice plaintiff also sought to bring a direct action against the first insurer for failing to notify the hospital where the physician practiced that it had canceled the policy. The court held that the plaintiff could not do so because "an injured person possesses no direct cause of action against the insurer of the tortfeasor prior to recovery of judgment against the latter." The court also noted that, in any event, the occurrence insurer had no duty to notify the hospital that coverage had lapsed due to nonpayment.

The malpractice plaintiff also sought to bring a claim against the hospital for failing to ensure that the physician complied with the requirement in the hospital's by-laws that all physicians maintain adequate malpractice insurance. The court held that the hospital had no such duty, reasoning that the by-laws shifted "the burden of compliance [to] the shoulders on those uniquely situated and in a superior position—the physicians." The court also held that the hospital had no common law duty to ensure that physicians practicing there had malpractice insurance.

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