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NEWSLETTER

Insured's Agreement To Deem Subsequent Policy Excess To Prior Policy's Extended Reporting Period Not Breach of Cooperation Clause

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A divided panel of the United States Court of Appeals for the Sixth Circuit, applying Ohio law, has held that a policyholder did not breach its cooperation obligations by amending its current policy to make it specifically excess to the extended reporting period it purchased from its previous insurer even though a claim was made during the 30-day period during which the policyholder could elect to purchase the extended reporting period. *Abercrombie & Fitch, Co. v. Fed. Ins. Co.*, 2010 WL 841174 (6th Cir. March 11, 2010).

The insured, a clothing company, decided not to renew its directors and officers policy and purchased a policy with another insurer. The expiring policy allowed the clothing company to purchase a one-year extended reporting period (the ERP) within 30 days of the expiration of the policy. One day after the previous policy expired, securities litigation was filed against the clothing company. The clothing company then elected to purchase the ERP under the expired policy. The clothing company and its current insurer agreed to an endorsement to the current policy making the current policy specifically excess of the prior policy. As part of that endorsement, the current insurer agreed to waive the $2 million retention and to renew the current policy without a premium increase. The prior insurer denied coverage for the securities litigation based on its contention that the clothing company violated the cooperation clause, which provided that "in the event of a Claim the Insureds will do nothing that could prejudice the [Insurer's] position or its potential or actual rights of recovery." The district court granted summary judgment in favor of the clothing company. The ERP insurer appealed.

The court of appeals affirmed the decision of the district court. As an initial matter, the court held that the district court's interlocutory order requiring the ERP insurer to pay defense costs was an injunction, and thus an appealable order.

The prior insurer argued that the clothing company and its current insurer colluded to extinguish, and thereby prejudice, the prior insurer's potential contribution rights against the current insurer. The clothing company contended that the cooperation clause, which was located in a section of the ERP policy titled "Defense and

Settlement," only applied in connection with defense and settlement of claims and not to contractual agreements with other insurers.

A divided court rejected the prior insurer's argument and held that the cooperation clause "did not address the parties' respective rights and obligations when a policy has elapsed, a claim has been brought against a (formerly) insured, and the insured is deciding whether to elect- and how best to structure- extended insurance coverage." The court also noted that the "no prejudice" portion of the clause could not apply to all situations because the clothing company's mere election to purchase the ERP after a claim was made would "prejudice" the insurer by placing the insurer back on the risk. The court further reasoned that the ERP provision placed no restrictions on the clothing company's ability to purchase the ERP if a claim was made during the 30 day election period, and the more specific provision of the ERP clause controlled over the more general cooperation clause. The court opined that the increased premium for the ERP likely factored in the risk that a claim could be made during the election period. The court thus held that the clothing company did not breach the cooperation clause and affirmed the district court's decision.

The dissenting judge contended that the cooperation clause imposed a duty on the clothing company not to prejudice the previous insurer's potential or actual rights of recovery when a claim is made. The dissent reasoned that, after electing to purchase the ERP, the clothing company could not take any action to prejudice the ERP insurer's then-existing right to seek contribution from the clothing company's current insurer if the ERP insurer paid more than fifty percent of the costs of the securities litigation. According to the dissent, the policy endorsement prejudiced the ERP insurer by requiring it to pay all of the costs of the securities litigation and abrogated its right to seek contribution from the clothing company's current insurer.