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NEWSLETTER

Prior Notice Exclusion Does Not Bar Coverage Where Notice of Circumstances Was Not Valid Under Prior Policy

March 2013

The United States Court of Appeals for the Ninth Circuit, applying California law, has held that the prior notice exclusion of an excess policy did not bar coverage for securities and derivative litigation where the insured's notice of a related patent infringement action had been held not to comply with the notice-of-circumstances clause of the prior policy. *Genesis Ins. Co. v. Magma Design Automation, Inc.*, 2013 WL 427805 (9th Cir. Feb. 5, 2013). The court determined, however, that the primary policy underlying the excess policy was not necessarily exhausted because the underlying insurer did accept the notice of circumstances.

The action involves primary and excess claims-made directors and officers liability insurance policies for successive policy periods. The insured provided notice of a claim for patent infringement under the first policy period. During the second policy period, securities and derivative litigation was filed that included allegations related to the alleged patent infringement. The primary insurer and the excess insurer for the first policy period advanced amounts in settlement of the securities and derivative litigation. The excess insurer for the first policy period then asserted a subrogation claim against the excess insurer for the second policy period, arguing that the notice of circumstances was not valid, so the securities and derivative litigation should be deemed first made in the second policy period, when the complaint in that litigation was filed.

In a previous opinion, the Ninth Circuit determined that notice of the infringement action did not constitute a proper notice of circumstances under the terms of the excess policy for the first policy period. That opinion was discussed in the August 2010 issue of *Executive Summary*. The excess insurer for the second policy period nevertheless contended that a prior notice exclusion for claims based upon, arising from, or in consequence of any fact, circumstance, situation, transaction, event or Wrongful Act" that had been "the subject of any notice given under any policy" for which the second-year excess policy was "a direct or indirect renewal or replacement." The court held that "in the context, it is reasonable to interpret 'under' to mean 'according to.'" Because notice of the patent infringement action had not complied with the notice provision of the first-year excess policy, the court held that "it follows that notice was not given 'under' this policy" and that the prior notice exclusion did not apply.

The court also held, however, that the second-year excess policy may not have been implicated because the primary policy during the second policy period may not have been exhausted. The second-year excess policy could be implicated only following the exhaustion of the underlying primary policy, which was issued by the same insurer for both policy periods. The primary insurer, however, treated the derivative and securities actions as claims made under the first policy period; the Ninth Circuit's previous rulings dealt only with the adequacy of notice under the excess policy. Accordingly, the court remanded for a determination of, among other things, whether the notice of circumstances was proper under the first-year primary policy or whether the securities and derivative litigation should be considered first made during the subsequent policy period, potentially exhausting the insurance underlying the second-year excess policy.