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NEWSLETTER

Maintenance of Insurance Exclusion Applies to Insured's Failure to Maintain Clients' Insurance

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The Colorado Court of Appeals has held that an exclusion in an E&O liability policy precluding coverage for the insured's failure to maintain insurance is not ambiguous and applied to the insured's failure to procure or maintain insurance for two of its clients. *Mgmt. Specialists, Inc. v. Northfield Ins. Co.*, 2004 WL 2503376 (Colo. Ct. App. Oct. 21, 2004). In addition, the court held that the insurer's assumption of the insured's defense without a reservation of rights did not estop the insurer from denying coverage on the basis of the exclusion at a later time, unless the insured could show that it was prejudiced by the withdrawal of the defense.

An insurer issued an E&O policy to a real estate property management company that represented homeowners associations and sometimes helped the associations to procure insurance coverage. The policy contained an exclusion for "[a]ny damages arising out of the [insured's] failure or inability to maintain adequate levels or types of insurance."

Two clients in separate actions sued the management company. In one action, a client alleged that the company had failed to purchase D&O coverage for the client as required by their contract. In the other action, a different client sought damages for fraud and misrepresentation, alleging that the company had paid the client's liability insurance premiums late and allowed the insurance to lapse. The E&O insurer for the management company declined to defend the first action and, after originally defending the second action without a reservation of rights letter, withdrew that defense prior to trial.

The appellate court first rejected the management company's contention that the policy exclusion was ambiguous because it was not clear whether the exclusion referred only to the company's failure to maintain its own insurance or also included the failure to maintain its client's insurance. According to the court, the exclusion meant:

"Simply that [the insured's] failure to maintain insurance of*any* kind, whether for itself or for others, is excluded from coverage" because it did not "differentiate between types of insurance or for whom the insurance is maintained."

The court next rejected the management company's assertion that the exclusion did not apply to the first action because a failure to "procure" insurance was not a failure to "maintain" insurance. The court reasoned that the word "maintain" is commonly understood to encompass "providing" or "procuring."

The court also rejected the company's contention that the exclusion did not apply to the second action because the alleged fraud and misrepresentation occurred before coverage actually lapsed and therefore did not "arise out of" the failure to maintain insurance coverage. Noting that the term "arising out of" created a "but for" test under Colorado law, the court held that the client's fraud and misrepresentation would not have occurred "but for" the lapse in coverage and, as a result, the exclusion applied.

Finally, the court addressed the company's contention that the doctrine of estoppel prevented the insurer from withdrawing its defense of the second action after it had initiated the defense without a reservation of rights. Although the court held that the insurer could be estopped to deny coverage if the management company had "relied on [the insurer's] defense to its detriment and was prejudiced thereby," the court determined that there was no prejudice in the insurer's "brief" assumption of the defense that concluded before the onset of the trial.

For more information, please contact us at 202.719.7130.