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NEWSLETTER

Other Decisions of Note

August 2006

Insurer Not Expected to Anticipate Claim; Denial Based on I v. I Exclusion Reasonable Even Under Wrong Policy Period

In an unreported decision, the United States District Court for the Western District of Washington, applying Washington law, has held that an insurer did not act in bad faith and did not violate the Washington Consumer Protection Act by denying a policyholder's claim. *Koch v. Travelers Cas. & Sur. Co. of Am.*, 2006 WL 1587437 (W.D. Wash. June 5, 2006).

The policyholder alleged that the insurer failed to conduct a reasonable investigation of its claim under a D&O policy prior to the policyholder's tender of the claim for attorneys' fees and that the insurer also failed to investigate the claim adequately once the policyholder tendered the claim, in violation of the implied covenant of good faith and fair dealing and the Washington Consumer Protection Act.

In dismissing the policyholder's suit, the court noted that the policyholder's first argument was without merit, as "an insurer cannot be expected to anticipate when or if an insured will make a claim for coverage; the insured must affirmatively inform the insurer that its participation is desired." The court acknowledged that the policyholder raised issues of material fact with respect to whether the insurer adequately investigated the claim once it was tendered since it denied the claim under the wrong policy period as a result of relying solely on information provided to it during the policy renewal process, in possible violation of provisions of the Washington Administrative Code.

However, regardless of the merits of the policyholder's argument regarding the investigation of the claim, the court concluded that, because the insurer properly denied coverage of the claim under an insured versus insured exclusion in the policy, the insurer's denial of coverage was reasonable, even though it mistakenly relied on the wrong policy period.

District Court Holds Notice-Prejudice Rule Does Not Apply to Claims-Made Policies Under Colorado Law

In an unreported decision, the United States District Court for the District of Utah has held that, under Colorado law, an insurer need not show prejudice to deny coverage for late notice under a claims-made policy. *Salt Lake Toyota Dealers Ass'n v. St. Paul Mercury Ins. Co.*, 2006 WL 1547996 (D. Utah June 6, 2006). The insurer provided coverage to a non-profit association under a claims-made, non-profit D&O policy that covered the period from December 31, 2000 to December 31, 2002.

In September 2003, the association reported to the insurer, by letter, a suit that was filed in October 2002. The insurer denied coverage; the association filed suit against the insurer. While recognizing the general rule that an insurer must demonstrate prejudice as a result of late notice before it can deny coverage, the court explained that the majority of courts, including Colorado courts, distinguish between claims-made policies and occurrence policies when applying the rule.

The court reasoned that, under a claims-made policy, "the event that invokes coverage . . . is the transmittal of notice of the claim to the insurance carrier." Therefore, the court observed that "application of the notice-prejudice rule [to claims-made policies] would have the effect of extending the coverage, thus depriving parties of what they had bargained for and re-writing the contract."

Letters Seeking Damages and Threatening Suit Are "Claims" Under D&O Policies

The United States Court of Appeals for the Fifth Circuit has held that letters sent to a policyholder alleging monetary damages and threatening litigation constituted "claims" as defined under claims-made policies. *Precis, Inc. v. Federal Ins. Co.*, 2006 WL 1675177 (5th Cir. June 12, 2006). It also concluded that the claims were not subject to coverage under the policy in effect at the time the letters were received because the insured waited more than nine months before advising the carrier of the letters, which constituted late notice as a matter of law.

In doing so, the court rejected the policyholder's argument that the insurer must show prejudice to rely on a late notice defense, citing to *Federal Insurance Co. v. CompUSA, Inc.*, 319 F.3d 746 (5th Cir. 2003), which held that a showing of prejudice was not required in connection with claims-made policies. The court also determined that the claims did not give rise to coverage under a subsequent policy because that policy did not provide coverage for claims made prior to its effective date.

No Coverage for Wrongful Acts Committed in an Uninsured Capacity

The United States Court of Appeals for the Tenth Circuit, applying Oklahoma law, has held that a D&O policy does not provide coverage where the insured was not sued in his capacity as an officer or manager of the insured organization. *Kite Family Invest. Co. v. Levings*, 2006 WL 1892588 (10th Cir. July 11, 2006). The court concluded that the underlying plaintiffs did not allege that the insured officer committed a "wrongful act" in his capacity as an officer of the insured company, where their complaint alleged that he caused a non-insured company—of which he was also an officer—to make a misrepresentation in a contract between the non-insured company and the insured company.

Knowledge of Claims by D&O Insurer Precludes Summary Judgment

The United States District Court for the Western District of Louisiana, applying Louisiana law, has held that: (1) a D&O insurer was not required to demonstrate prejudice in order to deny coverage based on a policyholder's failure to provide timely notice of claims, (2) the insurer did not waive its rights under the notice provision of the policy by advancing defense costs and (3) the insurer was not entitled to summary judgment on its late notice defense where the policyholder presented evidence that the insurer had actual knowledge of the claim against the policyholder prior to receiving formal written notice. *Argent Financial Group Inc. v. Fidelity and Deposit Co. of Md.*, 2006 WL 1793609 (W.D. La. June 28, 2006).

The policy required that notice of claims be provided to the insurer "as soon as practicable." The court noted that under Fifth Circuit case law, this phrase required notice "within a reasonable time under all the circumstances." The policyholder produced evidence that, although several months elapsed between the initiation of claims against it and its written notice to the D&O insurer, the D&O insurer had actual notice of those claims and participated in the management of the claims prior to receiving written notice. Under these circumstances, the court concluded, genuine issues of material fact remained as to whether the policyholder provided notice "as soon as practicable."

Prior and Pending Litigation Exclusion Does Not Preclude Duty to Defend

A New Jersey intermediate appellate court has held that the prior and pending litigation exclusion in a claims-made public officials liability policy did not preclude a duty to defend the insured municipality from a police officer's suit alleging retaliatory discrimination as a result of three prior lawsuits filed by the officer, two of which pre-dated the prior litigation date in the policy. *Township of Bridgewater in Somerset County v. Diamond State Ins. Co.*, 2005 WL 4123417 (N.J. Super. A.D. June 20, 2006).

The policy stated that "[t]his insurance does not apply to any 'claim,' 'suit' and/or payment for any 'damage(s)' in connection with such 'claim' or 'suit' made against any insured based upon, arising out of, in consequence of, or in any way involving: (1) Any prior and/or pending litigation as of 1/1/1999 including, but not limited to matters before local, state or federal boards, commissions, or administrative agencies, or (2) Any fact, circumstance, or situation underlying or alleged in such litigation or matter." The underlying plaintiff, a police officer, had filed previous discrimination claims against the insured in 1996, 1998 and 2000. In the 2003 complaint, the officer alleged that the insured retaliated against him for filing the prior complaints by denying him a promotion. The court held that the insurer owed a defense to the insured, concluding that the fact that the officer's retaliation complaint was based partly on his 2000 complaint rendered the prior and pending litigation exclusion inapplicable.

The court concluded that "[e]ven if we were to accept [the insurer's] interpretation of the policy exclusion with respect to the relationship between the 2003 complaint and [the insured's] pre-1999 complaints, [the insurer's] interpretation is irrelevant to the alleged retaliatory motive in relation to [the insured's] 2000 complaint," that "[t]he express language of the policy exclusion is for 'prior and/or pending litigation as of 1/1/1999'" and that "[the insured's] 2000 complaint does not fall within that express provision."

Policy Does Not Cover Pre-Policy Period Wrongful Acts

An intermediate Ohio appellate court has held that a lawyer's professional liability policy does not provide coverage for a malpractice claim that is based on allegedly wrongful acts that occurred prior to the policy period. *Javitch Block Eisen & Rathbone, PLL v. Target Capital Partners, Inc.*, 2006 WL 1781095 (Ohio App. June 29, 2006).

The policy provided specified coverage only for claims for wrongful acts that occurred within the policy period or prior to the policy period if the insured was unaware that the conduct constituted a wrongful act and did not give notice to the insurer. In reaching its conclusion, the court noted that prior to the effective date of the policy, the insured law firm withdrew as counsel in one of four lawsuits it had filed on behalf of its clients.

Subsequently, but also prior to the effective date of the policy, the clients retained a second law firm to review the insured firm's performance on their behalf, and the second firm concluded that the firm had committed multiple violations of its professional obligations and advised that the firm put its malpractice carrier on notice. At the same time, it made a settlement demand to resolve the malpractice claim. The court concluded that the firm "cannot claim that it was unaware that the [former clients] were seriously pressing a legal malpractice claim."

Louisiana Court: Untimely Notice of Claim Bars Coverage; Insurer Not Required to Show Prejudice
A Louisiana intermediate appellate court has held that an insurer was not liable for a third-party demand based on a legal malpractice policy because the third-party demand "was not a demand as required by the policy language to qualify as a claim made within one year of the wrongful act." *Regions Bank v. Kountz.*, 2006 WL 1473106 (La. Ct. App. May 31, 2006).

In its opinion, the appellate court addressed the "confusing" and inconsistent Louisiana case law with respect to whether reporting requirements in claims-made policies impermissibly limit the amount of time plaintiffs have to bring actions against insurers under Louisiana direct action statutes. The court concluded that, consistent with *Anderson v. Ichinose*, 760 So. 2d 302 (La. 1999), a claims-made policy provides coverage: (1) where an incident occurs within a claims-made policy's effective period, (2) a claim is not made within the policy period but (3) the claim is made and reported to the insurer within the statutorily proscribed period after the incident occurred (often one year).

The policy at issue also contained an endorsement providing that "coverage will not be denied or forfeited solely as a result of the failure of the INSURED to provide . . . notice . . . unless the Company can demonstrate actual prejudice." However, the court stated that the insurer did not need to prove prejudice in this instance because "[a]n interpretation of contractual language which would lead to absurd consequences must be rejected as unreasonable."

***Miller-Shugart* Agreement Unenforceable Because of Failure to Notify Insurer**
A federal district court in North Dakota, applying North Dakota law, has held that a *Miller-Shugart* settlement agreement between a policyholder and an underlying claimant is unenforceable as a matter of law because the insurer was not provided notice of the negotiations for, or terms of, the agreement prior to its execution. *TIG Ins. Co. v. Chapman and Chapman, P.C.*, 2006 WL 1876516 (D.N.D. Jun. 30, 2006).

A client of a law firm filed an action alleging that an attorney committed legal malpractice in recommending certain investments. Counsel for the claimant, the attorney and the attorney's professional liability insurer conducted extensive negotiations about settlement up to the eve of trial. Shortly before trial, the insurer received a fax of a just-signed *Miller-Shugart*settlement agreement between the claimant and the policyholder that provided that the policyholder stipulated to a settlement for $1 million, with the proceeds to be collected from the insurer.

Although the court held that the failure to provide notice to the carrier was sufficient to render the settlement unenforceable, it also noted that the "record does reflect that the reasonableness of the . . . agreement is questionable."