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NEWSLETTER

Policyholder's "Notice of Circumstances" Found Too General to Satisfy Notice Provisions

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A federal bankruptcy court in Illinois, applying both Illinois and Florida law, has granted summary judgment to several insurers, holding that a policyholder failed to provide sufficient notice of circumstances that could potentially give rise to a claim to trigger coverage under primary and excess D&O policies, where the policyholder informed the insurers that it was "contemplating" filing for bankruptcy and expected claims to be filed against its directors and officers, but did not learn of any claims or potential claims or provide additional information until after the policies had expired. *In re Nanovation Tech., Inc.*, 2006 WL 2129500 (Bankr. N.D. Ill. July 27, 2006).

Three insurers issued primary, first-layer excess and second-layer excess D&O policies to a high-tech company for the period from October 8, 2000 to October 8, 2001. The term of the primary policy was later extended until April 8, 2002. The primary policy provided that if the insured became aware of "any circumstances which may reasonably be expected to give rise to a Claim being made against the Insureds" and written notice of those circumstances "with full particulars as to dates, persons and entities involved" was provided to the insurer within the policy or discovery period, then any claim subsequently made against the insured that arose out of those circumstances "shall be considered made at the time such notice of such circumstances was given." The policyholder also had a "Technology Liability Insurance Policy" with another insurer that had the same corporate parent as the insurer for the primary policy.

In July 2001, the policyholder filed for relief under chapter 11 of the Bankruptcy Code. The bankruptcy was converted into a chapter 7 case in November 2001. Shortly before filing for bankruptcy, the policyholder's treasurer sent a "notice of circumstances" letter to its broker indicating that the policyholder: (1) was "contemplating" filing for bankruptcy, (2) "believe[d] that such filing will give rise to claims being filed against the Company, its Board and Officers," and (3) would "advise [the broker] of the specifics" as it became aware of them. The broker forwarded the letter to the insurers. On October 29, 2001, the primary insurer advised the policyholder that its letter did not constitute notice under the terms of its policy because it did not set forth any particulars about the circumstances that could give rise to a claim. The excess insurers also rejected the letter as insufficient notice. The policyholder never provided any additional information to the insurers before the policies expired.

In May 2002, the bankruptcy trustee filed an adversary complaint against certain of the policyholder's directors and officers. The insurers denied coverage on the grounds that the notice was untimely and a claim was not made against the insureds during the operative policy periods. The trustee then filed the instant coverage action against the insurers, and the parties filed cross-motions for summary judgment.

The court first observed that it did not need to engage in a choice of law analysis because there was no conflict between the law of the two potential choices, Illinois and Florida. In doing so, the court rejected the trustee's contention that a Florida statute preventing an insurer from denying coverage "on a particular coverage defense" unless the insurer asserted the defense within 30 days of learning of it created a difference between the states' laws. In the court's opinion, the Florida statute did not apply because a denial of coverage under a claims-made policy for lack of notice was not a "coverage defense" in that "[a]n insurer does not assert a 'coverage defense' where there was no coverage in the first place."

Second, the court concluded that the "notice of circumstances" letter was insufficient to trigger coverage. The court observed that "notice is crucial under a claims-made policy" and "'serves a very different function than prejudice-preventing notice required under an 'occurrence' policy." The court then likened the vague letter offered by the policyholder to *McCullough v. Fidelity & Deposit Co.*, 2 F.3d 110 (5th Cir. 1993), in which the Fifth Circuit found that "'[n]otice of an institution's worsening financial condition'" does not constitute proper notice under a claims-made policy. The court added that:

Relaxing the notice requirement, allowing coverage to be triggered by broadly phrased, innocuous, or non-specific statements, would permit an unbargained-for expansion of the policy, undermining the key distinguishing characteristic of a claims made policy—reduced exposure for the insurer and lower premiums for the insured.

Third, the court rejected the trustee's contention that the insurers waived their right to object to the notice by failing to respond in a reasonable amount of time. The court found that the two-and-a-half-month period that the primary insurer took to respond was "reasonable," especially where the insurer's actions did not suggest that the letter was proper notice. With respect to the excess insurers, the court noted that where the primary insurer's policy had not been exhausted, the excess carriers did not even have a duty to issue their reservation of rights letters, and thus any delay in objecting to the notice was also reasonable.

Fourth, the court held that the primary insurer was not estopped from denying the adequacy of the notice because the insurer that issued the "Technology Liability" policy, who had the same corporate parent, accepted the letter as adequate notice. The court reasoned that this was "a totally different policy issued by a separate division of [the corporate parent] . . . [that] insured a different type of risk from the D & O policy." Moreover, the court added that there was no evidence that the policyholder was misled into believing that the notice would be accepted by the D&O insurer.

Finally, the court rejected the trustee's contention that the insurers acted in bad faith by delaying their objections until after the excess policies had expired. The court found that where it had concluded that the primary insurer's objection was not unreasonably delayed, "it would be inconsistent to conclude here that [the primary insurer's] actions were deliberately deceptive or grossly negligent." The court also found that the trustee could not establish that the insurers' actions constituted bad faith under either Florida or Illinois law where: (1) the primary insurer had no obligation to respond prior to the expiration of excess policies under which it was not a party, and (2) the insurers were affected by the events of September 11, 2001, which occurred shortly after the policyholder sent its letter.