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NEWSLETTER

Other Decisions of Note

December 2006

Fourth Circuit Rules That Action for Rescission May Proceed at Same Time as Underlying State Court Actions

The U.S. Court of Appeals for the Fourth Circuit, applying federal law, has held that a D&O insurer's action for rescission, recovery of defense costs and multiple declaratory judgments against directors and officers could proceed in federal court while underlying civil actions were ongoing in state and federal court.*Great American Ins. Co. v. Gross*, 2006 WL 3059884 (4th Cir. 2006). The insurer sued to rescind the policy after two of the policyholder's directors pled guilty to conspiracy to commit fraud. The directors and officers contended that the federal court should abstain from hearing the insurer's action to avoid unnecessary entanglement with the ongoing underlying civil matters pending in Alabama state court.

The Fourth Circuit disagreed, reasoning that the rescission action did not constitute a parallel proceeding with the underlying state and federal civil actions sufficient to warrant abstention under *Colorado River Water Conservation District v. United States*, 424 U.S. 800 (1976), since the parties and issues were dissimilar. The court also held that while greater judicial discretion is permitted by the district court in determining whether to abstain from considering actions for declaratory relief pending conclusion of the underlying actions, the insurer's declaratory judgment claims "were so intertwined with the nondeclaratory claims" for rescission and recovery that an abstention of the declaratory judgment claims was not warranted.

Letter Requesting Benefits That Lacks Monetary Demand Does Not Constitute Claim under Claims-Made Policy

An Ohio appellate court has held that a letter sent prior to the inception of a claims-made policy requesting benefits was not notice of a claim because it did not include a monetary demand. Sesko v. Caw, 2006 WL 2976458 (Oh. Ct. App. Oct. 19, 2006). The court also concluded that the insured's failure to give subsequent notice of a claim until after default judgment was entered in the underlying action prejudiced the insurer and precluded coverage under the disability policy.

The putative insured paid for disability insurance through his employer. However, when he applied for benefits, he learned that his employer had failed to pay the premiums, even though it regularly made deductions from his paycheck. He then filed suit against his former employer for negligently failing to fund the plan. After securing a default judgment against his employer, the putative insured brought suit against the disability insurer.

The insurer argued that the claim was not first made during the policy period and was therefore not subject to coverage under the claims-made policy. The policy defined a claim as a "written demand for monetary damages" made during the policy period. Prior to the policy period, the putative insured's attorney sent a letter to the employer asking for documentation regarding benefits and stating that the putative insured was "hereby giv[ing] notice that he is applying for long-term disability benefits." The court held that the letter did not constitute a notice of a claim because it did not make a monetary demand. According to the court, the letter was merely a request for benefits.

The court found that the insurer did not receive notice until after a default judgment had been entered in the underlying action when the insurer received a faxed copy of the complaint filed in the underlying action. Adopting the prejudice standard in uninsured automobile insurance cases, the court found that, under Ohio law, an "insured's unreasonable delay in giving notice is presumed prejudicial to the insurer absent evidence to the contrary." The court had "no doubt" that the failure to give notice until after default judgment had been entered and the time for appeal had passed prejudiced the insurer.

Undisputed Lack of Notice Requires Proof of Prejudice to Negate Coverage

A Florida appellate court, applying Louisiana law, has held that an attorney's undisputed failure to notify his E&O insurer of a malpractice action and entry of default judgment did not preclude the plaintiff in the underlying action from seeking enforcement of the default judgment against the insurer. *Sheikh v. Coregis Ins. Co.*, 2006 WL 3208565 (Fla. Ct. App. Nov. 8, 2006). The court held that, under Louisiana law, "a third party's right to recover may be defeated if the insurer can prove prejudice from the insured's failure to comply with the notice requirements of the policy." Such prejudice was not established here, the court concluded, because the insurer's allegedly defective cancellation of the policy may have contributed to the lack of notice, and it was uncertain whether the insurer would have defended the action, which arose from the insured attorney's neglect of his practice due to drug addiction, even if proper notice had been given. Furthermore, the court found there was a disputed issue of fact regarding whether the plaintiff in the underlying action against the attorney knew of the malpractice insurance policy but deliberately chose not to notify the insurer of the claim prior to the entry of default judgment. Consequently, as the insurer had not established prejudice, the court held that coverage was not negated as a matter of law.

"Insufficient Notice" Is Not a "Coverage Defense" under Florida Law

A federal bankruptcy court in Illinois denied the motion for reconsideration by several insureds under a D&O policy and affirmed its prior decision that the determination by an insurer that a notice-of-circumstances letter is insufficient is not a "coverage defense" that must be raised within 30 days under Florida law. *In re Nanovation Tech.*, Inc., 2006 WL 3040788 (Bankr. N.D. Ill. Oct. 19, 2006). The insureds contended that the court made an error of law when it found that the insurers were not required to assert the "coverage defense" of insufficient notice within 30 days of receiving the letter under Fla. Stat. Sec. 627.426(2)(a). The court held that, under a claims-made policy, sufficient notice is a prerequisite to coverage. Therefore, if notice is insufficient, coverage does not exist in the first place, and the insurer has no need to assert a coverage defense.

Reversal of Underlying Verdict Renders Declaratory Judgment Action Regarding Insurance Coverage Moot

The Supreme Court of Alabama has held that its reversal of a medical malpractice verdict mooted an ongoing declaratory judgment action brought by an insurer to determine whether a medical professional liability policy provided coverage for the malpractice verdict. *Med. Assurance Co. v. Anesthesiology & Pain Med. of Montgomery, P.C.*, 2006 WL 3042905 (Ala. Oct. 27, 2006).

The underlying policy was issued to a clinic and its physicians and paramedical employees subject to a shared limit endorsement whereby coverage for any physician and the clinic was subject to a combined $1 million limit and coverage for any paramedical employee was limited to $100,000. The jury in the medical malpractice action returned a verdict against three of the defendants—a doctor, a nurse, and the clinic—without apportioning their individual liability. The insurer then filed a declaratory judgment action to construe and apply the shared limit endorsement. Subsequently, the Supreme Court of Alabama reversed the original malpractice action. In finding that the reversal of the malpractice action mooted the declaratory judgment action, the court reasoned that the malpractice action could result in a verdict against eight possible combinations of defendants, and, under many possible outcomes, no question as to the shared limit endorsement would be raised. Since state law precluded the court from issuing an advisory opinion, the declaratory judgment action had to be mooted. The court noted in closing that the insurer was not barred from litigating any coverage issues once a new verdict was reached.