CARLTON FIELDS

Claims-Made Policies and the Notice-Prejudice Rule

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In a majority of jurisdictions, the "**notice-prejudice rule**" provides that an insurer may not deny a claim on grounds of late notice without demonstrating prejudice. The rule is statutory in some states and judicially crafted in others. Most courts, however, also hold that the rule **does not apply** to late notice under a **claims-made-and-reported** policy, as opposed to an **occurrence policy**. In 2015, several cases have solidified this trend, and some of them actually extend it. **Occurrence vs. Claims-Made**

An occurrence policy covers claims that arise out of "occurrences that take place during the policy period, regardless of when the claim is made." A **claims-made** policy covers losses that arise out of claims that are made during the policy period, even if the claim arises out of an occurrence that took place when the policy was not in effect. A **claims-made-and-reported** policy provides coverage only for claims made within the policy period that the insured reports to the insurer within a specified time. Claims-made and claims-made-and-reported policies became popular in the 1970s, when the uncertainty of future developments in inflation, jury awards and substantive law significantly raised the price of liability insurance covering claims that might be asserted many years after the occurrence on which they were based. Most courts decline to apply the notice-prejudice rule to claims-made-and-reported policies, on the ground that the notice requirement in these policies helps **define the scope of coverage**. Imposing a prejudice requirement on a term that defines the scope of coverage, the courts reason, could result in the insurer's providing coverage it had not agreed to provide. *See, e.g.*, *Great American Ins. Co. v. Sea Shepherd Conservation Soc.*, 2014 WL 2170297, at *6 (W.D. Wash. May 23, 2014); *Yu v. Century Surety Co.*, 2014 WL 787880, at *4 (Cal. Ct. App. Feb. 27, 2014);*Fishman v. The Hartford*, 980 F. Supp. 2d 672, 680-81 (E.D. Pa. 2013); *ABCO Premium Finance LLC v. American International Group, Inc.*, 2012 WL 3278628, at *9 (S.D. Fla. Aug. 9, 2012); *Dardanelle & Russellville Railroad v. Certain Underwriters at Lloyd's, London*, 379 S.W.3d 734, 742-43 (Ark. Ct. App. 2011); *ITC Investments, Inc. v. Employers Reins. Co.*, 2000 WL 1996233, at *14 (Conn. Super. Ct. Dec. 11, 2000) (collecting cases). There are, however, some exceptions to the exception. Some courts have held that the notice-prejudice rule still applies to claims-made policies, if (a) the underlying claim was made during the term of one policy, (b) the insured was thereafter continuously insured under renewals of that policy, and (c) the insured provided notice during one of those renewal terms. *E.g.*, *AIG Domestic Claims, Inc. v. Tussey*, 2010 WL 3603844 (Ky. App. Sept. 17,

2010);*Cast Steel Products v. Admiral Ins. Co.*, 348 F.3d 1298, 1300–01 (11th Cir. 2003); *Helberg v. National Union Fire Ins. Co.*, 657 N.E.2d 832, 833 (Ohio Ct. App. 1995). Some states distinguish claims-made-and-reported policies from claims-made policies; because they find that the notice requirement in a claims-made policy does not define the scope of coverage, these courts subject those policies to the notice-prejudice rule. *E.g.*, *East Texas Medical Center v. Lexington Ins. Co.*, 2011 WL 773452, *2 n.5 (E.D. Tex. 2011). In Maryland, the state's notice-prejudice rule does **not** protect an insured under a claims-made-and-reported policy, **if** the insured fails to give notice **of any kind** during the policy term. However, if the insured acts within the policy term, but merely fails to comply strictly with the requirements governing **how** notice must be given, then the insurer might be required to demonstrate prejudice. *Sherwood Brands, Inc. v. Great American Ins. Co.*, 418 Md. 300, 13 A.3d 1268, 1288 (Md. 2011); *Minnesota Lawyers Mut. Ins. Co. v. Baylor & Jackson, PLLC*, 531 F. App'x 312, 325 (4th Cir. 2013). **For Liability Insurers, No News is Good News**

Several recent decisions strongly endorse the exemption of claims-made policies from the notice-prejudice rule, and each one does so in a slightly different way.

- In *Craft v. Philadelphia Indemnity Insurance Co.*, 343 P.3d 951 (Colo. 2015), the president and principal shareholder of a contracting company was sued for misrepresentations he allegedly made during merger negotiations. The company's liability insurance policy included D & O coverage that applied to the plaintiff, but he alleged that he was unaware of that coverage until more than a year after the end of the policy term, when the underlying case had already ended. The policy required insureds to provide written notice of a claim "**as soon as practicable**," and, in any case, "**not later than 60 days**" after the policy period expired.

The insurer denied the officer's claim under the policy, and he sued in federal court. The district court dismissed the case, holding that the "notice-prejudice rule" does not apply to claims-made liability policies, and the plaintiff appealed. Because Colorado's courts had not yet defined the scope of the notice-prejudice rule, the Tenth Circuit certified to the Colorado Supreme Court the question of **whether the notice-prejudice rule applies to the date-certain notice requirement of a claims-made policy**. The Colorado Supreme Court answered the question in the negative, citing the traditional rationale for the majority rule:

> *In a claims-made insurance policy, the date-certain notice requirement defines the scope of coverage. Thus, to excuse late notice in violation of such a requirement would re-write a fundamental term of the insurance contract.*

Following this ruling, the U.S. Court of Appeals for the Tenth Circuit duly affirmed the dismissal of the

officer's case.

- The plaintiffs in *Anderson v. Aul* (Wis. Feb. 25, 2015), sued their attorney for malpractice. The attorney had a liability policy that covered "claims that are first made against the insured and reported to the [insurance company] during the policy period." The attorney failed to report the claim during the policy period, although he admitted it had been reasonably possible to do so. Consequently, the insurer intervened in the case and sought summary judgment on the issue of coverage.

In Wisconsin, the notice-prejudice rule is defined in a statute, which provides that an insured's failure to furnish timely notice will not bar coverage unless (i) timely notice was "reasonably possible," and (ii) the insurance company was "prejudiced" by the delay. Wis. Stat. §§ 631.81(1) and 632.26(2). The Wisconsin Supreme Court held, however, that the statutes **do not** require insurers to show prejudice in connection with claims-made-and-reported policies, because the language of those policies, which defines the scope of coverage, trumps the effect of the statutes. The court noted that requiring coverage of an untimely reported claim "**would defeat the fundamental premise of claims-made-and-reported policies**," and it refused to interpret the notice-prejudice statutes to require that result. The court then added the following observation:

> *Even if we had determined that the notice-prejudice statutes supersede this reporting requirement, [the insurer] would prevail.* ***Requiring an insurance company to provide coverage for a claim reported after the end of a claims-made-and-reported policy period is per se prejudicial to the insurance company****.*

In jurisdictions where the issue is still unsettled, that statement is likely to be quoted frequently.

- In *C.A. Jones Management Group v. Scottsdale Indemnity Co.* (W.D. Ky. Mar. 25, 2015), a federal district court took a similar approach to construing the language of a claims-made policy. Ruling on a motion for reconsideration, the court decided it had committed a "**clear error of law**" by failing to enforce a notice requirement against a late-filed claim. The court's earlier ruling had been based on the decision of a Kentucky appellate court, but, on reconsideration, the court found that the appellate case had been **wrongly decided**, because it

> *depart[ed] from a long-held principle of Kentucky insurance law instructing courts construing an insurance policy to look to the language of the policy itself. … There has been no contention that the policy's language was vague, and the majority of courts addressing similar claims have found them to be clear and enforceable.*

On this basis, the court predicted that the Kentucky Supreme Court would find that there was no

coverage for the claim.

- Finally, in *Brenegan v. Fireman's Fund Ins. Co.* (Cal. App. April 21, 2015), the plaintiff was injured in a fall down the stairs of a parking facility. The owner's commercial general liability policy stated that it would cover medical expenses of up to $20,000, ***provided*** that "[t]he expenses are incurred **and reported to us** within one year of the date of the accident." The plaintiff's attorney wrote to the facility's owner within a month of the accident, asking that the letter be forwarded to the owner's liability carrier. But the owner did not forward the letter, and the insurer denied coverage.

It is at least arguable that pricing insurance for medical expenses that are incurred within one year of a policy period does not present the kind of underwriting problems that originally inspired claims-made-and-reported policies—especially where, as in *Brenegan*, coverage is capped at $20,000. Nevertheless, a California Court of Appeal found that the medical expenses clause of the owner's CGL policy was "**analogous to a claims-made policy clause**." It explained:

> *[T]he medical expenses clause 'contains a reporting element essential to coverage.' … Coverage is triggered not by the accident, but by reporting the medical expenses within one year of the date of the accident. …* ***Because the medical expenses clause 'makes notice an element of coverage,' the application of 'the notice-prejudice rule would materially alter the insurer's risk.'***

Brenegan suggests, therefore, that carefully drafted notice requirements can exempt at least certain elements of coverage from the notice-prejudice rule, even in the context of occurrence-based policies. *Republished with permission by Law360 (subscription required). Originally published by PropertyCasualtyFocus.*

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