

# MBT Insurance Law E-Alert



Insurance Law News Update

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*Welcome to MBT's Insurance Law E-Alert. These newsletters provide helpful information related to recent developments in insurance and reinsurance law. We welcome your feedback, so please feel free to contact us with any questions or comments.*

## Expanding Claims-Made Coverage Beyond Original Intent

Traditionally, claims-made policies were not subject to many of the same rules as occurrence-based policies, particularly rules that had developed in the context of notice, because of the clear differences in the policies. An occurrence-based policy, in general, provides coverage for injury, damage, or wrongful acts that take place during the policy period, regardless of when a claim is first made against an insured. A claims-made policy, on the other hand, provides coverage for claims first made during the policy period, although there typically is the additional requirement that the wrongful act take place after the retroactive date and before the end of the policy period. Some claims-made policies also require that the claim be reported to the insurer during the policy period or a specific discovery period (often referred to as "claims-made-and-reported" policies). Since the insurance coverage under a claims-made policy is not open-ended, but rather is limited to claims falling within a set time period, the cost of a claims-made policy typically is less than an occurrence-based policy.

Over the years, policyholders have been aggressive in trying to expand coverage under claims-made policies -- arguing that rules generally associated with notice requirements under occurrence-based policies should be extended to claims-made policies. These arguments have met with some limited success. This newsletter focuses on the recent Illinois case of Uhlich Children's Advantage Network v. National Union Fire Insurance Co. of Pittsburgh, PA, 2010 WL 395645 (1st Dist. 2010), petition for leave to appeal denied (Ill. May 26, 2010), as well as recent cases addressing policyholders' attempts to extend the notice-prejudice rule to claims-made policies.

### **A. Recent Decision of *Uhlich v. National Union***

In Uhlich, the policyholder was insured under a claims-made policy providing coverage for "a claim first made against the [insured] during the Policy Period . . . and reported to the insurer pursuant to the terms of this policy . . ." Uhlich, 2010 WL 395645, \*1. The policy required written notice "as soon as practicable and either: (1) anytime during the Policy Year or during the Discovery Period (if applicable); or (2) within 30 days after the end of the Policy Year or the Discovery Period (if applicable), as long as such Claim is reported no later than 30 days after the date such Claim was first made against an insured." Id. at \*2. While a claim was asserted against the policyholder

during the policy period, the policyholder did not provide notice of the claim to the insurer until more than 90 days after the expiration of the policy period. The insurer denied coverage for the claim and the policyholder later filed suit against the insurer for breach of contract. The policyholder argued that the insurer breached its duty to defend and, therefore, under the Illinois estoppel rule, the insurer was precluded from relying on its "late notice" defenses.

The Uhlich court discussed the differences between occurrence-based and claims-made policies, noting:

Conventional liability insurance policies are "occurrence" policies; they insure against a negligent or other liability-causing act or omission that occurs during the policy period regardless of when a legal claim arising out of the act or omission is made against the insured. Because of the indefinite future liability to which an occurrence policy exposes the insurance company, these companies now offer (also or instead) "claims made" policies, which limit coverage to claims made during the policy period. The coverage is less, but so, therefore, is the cost.

The purpose of a claims-made policy is to allow the insurance company to easily identify risks, allowing it to know in advance the extent of its claims exposure and compute its premiums with greater certainty. A "claims made and reported" policy requires not only that the claim be first made during the policy period, but also that it be reported to the insurer during the policy period.

Id. at \*3 (citations omitted). Even with this backdrop, for purposes of estoppel under Illinois law, the court equated the notice condition of an occurrence-based policy with the claims-made-and-reported requirements referenced in the insuring agreement of a claims-made policy and concluded that the Illinois estoppel rule applied.

By way of background, the Illinois estoppel rule provides that an insurer that breaches its duty to defend without filing a declaratory judgment action is estopped from raising any policy defenses to coverage. Employers Ins. of Wausau v. Ehlco Liquidating Trust, 186 Ill. 2d 127, 708 N.E.2d 1122 (1999). The estoppel doctrine does not apply where the insurer correctly refused to defend, defended under a reservation of rights, or sought a declaratory judgment. Id. A slightly different rule has been applied where the insurer's coverage defenses are solely based on notice conditions under an occurrence policy (in other words, there otherwise is coverage -- but for the notice conditions -- and the insurer would have a duty to defend). In that instance, the insurer must either defend under a reservation of rights or file a declaratory action; it cannot simply disclaim coverage. Id.

The Uhlich court found that the underlying claim was not reported during the specified time period in the policy, one of the requirements under the insuring agreement for there to be coverage, and concluded that, under Illinois law, no duty to defend would exist if the insurer was not otherwise estopped. However, for purposes of estoppel, the court viewed this as a "late notice defense" and, in reliance on Ehlco, concluded that the insurer could not simply deny coverage based on the claim not being reported during the policy period; instead, it had to either defend under a reservation of rights or timely file a declaratory judgment action, which it did not do. Thus, the court concluded that, despite the fact the insurer was correct in its coverage position, the insurer was estopped from

raising any coverage defenses.

The court's decision in Uhlich is troubling in a number of respects. First, the court failed to recognize that a requirement for coverage under the insuring agreement of the claims-made policy was that the claim be reported to the insurer during the policy period (or within 30 days thereafter) as distinct from a notice condition. See, e.g., Continental Cas. Co. v. Cuda, 306 Ill. App. 3d 340, 715 N.E.2d 663 (1st Dist. 1999). Under an occurrence-based policy, if the underlying claim does not potentially fall within the terms of the insuring agreement, the insurer may deny coverage without filing a declaratory judgment action and without being subjected to estoppel. It is when the insurer is relying on a notice condition that an insurer must timely file a declaratory judgment action to avoid estoppel. By treating the reporting requirement as a condition as opposed to an essential requirement under the insuring agreement, the court erroneously applied the Ehlco rule on estoppel. Based on Uhlich, at least in Illinois, claims-made insurers may be required to timely file a declaratory judgment action (or defend under a reservation of rights), if the claims-made requirements (at least relating to reporting) under the insuring agreement are not satisfied, in order to avoid estoppel.

Second, the court failed to recognize that the policy at issue in Uhlich was not a typical "duty to defend" policy (one of the essential requirements under Ehlco for estoppel to apply). The policy at issue in Uhlich provided that "[t]he Insurer does not assume any duty to defend. The Insureds shall defend and contest any Claim made against them." Uhlich, 2010 WL 395645, \*8. The policy further provided:

The Insureds shall have the right to tender the defense of any Claim to the Insurer, which right shall be exercised in writing. . . . This right shall terminate if not exercised within 30 days of the date the Claim is first made against an Insured, pursuant to Clause 7 of the policy. . . . Provided the Insureds have complied with the foregoing, the Insurer shall be obligated to assume the defense of the Claim even if such Claim is groundless, false or fraudulent.

Id. at \*9. It is undisputed that the policyholder in Uhlich did **not** tender the defense to its insurer in writing, as required under the above provision in order for the insurer to have an obligation to assume the defense. The policyholder did forward a copy of the complaint to its insurers, but there was no request that the insurer assume the defense.

The Uhlich court concluded that forwarding a copy of the complaint to the insurer was sufficient to trigger the insurer's duty to defend (even though there was no request by the policyholder that the insurer assume the defense). The court relied on Cincinnati Cos. v. West American Insurance Co., 183 Ill. 2d 317, 701 N.E.2d 499 (1998) in concluding that mere notice of the claim was sufficient to trigger a duty to defend. However, the policy at issue in Cincinnati specifically imposed a "duty to defend" on the part of the insurer for potentially covered suits. In Uhlich, the policy clearly stated the insurer "does not assume any duty to defend," unless within 30 days of the claim first being made, the policyholder exercises its right to tender the defense of the claim to the insurer (which was not done). The court failed to recognize this distinction and instead read into the policy a duty to defend where none existed. By reaching this conclusion, the court not only expanded the insurer's defense obligation beyond the contract terms, but it also used it for its basis to find estoppel (i.e., that the insurer breached its duty to defend).

## **B. Policyholders' Attempts To Extend The Notice-Prejudice Rule To Claims-Made Policies**

Policyholders have sought to expand coverage under claims-made policies by arguing that the notice-prejudice rule typically associated with occurrence-based policies should be extended to claims-made policies. For example, policyholders have argued that claims-made requirements should not be enforced if the insurer cannot establish prejudice, even if the policy requires that the claim both be made and reported during the policy period. Prodigy Communications Corp. v. Agric. Excess & Surplus Ins. Co., 288 S.W.3d 374 (Tex. 2009) (policyholder sought to extend the notice prejudice rule to both a claims-made policy and a claims-made-and-reported policy); Manufactured Housing Communities of Washington v. St. Paul Mercury Ins. Co., 660 F. Supp. 2d 1208 (W.D. Wash. 2009) (policyholder argued that notice-prejudice rule applied to claims-made-and-reported policies, claiming that public policy of Washington requires prejudice to the insured before a claim can be denied on the basis of failure to give notice within a specified time limit); Hermann Servs., Inc. v. Resurgens Specialty Underwriting, Inc., 2009 WL 2392910 (D.N.J. 2009) (policyholder "argues that late notice will not void an insurance policy unless there is both a breach of the notice condition and substantial likelihood of appreciable prejudice to the insurer" even in the context of a claims-made-and-reported policy).

Most courts have rejected the policyholders' argument that the notice-prejudice rule should be extended to claims-made policies, at least with respect to claims-made-and-reported policies. The rule in Illinois is unchanged by the decision in Uhlich. Under Illinois law, whether or not the insurer was prejudiced as a result of the policyholder's failure to give notice during the prescribed time period in a claims-made policy is immaterial. Cuda, 306 Ill. App. 3d at 350. Unless the notice requirement is strictly complied with, there is no coverage. Id. Other courts have reached a similar conclusion. In Manufactured Housing, the court concluded that public policy does not require the extension of the notice-prejudice rule to claims-made-and-reported policies, reasoning that to do so would be to negate the inherent differences between occurrence-based policies and claims-made policies. 660 F. Supp. 2d at 1213-14. The court agreed with an earlier court's recognition that to extend the rule to claims-made-and-reported policies would be "tantamount to an extension of coverage to the insured gratis, something for which the insurer has not bargained." Id. Likewise, in Hermann, the court rejected the policyholder's attempt to impose the "appreciable prejudice" rule (applicable to late notice defenses under occurrence-based policies) on a claims-made-and-reported policy, reasoning that such an imposition would essentially extend the notice period and "constitute an unbargained-for extension of coverage, gratis, resulting in the insurance company's exposure to a risk substantially broader than that expressly insured against in the policy." 2009 WL 2392910, \*6.

However, in Prodigy, the Texas Supreme Court did allow the extension of the notice-prejudice rule to a claims-made policy, where the issue was whether the policyholder provided notice of the claim as soon as practicable within the strict confines of the policy notice requirements (it was undisputed that the claim was reported during the discovery period). 288 S.W.2d at 382. While recognizing the distinctions between claims-made and occurrence-based policies and the fact that "notice requirements when found in a claims-made policy serve very different purposes," the court concluded that in "a claims-made policy, when an insured gives notice of a claim within the policy period or other specified reporting period, the insurer must show that the insured's noncompliance with the policy's 'as soon as practicable' notice provision prejudiced the insurer before it

may deny coverage." Id. at 380, 382. Under the circumstances of the case before it, the Prodigy court found that the policyholder's obligation to provide notice "as soon as practicable" was not a material part of the bargained-for exchange in connection with the claims-made policy.

Similarly, where the claims-made policy does not include a requirement that the claim be reported to the insurer during the policy period (in other words, where the policy is not a claims-made-and-reported policy), some courts treat the provisions requiring notice the same as those found in occurrence-based policies. See, e.g., Pension Trust Fund for Operating Eng'r v. Federal Ins. Co., 307 F.3d 944 (9th Cir. 2002) (notice-prejudice rule applies where the claims-made policy does not require that the claim be reported during the policy period to implicate coverage); Oakland-Alameda County Coliseum, Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa., 480 F. Supp. 2d 1182 (N.D. Cal. 2007) (under a claims-made policy as opposed to a claims-made-and-reported policy, the notice-prejudice rule applies to determine whether timely notice was provided).

Thus, where there is an issue regarding the timing of notice or reporting to the insurer of a claim, it will be important to determine whether the policy is a claims-made-and-reported policy and, if so, whether the claim was reported during the specified reporting time period. In the event the policy does not require reporting during a specified time period or the claim was reported during the specified time period (but arguably not timely), it is possible that the notice-prejudice rule will apply in determining whether there has been compliance with the notice requirement (at least where the applicable state's law requires prejudice to establish late notice).

## Upcoming Events

Scott Seaman will present on advance insurance topics at the HB Litigation Conference on "Oil in the Gulf-Litigation and Insurance Coverage" in Atlanta, GA on June 24-25, 2010.

Meloney Perry is a program chair for the Plenary Session entitled, "Would You Mind Explaining This? The Cultural Clash in International Litigation - What Transatlantic Clients Expect From Their Lawyers," at the Federation of Defense and Corporate Counsel Annual Meeting in Munich, Germany on Jul 29, 2010.

## MBT's New "Duty to Defend: A Fifty-State Survey" Book Will Be Available Next Month!

MBT is pleased to announce the release of the first volume of the MBT Insurance Law Series, periodic national surveys of insurance law issues oriented toward claims professionals. The first volume of the series, "Duty to Defend: A Fifty-State Survey," will be released in July. The Duty to Defend survey addresses seven fundamental issues of interest to claims professionals and lawyers making decisions about properly responding to complaints tendered for a defense:

- The standard for determining whether an insurer has a duty to defend;
- Under what circumstances the insurer may consider information not contained in the policy or underlying complaint in determining whether it has a duty to defend;

- Whether an insurer must defend a lawsuit if only some of the facts alleged or counts included in the underlying complaint are covered;
- The circumstances under which an insured may select its own defense counsel to be paid for by the insurer;
- The consequences of breach of the duty to defend;
- Whether the insurer may recoup from the insured the defense costs allocable to claims that are not covered; and
- Whether an insured that prevails in coverage litigation may recover from the insurer the attorney's fees expended by the insured for litigating coverage, without demonstrating common law or statutory bad faith.

Please contact us to reserve your complimentary copy of the book.

MBT is a leading litigation firm with 90 attorneys and offices in Chicago, Dallas and Phoenix. In addition to concentrating in insurance and reinsurance law and litigation, our attorneys focus on commercial litigation, employment and labor law, professional liability defense, attorney fee disputes and environmental law.

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