Risk Radar

HOT TOPICS TO WATCH IN THE COMING MONTHS

Claims-Made-And-Reported Policies: The Notice/Prejudice Rule

This past February 2011, the Maryland Court of Appeals found in *Sherwood Brands, Inc. v. Great American Ins. Co.*, 418 Md. 300 (Md. 2011) that the notice-prejudice rule applied to every late notice of claim, even under claims-made-and-reported policies.

There, policyholder Sherwood Brands bought a claims-made-and-reported policy from Great American Insurance Company with a period of May 1, 2007–May 1, 2008. The policy covered claims (lawsuits, demand, etc.) made against the policyholder as long as (1) the claim was made against the insured during the policy period, and (2) the claim was reported to the insurance company within 90 days after the end of the policy period. Sherwood was sued in December 2007 (within the policy period), but failed to notify Great American until October 2008, about two months after the end of the reporting window.

Maryland Code (1997, 2006 Repl. Vol.), Insurance Article section 19-10 provides that "[a]n insurer may disclaim coverage on a liability insurance policy on the ground that the insured . . . has breached the policy . . . by not giving the insurer required notice only if the insurer establishes . . . that the lack of . . . notice has resulted in actual prejudice to the insurer." In *Sherwood Brands*, the Maryland Court of Appeals revisited the history of the notice-prejudice rule under Maryland law, including the development of this statutory language. The court noted that while the requirement that a claim be made against the policyholder during the policy period was a condition precedent to coverage, the statute characterized the policyholder's promise to a timely report of the claim as a covenant that could be "breached" within the provisions of the statute. The court found that, even under a claims-made-and-reported policy, the statute required that the insurance company demonstrate prejudice before denying the claim based on late notice, as long as the claim itself was made against the policyholder during the policy period.

Nationwide, insurance companies cry foul when they learn of a late claim, even where they would have denied coverage on other grounds anyway. The *Sherwood Brands* decision stands for a more equitable result for the policyholder. ▲

Excess Insurance: Exhaustion Provisions

Excess insurers are fighting hard to persuade courts to construe exhaustion provisions as to eliminate coverage where the policyholder compromises its claim under the primary policy. In *Qualcomm v. Lloyd's et al.* (2008) 161 Cal.App.4th 184, policyholder Qualcomm settled a coverage dispute with its primary insurer over a loss spanning the primary and excess layers. Under the settlement, the primary paid less than its policy limits and Qualcomm paid the difference between the settlement amount and the primary limits out of pocket. Qualcomm then sought coverage for the rest of its loss under its Lloyd's excess policy. Lloyd's denied coverage, pointing to its exhaustion provision requiring the underlying insurer to pay its full limits before Lloyd's' duty to pay arose. The California Court of Appeal upheld this result, based on the excess policy's "clear and explicit" requirement that the primary insurer actually pay the full policy limit before triggering excess coverage.

A recent Seventh Circuit decision underscores the importance of analyzing the excess insurer's exhaustion provision before compromising primary limits. In *Trinity Homes LLC v. Ohio Casualty Ins. Co.*, 629 F.3d 653 (7th Cir. 2010), the excess insurer's exhaustion provision was less precise than the Lloyd's clause in *Qualcomm* about who could pay the primary limits and still trigger excess insurance. There, the exhaustion provision in a commercial general liability (CGL) policy conditioned excess coverage on "the insured being legally obligated to pay as damages" in excess of the underlying insurance. When the policyholder settled with its primary insurer for less than limits, excess carrier Cincinnati Insurance Company denied coverage because the primary insurer had not actually paid its limits, and Trinity Homes was not entitled to pay the difference between the settlement with the primary carrier and primary limits and still trigger excess coverage.

In response to *Qualcomm* and *Trinity Homes*, excess insurers are rewriting their exhaustion provisions to condition coverage upon an actual, cash payment by the primary insurer of its entire limits. The effect is to preclude compromises of coverage disputes with underlying carriers, lest this defeat a condition precedent to excess insurance. In an age in which voluminous reservations of rights from primary insurers in complex claims can be de rigueur, policyholders have to be mindful of the potential consequences of settling coverage disputes with these carriers: loss of excess insurance. ▲

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