

Court Excuses Reporting Requirement of Claims-Made and Reported Policy to Avoid Forfeiture

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A California appellate court has reversed a trial court's grant of summary judgment in favor of an insurer, holding that compliance with the reporting requirement in a claims-made and reported legal malpractice insurance policy may be equitably excused in the narrow circumstances of the case. *Root v. Am. Equity Spec. Ins. Co.*, 2005 WL 1515941 (Cal. Ct. App. June 28, 2005). In so holding, however, the court went to great lengths to emphasize the narrow nature of its ruling.

The insurer issued a claims-made and reported lawyer's malpractice policy to an attorney. The policy contained a prominent notice that stated in part "[t]he coverage afforded by this policy is limited to claims arising from the performance of Professional Services which are first made against the insured and reported in writing to the Company while the policy is in force." The insuring agreement in the policy obligated the insurer to pay "all sums in excess of the Deductible . . . which the Insured shall become legally obligated to pay as Damages as a result of claims first made against the Insured during the policy period and reported in writing to the company during the policy period."

A former client of the attorney filed a malpractice suit against the attorney three days prior to the end of the policy period. The former client did not serve the attorney with notice of the suit until after the close of the policy period. On the day the suit was filed, however, a journalist contacted the attorney seeking his reaction to the filing of the suit. The attorney dismissed the reporter's call as "a possible prank" and did not provide any information regarding the potential claim to the insurer at that time. Once the lawyer received service of the suit, the lawyer immediately provided notice to the insurer. The insurer denied coverage on the grounds that the lawyer did not report the claim during the policy period. The lawyer also tendered the claim to his subsequent insurer and that insurer denied coverage as a claim first made against the lawyer during the prior policy period. The lawyer subsequently filed the instant coverage action, and the trial court granted the insurer's motion for summary judgment based on the lawyer's failure to comply with the reporting condition in the policy.

In considering the case, the appellate court first held that a claim had been made during the first insurer's policy period. The court reasoned that the broad definition of "claim" as a "demand . . . for money against an insured," which could apply to filing or service of a suit, was in tension with the prior acts exclusion, which obligated the insured to report acts that could result in future claims. The court explained that as a result, the "insured can be whipsawed by an ambiguous definition of claim and a parallel requirement of reporting anything which constitutes a reasonable 'basis' to believe a claim is being made into having no coverage under policies on either side of a policy period expiration divide." Confronted with this dilemma, the court concluded that "given the ambiguity in the word 'claim,' the word must be given an interpretation which favors the insured on both sides of the policy period divide, lest the insured be trapped by competing, but mutually exclusive, reporting triggers of a 'basis to believe' versus 'service of a suit.'"

The court next reviewed precedent regarding such situations, noting "there is much uncharted territory involving the problem of the 'last minute claim' in a claims made and reported policy." Based on its review of three California appellate court opinions and one from the Florida Supreme Court, the court concluded that "[w]e are . . . aware of no case, such as the one before us, where the late report was made a *de minimis* time after the expiration of the policy and where the insured had not been given the opportunity to be protected under an extended claim reporting endorsement."

The court then proceeded to review California law regarding conditions precedent and disproportionate forfeitures. The court noted that "California's common law of contracts has traditionally allowed for the equitable excusal or remediation of non-occurrence of conditions precedent in contracts when such non-occurrence works a forfeiture." The court also pointed out that Section 3275 of the California Civil Code provides a statutory basis for the anti-forfeiture rule. The court, following *O'Morrow v. Borad*, 27 Cal. 2d 794 (1946), held that these common law and statutory rules apply to insurance contracts, notwithstanding the fortuitous nature of the risk covered by an insurance contract.

Applying this doctrine to the facts of the instant action, the court first held that the reporting requirement in the policy at issue was a condition precedent to coverage despite its placement in the insuring agreement. The court specifically held that "the reporting condition in [the lawyer's] policy here does *not* go to basic coverage but quacks, walks, looks and functions like a condition, not an element of the fundamental risk insured." The court also noted that text of the "claims" section of the policy indicated that reporting is a condition precedent to coverage and that the commercial reality of pricing of claims-made and reported policies provides further evidence that timely reporting is a condition precedent to coverage rather than an element defining the essential scope of coverage.

The court next distinguished the equitable excuse of a condition doctrine it applied in this case from the notice-prejudice rule. The court noted that prior California courts had correctly declined to adopt the notice-prejudice rule in the context of cases involving claims-made and reported policies because "[t]o apply the notice-prejudice rule to a claims made and reported policy would have been to convert that policy into a pure claims made policy, and therefore give the insured a better policy than he paid for." In contrast, the court reasoned that "the possible equitable excusal of a condition precedent is [] much more flexible, nuanced, and does no violence to the claims made and reported nature of the policy" based largely on its observation that

the equitable excusal rule is not a bright line test and its application is highly factually dependent.

The court then concluded that equity required the application of the excuse doctrine on the facts before it. In doing so, it emphasized that the insured had not had the opportunity to conduct an investigation regarding whether a claim would be brought and was not offered an extended reported period by the insurer. It also noted that the insured had reported the claim promptly upon receiving confirmation of the claim. Based on such facts, the court stated that it would be "most inequitable" to enforce the condition precedent of a report during the policy period" and reversed the trial court's grant of summary judgment to the insurer.

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