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Preparing To Win: Common Insurance Coverage Traps And How To Avoid Them

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When risk is managed poorly, business suffers and people lose jobs. When it is managed effectively – saving capital and earnings – business succeeds and expands, and people get promoted. Corporate counsel are in a unique position to quarterback the risk management process through careful selection and deployment of insurance. This article will help you "prepare to win" by identifying common coverage traps in liability insurance policies and how to avoid them.

Trap No. 1: Notice

Insurance policies require policyholders to provide notice of a "claim." In the context of third-party liability insurance, we typically think of a "claim" as a lawsuit. But some policies define "claim" much more broadly to include investigative orders, tolling requests and even simple written demands. Always check your policy for the precise definition, and when in doubt, consult coverage counsel – or just err on the side of providing notice.

Once you determine you have a claim, the next issue to address is how soon you need to tell your insurers about it, or risk losing coverage. The required timing of notice will depend on the type of policy you have.

"Occurrence-based" policies, which generally cover incidents that occur within the policy's effective period regardless of when a claim is made, do not set a

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specific date by which notice must be given. Typically, however, the policyholder must tell carriers about a claim "as soon as practicable" in order to trigger coverage.

By contrast, "claims-made-and-reported" policies cover only those claims that are both made against the insured, and reported to the carriers while the policy is in effect. Some policies extend the deadline for notifying insurers beyond the policy termination date for a short period (such as 45 or 60 days) without charging additional premium. Claims-made-and-reported policies almost always offer the policyholder the option to extend the notice period for longer periods, for additional premium.

After you identify when to provide notice of a claim, you need to know how to notice it – what format is required? How much detail must you include? Should you attach any documents? Again, your policy likely specifies the required medium ("written notice") and any attachments ("a copy of the complaint or demand"). Keep in mind that the general purpose of a notice provision is to make your insurer aware that a claim exists, and to provide the insurer with an adequate opportunity to investigate it. The simplest and safest approach, especially if you are proceeding without coverage counsel, is to forward a copy of the complaint, subpoena or demand letter, or copy and paste from such documents. If you characterize the claim in any way, you risk a loss of coverage.

Our clients also often ask us an important question: If a claim is relatively small, can we settle it without involving our carrier to avoid the premium increase that will likely accompany giving notice? In the commercial insurance context, this practice should be avoided, as the consequences of not giving notice of such a claim can be catastrophic. This is because most claims-made-and-reported policies contain aggregation provisions, which lump related claims together and treat them as a single claim. Thus, if notice of a small claim is withheld and a much larger, factually related claim is made later, the failure to give notice of the earlier claim can jeopardize coverage for the later, related one.

Trap No. 2: Cooperation

After you give notice of a claim, your carrier may ask you to assist in defending the claim or provide information about how you plan to defend the claim; either way, so-called "cooperation clauses" in your policies will come into play. Generally speaking, cooperation clauses obligate an insured to assist an insurance company in its defense of a claim on the insured's behalf (under a duty to defend policy) or provide certain information to the insurer when the insured selects and controls its own defense counsel (under a duty to reimburse policy).

Often, depending on the state law governing interpretation of the policy, an insured's failure to cooperate does not automatically result in a forfeiture of coverage; rather, a carrier must show that the cooperation failure substantially prejudiced its ability to defend or settle a claim.

It is important, however, to be alert to the possibility that providing confidential materials to your insurer (such as defense counsel's written evaluation of liability and damages) in an effort to cooperate could result in a waiver of privilege or work product protection. And if your policy provides for reimbursement of defense costs rather than an actual defense, there is even greater risk of this kind of waiver. There are, however, steps that an insured can take to alleviate this the risk, like entering into a carefully-worded confidentiality and common interest agreement.

If your carrier has denied coverage entirely, however, there is no common interest between your company and the carrier. Therefore, providing privileged or protected information to a carrier, hoping it will change its position, will result in a waiver of any privileges or protections attaching to the information.

Trap No. 3: Settlement

To achieve an insurer-funded settlement, it is important to plan ahead. When a carrier receives notice of a claim, the adjuster is obligated by insurance regulations to set a reserve for the cost to pay a potential settlement, or an adverse judgment or award against the policyholder. Insurers cannot fund or contribute to a settlement that exceeds the loss reserve – to offer a larger amount; the adjuster must go through the insurer's internal process for increasing the reserve. Because carriers are notoriously slow to revise their reserves, it is important for corporate counsel to educate adjusters about changes in exposure presented by claims well in advance of a mediation or settlement opportunity, giving the adjuster time to increase their reserve and potentially pay for a settlement.

Your company may also have valuable leverage in the settlement process if the insurer refuses to settle a claim or lawsuit. Under the so-called "Excess Judgment Rule," your carrier has a duty to act in good faith by settling a lawsuit or claim if your company's liability exposure exceeds the limits of your policy or insurance tower (subject to certain limitations depending on which state's law applies). If this exposure exists, and the plaintiff makes a settlement demand for or within insurance limits, then the carrier must pay it or risk becoming responsible for the entire amount of any subsequent adverse judgment or award – even if it far exceeds policy limits.

The best way to trigger the Excess Judgment Rule is to create a paper trail of correspondence to the insurer citing the facts generated in discovery, and law applicable to liability and damages, showing that the insured's exposure exceeds policy limits, rendering the carrier's refusal to accept a within-limits demand unreasonable.

Successfully navigating these common coverage traps takes attention to detail and careful planning, but corporate counsel is in the perfect position to do just that and, where appropriate, leverage outside resources like your company's insurance broker or outside coverage counsel to add game-changing value.

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