Navigating the Currents of Timely Notice in Third-Party Liability Policies – Best Practices

BY KRISTEN HUDSON

Sooner or later, every insurance policyholder faces a potential storm: an accident or mistake has happened, a suit is threatened, now what? It is the age-old quandary for insurance policyholders, when to give notice of a potential claim. This is not a philosophical or esoteric inquiry; the stakes are high. Failure to give timely notice of a covered claim may defeat insurance coverage entirely.

Under many insurance policies, notice must be given as soon as practicable, which courts have interpreted as within a "reasonable" time. To determine what is reasonable, courts look to the facts and circumstances of each particular case. Factors involved in this determination include the specific language of the policy's notice provision, the insured's sophistication in commerce and insurance, the insured's awareness of an event that might trigger insurance coverage, the insured's diligence in ascertaining whether coverage is available, and whether the insurer will suffer prejudice as a result of the late notice.[1] Thus, whereas in earlier cases, courts looked only to whether the insurer was prejudiced by the late notice, courts now look to a variety of factors, with prejudice to the insurer being just one of them.

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Moreover, prejudice is typically not a factor in claims-made policies, such as errors and omissions policies and directors' and officers' liability policies. In these policies, notice is a condition precedent to coverage, and the policies mandate that both the claim and notice of the claim be made within the policy period to trigger coverage.

What are the best practices for giving notice of circumstances, an occurrence or an event that may give rise to the claim or lawsuit? Litigation is inherently unpredictable. Thus, it goes without saying that predicting when an event may give rise to a claim under an insurance policy can be tricky at best. There are a few best practices, however, that can help you navigate the currents.

STEP ONE – RECOGNIZE THE CIRCUMSTANCES THAT MAY GIVE RISE TO A CLAIM

1 *West American Ins. Co. v. Yorkville Nat'l Bank*, 238 Ill. 2d 177, 185-86 (2010).

Definitions of what constitutes a claim, suit or occurrence vary from policy to policy, but a good rule of thumb to ask is whether the third party demanded some form of money or services, or requested that the insured refrain from some activity. For example, is the third party requesting that you cease and desist from some activity? Has opposing counsel asked you to enter into a tolling or standstill agreement? While this may not seem to qualify as a "claim" or a "suit" under the policy, it may certainly give rise to one, and the failure to give notice of the cease and desist or tolling agreement may result in a denial of coverage down the road.

Another consideration is whether a litigation hold has been issued related to the event. If so, then notice should be provided to all carriers that might potentially be at risk. If not, the carrier may use the date of the issuance of the litigation hold to deny coverage.

Even where the original claim is uncovered, to preserve future coverage, policyholders should consult coverage counsel or their broker to determine whether it is advisable to give notice of circumstances in the event that the original claim is later amended to add covered claims.

STEP TWO – GIVE NOTICE EARLY AND OFTEN

With a few possible exceptions, there is no downside to giving notice. If there are circumstances that warrant notice, but ultimately do not give rise to a claim, there is no loss and thus the notice will not appear on a loss run or will likely not impact premiums on a going-forward basis. If the circumstances do result in a claim, then you will be grateful for the timely notice.

One exception is in states where, upon notice, an insurer must issue a coverage opinion and/or file a declaratory judgment action to determine coverage. In those states, of which Illinois is one, communication with the insurer is key to navigating this issue. An insurer may ask that the insured withdraw the notice on the condition that if a claim later arises, and it is retendered, then notice will be considered timely.

Another potential pitfall to avoid is when the policyholder is an additional insured under other policies. Be sure to provide notice under any policies where there is additional insured coverage if the claim implicates a named insured's operations in any way. This is true even if the named insured is not currently a target for liability. In considering notice issues for additional insureds, analyze carefully whether issuing notice selectively under the Illinois target tender rule would be prudent.

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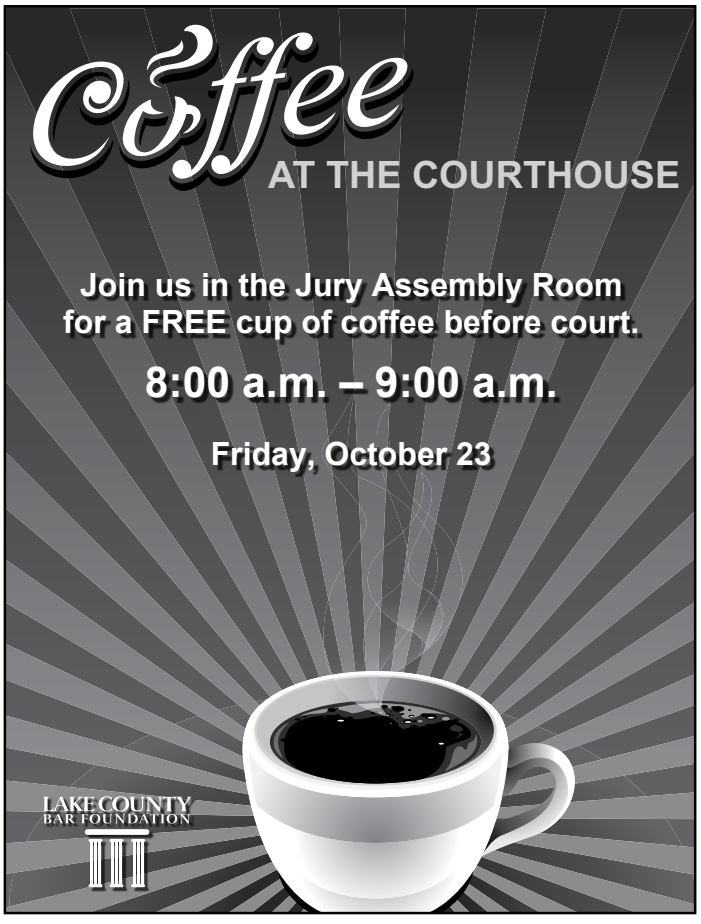
STEP THREE – DOCUMENT THE NOTICE

Make sure the notice to the insurance company is in writing and the terms for notice under the policy are followed. Where there are questions about whether notice is appropriate, it is a good idea to get insurance coverage counsel or the broker involved to coordinate and confer with the insurer. Maintain copies of all notice letters sent.

In sum, the following 3 steps can help you preserve insurance coverage when facing third-party liability claims:

When an event occurs, ask whether the third-party is demanding money, services, or asking the insured to refrain from some activity;

When in doubt, give notice; and document, document, document.



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