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ALERTS

Seventh Circuit Takes Broad View Of Relatedness Under D&O 'Claims Made' Policies

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Highlights

Federal appeals court holds a complaint that originally has one declaratory-relief claim against one company and is amended to add damages claims against additional companies and directors constitutes a single claim for the purposes of a "claims made" D&O policy

The defendants were required to notify their insurer when the original complaint was filed

The concurring opinion observes that the decision gives policyholders a powerful incentive "to flood the D&O insurer with notice of even seemingly minor claims (even well within a policy deductible)"

On Oct. 24, the U.S. Court of Appeals for the Seventh Circuit adopted a broad view of "related claims" and "related wrongful acts" in a decision that could affect numerous holders of "claims made" insurance policies.

The Seventh Circuit's decision, denying coverage under a directors and officers (D&O) "claims made" policy, provides an important reminder to policyholders: send, send, send the insurer notice, even for seemingly

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minor claims. Failure to submit notice may result in losing out on valuable coverage if and when the claim evolves. Indeed, the decision includes a concurrence that gives policyholders remarkably candid advice on how to respond to claims.

The panel opinion explained: “The distinguishing feature of ‘claims made’ insurance is that the insured must notify the insurer of a ‘claim’ in the same policy period in which it is first ‘made.’ If a claim goes unreported in the relevant policy period, then the insurer owes no duty to defend or indemnify.”

In this case, the claims made policy covered a handful of affiliated family construction companies and those companies’ directors and officers. Multiple family members retained ownership shares in one of the covered companies. When a dispute arose over the size of one family member’s share in the company, the shareholder’s estate filed a state court complaint against the company. The complaint solely sought a declaration that the plaintiff owned a certain percentage of the company’s shares.

The company did not notify the insurer of the original complaint. And about a year later, the plaintiff amended the complaint to add new allegations and new codefendants: It added 1) additional covered companies and individual directors as defendants, and 2) new damages claims against the directors for breach of fiduciary duty, fraud, and conspiracy (including for serious alleged misconduct many years removed from the conduct alleged in the original complaint).

The panel opinion unanimously held that the original complaint stated a “claim” of which the policyholder was obligated to notify its insurer. It also held that the amended complaint’s new allegations were “related wrongful acts” and the claims against new parties were “related claims.” As a result, none of the defendants were entitled to coverage under the policy, including the newly added policyholder-defendants.

Judge David Hamilton concurred and noted “three practical implications” of the panel’s decision:

1. The decision “creates a powerful incentive for any company with a claims-made D&O policy to give the insurer notice of even the most minor claims, including those against only the company.” Thus, policyholders should consider acting with utmost prudence in order to preserve coverage under claims made policies: “As this case shows, …. failure to give notice of the original minor claim against only the company will leave the insureds without defense or coverage for the larger threat that emerges later.”
2. The decision gives “outside directors incentives to pressure management to make sure the company gives notice of … minor claims asserted against only the company.” Indeed, the decision means “directors can lose coverage for their personal defense and personal liability if, through no involvement or fault of the directors, the company fails to give the insurer timely notice of a minor claim against only the company.”
3. The decision “cuts both ways” – when insureds do give notice of initially minor claims, they can “trigger coverage for the much larger, more extensive, and more complex ‘related claims’” that may arise down the road. Essentially, although

the initial claim may not seem significant, by providing notice, the policyholder can make certain the insurer will be on the hook later – if and when the claim evolves.

Claims that start small can often grow large, so it is best practice to not hesitate to send notice – even for seemingly minor claims. Policyholders must proceed with caution or otherwise risk losing out on the valuable claims made coverage for which they paid.

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