"UNCONDITIONAL LOVE" – POLICY CONDITIONS AND COVENANTS

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I. *CUTAIA*—ANCIENT HISTORY

In 1972, the Texas Supreme Court held that the notice of suit provision in an auto policy requiring that suit papers to be sent promptly was a condition precedent, the breach of which relieved the carrier of its policy obligations without any showing of prejudice being required. *Members Mutual v. Cutaia, 476 S.W.2d 278 (Tex. 1972)*. In *Cutaia*, the carrier even knew of the suit and defended it under a non-waiver agreement. The Court, however, held that it was up to the Legislature or the then State Board of Insurance, to "insert a provision that violations of conditions precedent will be excused if no harm results from their violation." *Id.* at 281.

II. THE 1973 BOARD ORDER

The Texas State Board of Insurance got the message apparently because the very next year it issued Board Order 23080, that required a mandatory endorsement to all Texas CGL policies requiring the insurer to show prejudice in order to avoid coverage based on the insured's breach of the policy's notice provisions. *See* State Board of Insurance, *Revision of Texas Standard Provision For General Liability Policies – Amendatory Endorsement-Notice*, Order No. 23080 (Mar. 13, 1973). The endorsement provides:

> As respects bodily injury liability coverage and property damage liability coverage, unless the company is prejudiced by the insured's failure to comply with the requirement, any provision of this policy requiring the insured to give notice of action, occurrence or loss, or requiring the insured to forward demands, notices, summons or other legal process, shall not bar liability under this policy.

See PAJ, Inc. v. Hanover Ins. Co., 243 S.W.3d 630, 632 (Tex. 2008).

Note that the language of the board order is limited to coverage for bodily injury and property damage. In 1973 when the Board Order was promulgated, the CGL policy only afforded coverage for "bodily injury" and "property damage". The standard CGL policy did not afford the "personal injury" or "advertising injury" coverage like it currently does under Coverage B. In 1981, the Insurance Services Office promulgated an "advertising injury" Broad Form Coverage Endorsement that could be purchased separately as an add on coverage to the basic CGL coverage form. Then in 1986, major revisions were made to the standard CGL coverage form and "advertising injury" and "personal injury" coverages became part of the basic policy coverage that now was split out into Coverage A and Coverage B. The Texas Department of Insurance, however, continued to only require the "Texas Amendatory Endorsement" imposing the prejudice requirement as to the "bodily injury" and "property damage" coverage,

i.e. Coverage A until 2000. Since October 2000, the ISO version of the Texas mandatory endorsement now requires prejudice to be shown under CGL policies with regard to personal injury and advertising injury coverages as well.

III. HERNANDEZ v. GULF INS.—A CRACK IN THE DIKE OR COMPLETE DEMOLITION OF CUTAIA?

Hernandez v. Group Gulf Lloyds, 875 S.W.2d 691 (Tex. 1994), was a first party UM/UIM coverage case. The issue was whether the insurer could avoid coverage for a UM claim based on the fact that the insured had entered into a settlement with the at fault driver without the insurer's consent in violation of the "no settlement without consent" provision in the UM coverage. That provision, which was actually phrased as an exclusion from coverage, stated that "this insurance shall not apply" to a claim where the insured had already settled with the uninsured motorist without the insurer's consent. In an 8-1 decision, the Supreme Court held that under general contract law, failure of one party to an agreement to perform will not excuse the other party's performance of the contract, unless the breach of contract thereby committed is material. Materiality is a function of prejudice. Although the *Hernandez* court did not expressly address whether the provision in question was a covenant, as opposed to a condition precedent, the "material breach" analysis that the court employed is the type of analysis generally employed with covenants and not conditions precedent.

Hernandez laid the foundation for a possible overruling of *Cutaia;* after all, if prejudice will not be presumed and must be shown in a breach of the "consent to settle" context where the settlement will almost always affect the UM insurer's subrogation rights, it would be curious, to say the least, if prejudice was not a requirement for avoiding coverage due to the insured's breach of notice provisions which breach may or may not actually affect the insurer's rights.

IV. POST *HERNANDEZ* CASE LAW AND THE "CLAIMS MADE" v. "OCCURRENCE" TYPE POLICY DISTINCTION

After *Hernandez*, several Texas courts have held that any notion of classifying a particular policy provision as a condition precedent v. a covenant under basic contract law is irrelevant. Likewise, some Texas courts have, after *Hernandez*, concluded that whether the Board Order requiring prejudice technically does or does not apply to the particular coverage or policy involved is likewise irrelevant.

For example in *St. Paul Guardian Ins. Co. v. Centrum G.S. Ltd., 383 F. Supp. 891 (N.D.Tex. 2003)*, the court held that based on *Hernandez*, Texas would require prejudice under a CGL policy even if the claim fell under Coverage B not governed by the Board Order, as opposed to Coverage A. See also,

Hanson Prod. Co. v. Americas Ins. Co., 108 F.3d 627, 630 (5th Cir. 1997) (holding that prejudice required even though Board Order did not apply to surplus lines CGL policies); *Comsys Info. Tech. Servs. Inc. v. Twin City Fire Ins. Co., 130 S.W.3d 181 (Tex. App.—Houston [14th Dist.] 2003, pet. denied)*(prejudice required to assert breach of consent to settle provision under "claims made" policy);

Notwithstanding *Hernandez*, however, some courts have continued to hold that no prejudice is required to be shown by the insurer to avoid coverage for breach of notice provisions under a "claims made" policy, as opposed to an "occurrence" based policy. The rationale appears to be that under a "claims made" policy, notice of the claim within the policy period is fundamental to the insurance bargain/premium setting calculus agreed to, whereas under a typical "occurrence" based policy like the CGL policy or an auto policy, the critical part of the bargain struck is simply that the "occurrence" or "accident" must occur within the policy period and notice provisions are ancillary and merely intended to protect the insurer's ability to investigate and respond to the claim in a way that its interests can be protected.

In *Ridglea Estate Condo. Assoc. v. Lexington Ins. Co.*, 415 F.3d 474, 480 (5th Cir., 2005) the Fifth Circuit, applying what it understood to be Texas law, concluded that, under *Hernandez*, prejudice was required in order to excuse the insurer from providing coverage in a first party property damage case involving late notice (6 years late to be precise) of a hail damage claim. Under *Hernandez*, the court concluded that whether prejudice is required or not is not a function of the Board Order but applies to policies generally; at the same time, however, the court noted that there is an exception for "claims made" policies.

Ridglea followed *Matador Petroleum Corp. v. St. Paul Surplus Lines Ins. Co.*, 174 F.3d 653 (5th Cir., 1999), which held that whether prejudice is required for the carrier to successfully avoid payment on the basis of late notice is a simple matter of determining, *not whether notice is a "condition" or a "covenant,"* but what *type* of policy is at issue. Claims-made policies are *not* required to show prejudice; occurrence based policies *are, whether or not they are policies covered by the* Department of Insurance Board Order. While *Matador* involved third-party liability coverage, *Ridglea* simply applied the same holding to property policies that are occurrence based.

The *Matador* court reasoned that occurrence-based policies are *different* on a number of related analytical levels from "claims made" policies:

a. "In the case of an 'occurrence' policy, any notice requirement is subsidiary to the event that triggers coverage.
b. "the requirement of notice in an occurrence policy is subsidiary to the event that invokes coverage"

c. "in the case of a 'claims-made' policy, however, notice itself constitutes the event that triggers coverage."

d. Courts interpret notice provisions in 'claims-made policies strictly because in these types of policies, unlike in 'occurrence' policies, the insured and insurer specifically negotiate the terms of the notice provisions.

See also, *Fed. Ins. Co. v. CompUSA, Inc.*, 319 F.3d 746 (5th Cir. 2003) (per curiam) (holding that under Texas law, an insurer need not demonstrate actual prejudice from the absence of notice in a claims-made policy); *St. Paul Guardian Ins. Co. v. Centrum G.S. Ltd., 383 F.Supp.2d 891, 900 (N.D.Tex. 2003)* (noting that type of policy is relevant to whether prejudice requirement applies).

In 2007, the Houston 14th Court of Appeals explicitly raised the question of whether *Cutaia* was even still good law generally. *Coastal Ref. & Mktg. v. United States Fid. & Guar. Co.*, 218 S.W.3d 279, 285 (Tex. App. – Houston [14th Dist. 2007, pet. denied) (suggesting that there was a trend moving away from *Cutaia's* no-prejudice rule and charactering as "unsettled" the contexts in which prejudice requirements apply).

However, even after *Hernandez*, some other courts continued to hold that *Cutaia* was still the law of Texas so that if the Board Order did not apply to the particular policy or coverage in question, there was no prejudice requirement. *Prodigy Communications Corp., v. Agricultural Excess & Surplus Ins. Co., 195 S.W.3d 764 (Tex. App.—Dallas 2006, pet. granted)*(notice requirement under directors' and officers policy was condition precedent to coverage and no prejudice required to be shown by insurer—8 months late as a matter of law); *PAJ, Inc. v. Hanover Ins. Co., 170 S.W.3d 258, 261 (Tex. App.—Dallas 2005, pet. granted)*(no prejudice required to be shown to deny coverage for copyright infringement claim under CGL policy's Coverage B); *Caddell v. Travelers Lloyds of Texas Ins. Co., 2007 WL 1574244 (Tex. App.—Texarkana, June 1, 2007)* (*Cutaia* still controls for policies not governed by the Board Order—first party property claim).

As noted, however, the Texas Supreme Court granted the petitions for review in both *Prodigy* and *PAJ.* (See Below)

V. ***PAJ V. HANOVER***

In *PAJ, Inc. v. The Hanover Ins. Co.*, 243 S.W.3d 630 (Tex. 2008) the Texas Supreme Court held that an insured's failure to timely notify its insurer of a copyright infringement claim or suit does not defeat coverage under the advertising injury coverage of an occurrence-based CGL policy if the insurer was not prejudiced by the delay.

PAJ, Inc. had a CGL policy with Hanover that covered, among other things, injury arising our of copyright infringement. The policy required PAJ to notify Hanover of any claim or suit brought against it "as soon as practicable." In 1998, Yurman Designs, Inc. demanded that PAJ cease marketing a particular jewelry line and ultimately sued PAJ for copyright infringement. PAJ failed to notify Hanover of the suit until "four to six months after litigation commenced." *Id.* at 631. PAJ filed a declaratory judgment action.

The parties stipulated in the declaratory judgment action that PAJ failed to notify Hanover "as soon as practicable" and that Hanover was not prejudiced by the lack of notice. Both sides moved for summary judgment. The trial court granted Hanover's motion, holding that Hanover was not required to demonstrate prejudice to avoid coverage under the policy. The court of appeals affirmed.

On appeal to the Texas Supreme Court, Hanover contended that the provision was a condition precedent, the failure of which defeated coverage regardless whether Hanover was prejudiced. PAJ argued that the provision was a covenant, the breach of which would excuse Hanover's performance only if the breach was material. PAJ also argued that, even if the requirement were specifically couched in "condition precedent" language, Texas law nonetheless would require an insurer to demonstrate prejudice before it could avoid coverage on this basis alone.

The majority opinion in *PAJ* notes the distinction between occurrence and claims-made policies:

> In addition, the timely notice provision was not an essential part of the bargained-for exchange under PAJ's occurrence-based policy. The Fifth Circuit, applying Texas insurance law, aptly describes the critical distinction between "occurrence" policies and "claims-made" policies as follows:
>
> In the case of an "occurrence" policy, any notice requirement is subsidiary to the event that triggers coverage. Courts have not permitted insurance companies to deny coverage on the basis of untimely notice under an "occurrence" policy unless the company shows actual prejudice from the delay.
>
> *Matador Petroleum Corp. v. St. Paul Surplus Lines Ins. Co.*, 174 F.3d 653, 658 (5th cir. 1999) (citations omitted); *see also FDIC v. Booth*, 82 F.3d 670, 678 (5th Cir. 1996); *Centrum G.S.*, 383 F.Supp.2d at 900-01; *Hirsch v. Tex. Lawyers' Ins. Exch.*, 808 S.W.2d 561, 563 (Tex. App. – El Paso 1991, writ denied). The dissent, by focusing on the type of *coverage* rather than the type of *policy*, entirely disregards this important distinction.

PAJ, 243 S.W.3d 630, 636 (Tex. 2008).

The court, relying on *Hernandez*, held that only a material breach of the timely notice provision would excuse the insurer's performance under the policy. *Id. at 632.* The court noted that at the time of the 1973 Board Order, the standard CGL policy only covered bodily injury and property damage claims. *Id. at 633.* The court held that *Hernandez* was not predicated on a distinction between condition precedent language v. covenant language. *Id. at 633.* The court noted that since *Hernandez*, courts in other states, treatises and commentators had all noticed the trend away from the strict rule of *Cutaia* in favor of the modern trend of requiring prejudice to be shown. *Id. at 634.* Finally, the court rejected the dissent's argument that *Hernandez* was distinguishable because the consent to settle language was couched as an exclusion rather than a condition. *Id. at 635.*

The court reasoned that "'when a condition would impose an absurd or impossible result, the agreement will be interpreted as creating a covenant rather than a condition.'" *Id.* at 635-36 (quoting *Criswell v. European Crossroads Shopping Ctr., Ltd.*, 792 S.W.2d 945, 948 (Tex. 1990)). The court concluded that a denial of coverage without a showing of prejudice would be such a result, imposing "draconian consequences for even *de minimis* deviations from the duties the policy places on the insureds." *Id.* at 637. In reaching its conclusion, the court also noted that the timely notice provision "was not an essential part of the bargained-for exchange under PAJ's occurrence-based policy." *Id.*. Distinguishing such a policy from a claims-made policy, the court recognized that, with respect to occurrence-based policies, a notice requirement "'is subsidiary to the event that triggers coverage.'" *Id.* (quoting *Matador Petroleum Corp. v. St. Paul Surplus Lines Ins. Co.*, 174 F.3d 653, 658 (5th cir. 1999)).

VI. WHAT IS PREJUDICE?

Various courts have given some guidance on what constitutes prejudice.

- The requirement of "actual prejudice" means that the insurer may not disclaim coverage on the basis of prejudice that is only theoretical or presumed merely from the length of delay. *See, e.g., Gen. Acc. Ins. Co. v. Scott*, 669 A.2d 773, 799 (Md. Ct. Spec. App. 1996) (holding that an insurer who receives notice before trial cannot rely on delayed notice alone to show prejudice);

- *Wilson v. Progressive N. Ins. Co.*, 868 A.2d 268, 272 (N.H. 2005) (noting that, although the insurer need not show actual loss of evidence to demonstrate prejudice from insured's delay in providing notice, it must at the very least provide the court with facts showing prejudice and not merely surmise that it may be prejudiced because

certain events may have occurred in the abstract during the period of delay);

- *Canron, Inc. v. Fed. Ins. Co.*, 918 P.2d 937, 943-44 (Wash. Ct. App. 1996) (determining that evidence that a liability insurer's ability to investigate underlying environmental contamination claim against its insured was compromised by insured's delayed notice of claim, standing alone, is insufficient to support jury's conclusion that insurer had suffered the actual prejudice necessary to deny coverage based on the delayed notice; what is lost or changed must be material and not otherwise available or subject to reasonable reconstruction).

- *Lennar Corp. v. Great Am. Ins. Co.*, 200 S.W.3d 651, 695 (Tex. App. – Houston [14th Dist.] 2006, pet denied) (holding that the insurer's "inability to parse its damages any finer through allocations for inspection and repair, and accompanying administrative and legal costs" as a result of the insured's settlement of claims without notice to or the consent of the insurer does not constitute prejudice as a matter of law).

- *Blanton*, 185 S.W.3d at 612-13 (holding that the insurer was prejudiced by the insured landlord's delay of two and one-half years in providing notice of thirty complaints of a leaking roof because the delay prevented the insurer from protecting itself from further loss and resulted in health claims by the tenant and thousands of dollars in avoidable defense costs).

- *Motiva Enters., LLC v. St. Paul Fire & Marine Ins. Co.*, 445 F.3d 381, 386-7 (5th Cir. 2006) (finding that when insurer was not consulted about the settlement, the settlement was not tendered to it, and the insurer had no opportunity to participate in or consent to the ultimate settlement decision, the insurer is prejudiced as a matter of law.)

- *Coastal Ref. & Mktg. v. United States Fid. & Guar. Co.*, 218 S.W.3d 279, 285 (Tex. App. – Houston [14th Dist.] 2007, pet. denied) (concluding that insurer was not prejudiced as a matter of law when insurer was invited to the mediation, offered documents, told about the settlement and given an opportunity to participate).

- *Liberty Mut. Ins. Co. v. Cruz*, 883 S.W.2d 164, 166 (Tex. 1993) (holding that insurer is prejudiced as a matter of law where notice is not received until after default judgment is taken, where insurer had no actual knowledge of suit.)

- *St. Paul Guardian Ins. Co. v. Centrum, 383 F.Supp.891 (N.D. Tex. 2003)* (lost opportunity for 18-24 months to participate in case and manage defense and settlement and alleged lost opportunity to resolve case for minimal settlement amount not prejudice when insurer did receive notice of suit more than two years prior to trial; by contrast, notes prior cases holding that prejudice established when notice given after entry of default judgment or notice given on the eve of trial fast approaching). .

VII. POLICY CONDITIONS AS APPLIED TO ADDITIONAL INSUREDS—*CROCKER*

In *National Union v. Crocker, 246 S.W.3d 603 (Tex. 2008),* a case after *PAJ*, the court, on certified question from the Fifth Circuit, addressed breach of policy notice provisions by an additional insured and held that an insurer has no duty to affirmatively inform the additional insured of his right to defense or coverage under the policy even if the insurer knows that the additional insured has been sued and served. The court held that if the additional insured fails to notify the insurer and request a defense, the insurer has been prejudiced even though the insurer knows about the case. Ignorance of coverage by the additional insured is no excuse; and knowledge of the suit by the insurer does not negate prejudice.

The court held that mere awareness of a claim or suit does not impose a duty on the insurer to defend unless requested by the additional insured to do so. *Id. at 608.* The court distinguished *PAJ* on the basis that in *PAJ*, the insured had made a request for defense, albeit tardily. *Id. at 609.* The court held in contrast to the situation in *PAJ* where notice and request for defense has been made by the insured, the insurer cannot assume that an additional insured who has been served but who has not given notice is looking for the insurer to interpose a defense on his behalf. *Id. at 609-10.*

VIII. CURRENT CASES PENDING IN THE PIPELINE

A. *XL SPECIALTY v. FINANCIAL INDUSTRIES* (Certified Question from the 5th Circuit)

As noted above, in *PAJ*, the court seems to hang on loosely to the possibility that notice under a "claims made" policy may call for a different result than under an "occurrence"-based policy.

The Supreme Court of Texas may consider whether there is still a distinction between "claims made" and "occurrence"-based policies in *XL Specialty Insurance Co. v. Financial Industries Corp.* Under the typical "claims made" policy, there are typically two kinds of notice. First, the policy insuring agreement typically provides that the policy only applies to claims first made (and sometimes also reported) during the policy period. Second, the policy then typically also requires that the insured, even if this basic timing element is met, provide "prompt" or "immediate" notice to the insurer of the claim, much like the typical "occurrence"-based policy condition.

In *XL Specialty*, the Fifth Circuit certified the following question to the Supreme Court of Texas: "Must an insurer show prejudice to deny payment on a claims-made policy, when the denial is based upon the insured's breach of the policy's prompt-notice provision, but the notice is nevertheless given within the policy's coverage period?" *No. 06-51683, 2007 U.S. App. LEXIS 29372, at *7-8 (5th Cir. Dec. 19, 2007) (not designated for publication).* In *XL Specialty*, the claims made policy had a policy period from March 12, 2005 to March 12, 2006. Plaintiffs filed suit against Financial on June 5, 2006, i.e. within the policy period. Financial did not notify XL of the suit until 7 months later, however, but still within the policy period. Thus, the basic insuring requirement that the claim be made and reported to the insurer was satisfied; XL, however, asserted that the 7 month delay in reporting the suit breached the separate prompt notice condition. The district court granted summary judgment for XL, concluding that since a claims made policy was involved, there was no prejudice requirement and notice was late as a matter of law.

The Fifth Circuit noted that there is tension between *Cutaia* and *Hernandez* and that *Hernandez* did not even cite *Cutaia* much less overrule it, even though the language of the court in *Hernandez* is arguably broad enough to operate as an overruling of *Cutaia.*

B. PRODIGY (Petition Granted)

On the same day the court accepted the Fifth Circuit's certified question in *XL Specialty*, it also granted Prodigy's petition for review in the *Prodigy* case, also involving late notice under a claims-made policy. *See Prodigy Commc'n Corp. v. Agric. Excess & Surplus Ins. Co.*, 195 S.W.3d 764 (Tex. App. – Dallas 2006, pet granted Jan. 11, 2008). The court has heard oral arguments in both.

Prodigy involves a claims-made director and officer's liability policy. The Dallas Court of Appeal's decision did not focus on the claims-made nature of the policy, but instead applied the court's own, now overruled decision in *PAJ.*.

VIII. AVOIDANCE OF NOTICE DEFENSES THROUGH WAIVER AND ESTOPPELL—*ULICO*

On August 29, 2008, the Texas Supreme Court issued its opinion in *Ulico Cas. Co. v. Allied Pilots Assoc., 2008 WL 3991083 (Tex. Aug. 29, 2008)* holding that "if an insurers actions prejudice its insured, the insurer may be estopped from denying benefits that would be payable under its policy as if the risk had been covered, but the doctrines of waiver and estoppel cannot be used to re-write the contract of insurance and provide contractual coverage for risks not insured." *Id. *4.*

This case is relevant to the issue at hand because the coverage issue involved in ULICO was the fact that the claims made policy at issue required that the claim be made against the insured and reported to the insurer during the policy period. The claim was made against the insured during the policy period but was not reported by the insured to the carrier until a few days after the policy expired.

The policy was a "claims made and reported" policy requiring that the claim against the insured be both made and reported to the carrier within the policy period. The policy period was August 25, 1998 through August 25, 1999. However, by virtue of two one-month extended reporting period endorsements that the insured purchased, the policy period was extended to October 25, 1999. On October 4, 1999, APA was served with a suit. It forwarded the suit to its broker and its regular outside defense counsel. Ulico did not receive notice of the suit, however, until November 5, 1999, i.e.11 days after the extended policy period expired.

Nevertheless, Ulico acknowledged the claim in December 1999 and stated that APA would be notified of its coverage position once its review was completed. In March 2000, Ulico notified APA that the policy also covered defense costs but reserved rights generally to deny coverage. Ulico enclosed litigation guidelines for counsel to follow, attorney evaluation forms and a form for counsel to submit a budget. Defense counsel did not respond. In April 2001, Ulico notified defense counsel and APA that Ulico agreed to reimburse reasonable and necessary defense costs. In response to this letter, in May 2001, defense counsel sent Ulico its billings totaling approximately $635,000. Thereafter, APA obtained summary judgment in the suit.

In November 2001, Ulico filed a declaratory judgment action based on the fact that the claim was not reported within the policy period and thus did not satisfy the insuring agreement of the policy. The jury in the dec suit ultimately found, among other things, that Ulico had waived or was estopped to deny coverage of the defense costs. The jury did not find that APA had suffered any

damages due to reliance or any action on the part of Ulico, however; instead, the jury awarded the defense costs it found to be reasonable. The court of appeals affirmed recovery based on the "*Wilkinson* exception" to the general rule that coverage cannot be created by waiver or estoppel. Under the Wilkinson exception, "if an insurer assumes the insured's defense without obtaining a reservation of rights or a non-waiver agreement and with knowledge of facts indicating noncoverage, all policy defenses, including those of noncoverage, are waived, or the insurer may be estopped from raising them." *Farmers Texas County Mutual Ins. Co. v. Wilkinson, 601 S.W.2d 520, 521-22 (Tex. Civ. App.—Austin 1980, writ ref. n.r.e.).*

Focusing on the "claims made and reported" aspect of the policy, the court first states that "when a policy covers risks for a certain time period, the time of the event allegedly triggering coverage is a precondition to coverage and is not considered a defensive matter to be pleaded and proved by the insurer." *Ulico, at *7.* Thus, ,the court treated the notice issue as one of threshold coverage and not as a ancillary reporting requirement or condition. This is different than the notice issue that is to be decided in *XL* and *Prodigy*.

The court then examines whether there is, in fact, a "*Wilkinson* exception" to the general rule that coverage cannot be created by waiver and estoppel and holds that *Wilkinson* is bad law. The court says "We do not agree with *Wilkinson's* statement to the effect that noncoverage of a risk is the type of right an insurer can waive and thereby effect coverage for a risk not contractually assumed." *Id. * 10.* The court then proceeds to examine the cases that the *Wilkinson* court had relied upon for the so-called exception and found that none of them support the conclusion that assumption of defense by the insurer without a reservation of rights letter or non-waiver agreement operates as waiver or estoppel. *Id. * 13.*

The court rejected the notion that the mere "apparent" conflict of interest that "might arise" is sufficient harm. *Id. *13.* The court then says, however, that "under some circumstances", an insurer who takes control of the defense without a valid reservation of rights or non-waiver agreement can be "prevented from denying benefits that would have been payable had the claim been covered because the insured is <u>actually</u> <u>prejudiced</u> by the insurer's actions." *Id.* (emphasis supplied). The court contrasted the case of *Pacific Indem. v.. Acel Delivery, 485 F.2d 1169 (5th Cir. 1973)* where estoppel was found to apply on the grounds that in *Acel* the court found specific prejudice to the insured from the insurer's unqualified defense in that the insurer failed to notify the insured of lack of coverage so that the insured could protect itself, the manner in which the defense was conducted before the insurer withdrew, and the fact that the withdrawal took place just before trial. *Id. *11, 13..* According to the court, "The question upon which the insurer's liability should turn is whether an insured is prejudiced as a result of the conflict, an inadequate or absent disclosure, or other actions of the insurer." *Id. *14.*

Justices Jefferson and O'Neill concurred on the basis that the majority opinion was not precluding the policy benefits as the proper measure of damages if there has been actual prejudice. They say, "To that extent, it matters little whether a court says coverage was created or that the benefits are those that would have been payable had there been coverage; a rose by any other name would smell as sweet." *Id.* *20 (Jefferson, concurring).

It is hard to know for sure what the court in *Ulico* is saying exactly. Perhaps if there had been actual damage findings accompanying the estoppel findings of specific damages flowing from the alleged prejudice the result would have been different. The facts in *Ulico* (Cadillac defense and good result for the insured) established no harm to the insured other than that the insured was out the defense costs after being told incorrectly initially that they were potentially covered. The court also seemed to be somewhat troubled by the fact that once the insurer acknowledged the claim the defense proceeded without much additional communication between the insured and the insurer.

For purpose of the issue that is the focus of this paper, the main point from *Ulico* is that under a claims made policy, the reporting of the claim is an operative coverage v. noncoverage threshold determinative fact and not just a condition to be complied with.

Query:

- Would the result have been different if the insured had put on proof that the only reason that it allowed its counsel to run up $600k in defense bills was that it had been led to believe by the insurer that it had coverage for them and that if it had been told up front that there was not any coverage, it could have opted for a scaled down defense but still achieved the same good result??
- But would that make the defense costs incurred no longer reasonable and necessary??
- Would the result be different if only breach of a notice provision in an "occurrence" policy was at issue instead of a claims made policy?
- If so, can there be a weighing of the prejudice suffered by the insurer from the insured's breach of a notice condition against the prejudice suffered by the insured caused by the insurer's actions in not alerting the insured to its defense??