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FINANCIAL AND PROFESSIONAL LIABILITY | JULY 2020

# When in doubt : Notify

## A timely reminder when renewing programs with different ABC/Side A only limit composition

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Appropriate notifications are particularly important in today's market conditions, where insurers are either not supporting an existing Directors and Officers (D&O) program going forward, or are proceeding only on more restrictive terms and with new insurers taking on risk.

In this paper we explore this requirement in relation to a hypothetical scenario, one that we are increasingly facing in the challenging post COVID-19 market. However, many of the issues, coverage concerns, thought process and steps outlined below would also be applicable for other instances when "continuity of coverage is broken" for example:

- Where the expiring ABC limits are reduced going forward.
- Where there is a need to replace one or more insurers in the expiring tower with new insurer(s) at renewal without a new insurer(s) providing full continuity by the imposition of a Specific Matter exclusion or by updating the Pending & Prior Litigation exclusion (to the current date).
- Where the going forward program has significantly higher retentions.
- When a Specific Matters Exclusion is added at renewal.
- Where notable new exclusion(s) – COVID-19, or other "event driven" issues are added at renewal.

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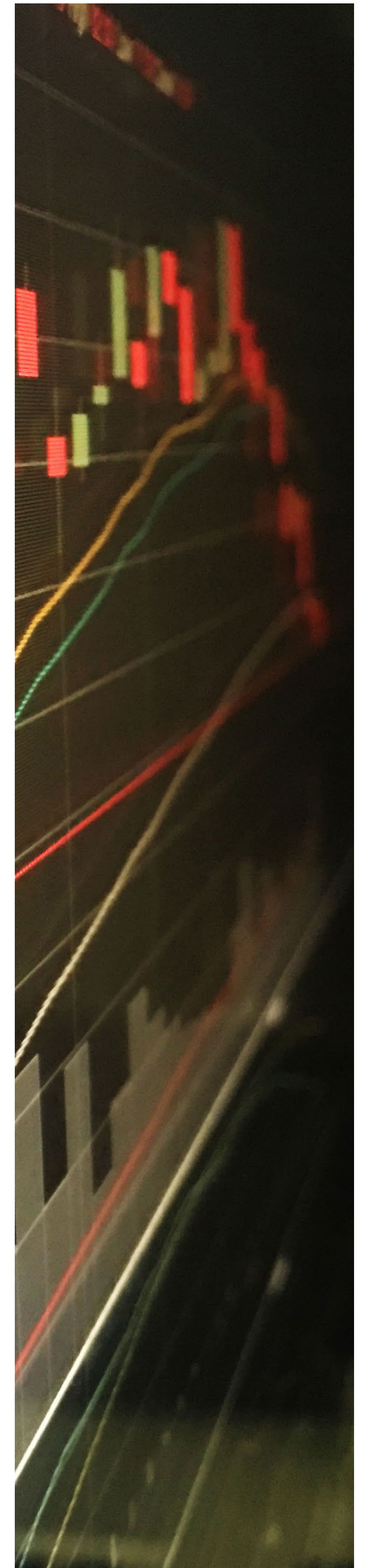
## Theoretical example – Different ABC/ Side A only limit composition

- A company's Directors' and Officers' (D&O) Liability Policy is due for renewal 30/7/2020.
- They currently buy $50M total ($40M for the main program with Side ABC[1] coverages and $10M for a separate Side A cover).
- At renewal because of inter alia lack of support and cost, they are considering buying $50M made up as follows ($25M ABC and $25M Side A) resulting in $15M less ABC.
- In the past month, the company's market cap has tanked but no Securities Class Action ("SCA") Claim has been filed as yet.
- An SCA Claim could be filed after the renewal (could be a myriad of issues that arguably lead to the stock decline - COVID-19, related business issues, maybe change in guidance or lack of etc.).
- The available limit for SCA post renewal is now $25M (and was $40M in expiring program).



1 Side A covers the individual directors and officers for losses not indemnifiable by the company, Side B (also known as Company Reimbursement cover) reimburses the company for amounts paid to its directors and officers as indemnification. Side C (also known as Securities Entity Cover) insures losses incurred by the company resulting from claims made against the company for its own liability in relation to its securities, even if directors and officers are not named as defendants.

# Notification of circumstances: Important coverage considerations

## i. Beware the interplay between Sections 40 and 54 of the Insurance Contracts Act 1984 (Cth)

While all D&O policies "require" notice of Claims made during the policy period, not all D&O policies contain an express contractual right to notify "circumstances" that might give rise to a claim on the policy. The Insurance Contracts Act 1984 (Cth) does, however, provide insured's with a statutory right to do so.

**Section 40 of the Insurance Contract Act 1984 (Cth) provides insureds with a statutory right to notify insurers of 'facts that might give rise to a claim' (that is a 'potential claim').**

If an insured notifies their insurer of a potential claim after they became aware of a potential claim and before the expiration of the policy, then the policy should, subject to its terms and conditions, cover them notwithstanding that a claim arising out of the facts they notified isonly made after the end of the policy period. **If however, they fail to notify a potential claim within the policy period, their insurer may be entitled to deny any claim that may subsequently arise out of the circumstances they failed to notify**. More importantly, any subsequent insurer may also be entitled to deny a claim arising out of facts of which they were aware prior to policy inception as such claims are generally excluded from cover.

The relief provided by section 54[2] of the Insurance Contracts Act 1984 (Cth) **does not apply to a failure by an insured to exercise their section 40 statutory rights**.

Some relief may be provided by section 54, if the policy contains a deeming clause. A deeming clause provides that a claim is deemed to have been made during the policy period if it arises from circumstances which were notified during the policy period.

If a policy contains a 'deeming clause' and an insured fails to notify a fact (circumstance) that might give rise to a claim under the policy, the insurer may not necessarily be relieved of its' liability to pay pursuant to the policy by reason only of the failure to notify within time. This is provided the failure occurred after the policy was entered into and could not reasonably be regarded as having caused or contributed to the loss. An insurer may, however, be entitled to reduce any payments made in respect of a matter covered under the policy to the extent of any prejudice it has suffered as a result of the delay in notification.

**It is therefore imperative INSUREDS carefully consider their rights to provide the expiring insurer a 'notice of circumstance' before binding a new program with less balance sheet protection.**

The late notification of circumstances creates unnecessary difficulties as between insureds and their insurers. While there is potential for cover to be provided in certain circumstances as outlined above it is not guaranteed. Late notification is an issue that has often required a Court adjudicated outcome. To avoid these complications always notify any circumstances or matters covered under the Policy **promptly and during the policy period**.

## ii. What is a 'notifiable circumstance'?

While some D&O policies may contain a definition for 'circumstances' many however do not.

Broadly, speaking a 'circumstance' can be a fact, situation, event or matter that an insured knows about and reasonably considers (check specific policy language, if any) may give rise to a claim against them in the future. It is an objective test predominately, that is whether a reasonable person in the insureds position would have considered that a claim might arise out of the circumstance they are confronted with.

Some examples of 'circumstances' having regard to the above theoretical example may include:

- Receiving a letter from a shareholder raising concerns in respect of stock drop or financials or disclosure or business continuity plans or impacts working remotely has in respect of the security of private and confidential and sensitive held information
- An Occupational Health and Safety authority commencing investigations into a workplace incident
- A regulator obtaining a search warrant against the company's records
- Accuracy of representations made in a recent merger or acquisition
- A company going into liquidation or voluntary administration
- Receiving a letter of demand from a creditor
- Complaints made or question raised at the company's Annual General Meeting about the company management of or ability to respond sufficiently or appropriately to dramatically changed operating conditions including in respect of COVID-19
- Notice of regulatory investigations into the company's management of health and safety laws and regulations, employment laws or securities laws in connection with a company's response (or failure to respond) appropriately to the coronavirus outbreak

Courts have recognised that it is not always easy to judge the materiality of a circumstance at any given time and have used the benefit of hindsight when considering if a circumstance was material and capable of notification.

## iii. What level of detail is required for a 'notification of circumstance'?

If the policy provides an express contractual right to notify facts or circumstances likely to give rise to a 'Claim' what is the level of specificity that is required by the policy?

There is a myriad of ways the notification requirement in a policy may read. Please take the time to understand and take advice on the relevant clause in your policy.

If the policy does not provide an express contractual right to notify facts or circumstances likely to give rise to a Claim,an insured can rely on their statutory rights. Relevantly,section 40(3) of the Insurance Contracts Act 1984 (Cth) provides as follows:

> *'Where the insured gave notice in writing to the insurer of facts that might give rise to a claim against the insured as soon as was reasonably practicable after the insured became aware of those facts but before the insurance cover provided by the contract expired, the insurer is not relieved of liability under the contract in respect of the claim, when made, by reason only that it was made after the expiration of the period of the insurance cover provided by the contract'.*

Drafting a notification of circumstances can often be tricky at the best of times. In today's rapidly changing social, economic and financial times we highly recommend you engage with your insurance broker and with your internal and external legal counsel early to assist in this process.

Some insurers do try to reject notifications that are too broad or 'blanket' in nature notwithstanding the broad and often 'blanket' type exclusions some insurers are proposing for their ongoing support on an existing program. Other insurers have rejected notifications that do not contain sufficient detail surrounding the circumstances being notified. **The good news is that notwithstanding these purported rejections the validity or otherwise of any notification of circumstances and whether it, in fact, captures a subsequent claim can only (and will) be tested when a subsequent claim is made. So when in doubt always notify**.

## iv. Don't forget about your going forward policy and the Prior Notice Exclusion

All D&O policies contain a Prior Notice or otherwise known as the Prior Known Matters exclusion. This exclusion operates to exclude any matters policyholders were aware of prior to entering into the policy and may also give rise to non-disclosures issues.

How does the Prior Notice Exclusion wording read in your policy? Does it exclude all matters "known" or all matters notified? Or does it only exclude "notifications that have been accepted"? In rare instances, the prior notice wording might only exclude "noticed matters" that are "covered" in the prior program.

2 The ability to notify a claim after the policy expires is governed by section 54 of the Insurance Contracts Act 1984. Section 54 provides that an insurer may not, by virtue of the effect of the particular contract of insurance, refuse to pay a claim by reason only of an act or omission of the insured or any other person being an act that occurred after the policy was entered into and which could not reasonably be regarded as capable of causing or contributing to the loss. The insurer may, however, reduce its liability to the extent that its interests were prejudiced by the act or omission.

"When contemplating a move from an existing insurer to a new insurer, it is important to understand how the Continuity Cover applies."

## Impact on renewal negotiations and going forward covers: Concluding remarks

Many insured's are concerned about the impact placing a notice of circumstance will have on the renewal program and quotes issued to date. Impacts on pricing and coverage going forward are of particular concern. Many insurers may try to impose a Specific Matters exclusion to deal with the notification. In this situation, any such exclusion must align with the scope of the notification made and the related claims wording in the expiring policy. These concerns however, pale in comparison to an insured potentially prejudicing coverage in an expiring policy that they have paid for and which may have more favourable terms and limits or remedies that are available to insurers where an insured does not meet its duty of disclosure obligations before entering into a contract of insurance. And let's not forget a notice of claim in an expiring policy will free up the new program and limits for new unrelated claims.

## Changing Insurers? An additional reason to notify

When changing insurers, it is important to note that where the Continuity Date is noted as the inception date of the new policy, the Continuity Cover will only apply to claims arising from wrongful acts/facts/circumstances occurring after the inception of the new policy. This effectively means that Continuity of Cover will be lost in relation to claims arising from wrongful acts/facts/circumstances occurring prior to the inception date of the new policy. As a result, we strongly recommend that clients notify all known claims/investigations/circumstance/facts to the insurer of the expiring policy prior to the expiry date due to the claims made and notified nature of the policy.

When contemplating a move from an existing insurer to a new insurer, it is important to understand how the Continuity Cover applies.

Normally "claims made and notified" policies specifically exclude the following at the beginning of each new policy period:

- Claims known by the insured or which ought reasonably to have been known to the insured prior to the policy inception date.
- Claims arising from wrongful acts committed or allegedly committed before the policy inception date if the insured knew or ought reasonably to have known that such wrongful act would or could lead to a claim being made against them.
- Claims connected in any way with facts or circumstances of which notice was given or ought reasonably to have been given under any policy in force prior to the inception date of the new policy period;
- pending or prior litigation (or litigation derived from the same or essentially the same facts alleged in pending or prior litigation) as at the inception date of the new policy period.

Continuity Cover acts as an exception to some or all of these exclusions, allowing a claim to be notified in a current policy period, notwithstanding that the claim or wrongful acts, facts or circumstances that led to the claim were known to the insured prior to the inception of the current policy period. Continuity Cover is subject to a number of provisos, including but not limited to:

- The claim/wrongful acts/facts/circumstances occurred after the Continuity Date (usually the date the current insurer first came on risk).
- The insured having maintained the relevant type of cover continually from when the claim/wrongful acts/facts/circumstances occurred to the date when they are notified inclusive.

When moving to a new Insurer, it is likely the Continuity Date will be changed to the date the new insurer comes on risk (ie the inception date of the new policy). This essentially means an insured will lose the benefit of Continuity Cover for claims arising from wrongful act/facts/circumstances that occurred prior to the inception date of the new policy.

As a result, should clients decide to move cover to a new insurer, we strongly recommend that theynotify any claims and/or wrongful acts/facts/circumstances which could give rise to claims under the current policy prior to its expiry, so as to maximise the potential for cover for such claims.

For further information, please contact your local Marsh office or visit our website at marsh.com.

MELITA SIMIC
Head of FINPRO Technical – Marsh JLT Specialty, Pacific
+61 405 005 274
melita.a.simic@marsh.com

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