

CLAIMS-MADE-AND-REPORTED POLICIES
AND CIVIL CODE SECTION 3275

What relief is available to policyholders who run afoul of the reporting provision in a “claims-made-and-reported” policy?

Policyholders have argued for application of the notice-prejudice rule to claims-made-and-reported policies. This rule requires an insurer to demonstrate actual prejudice before denying coverage on the ground of late notice. While this argument has met resistance from several trial and appellate courts, it remains to be seen how the California Supreme Court will rule on this issue.

The notice-prejudice rule, however, is only one of several possible remedies available to policyholders facing a forfeiture of benefits on the grounds of late notice. Insurance policies, including claims-made-and-reported policies, are also subject to California’s more general common and statutory laws governing contractual forfeitures, including Civil Code section 3275. *See Root v. American Equity Specialty Ins. Co.*, 130 Cal. App. 4th 926 (2005).

As discussed below, the court in *Root* commented that common law equitable relief should be limited in the case of late notice. The decision left unanswered, however, important questions concerning the potentially broader relief available under section 3275, a statute which provides relief from forfeiture “*except in case of a grossly negligent, willful, or fraudulent breach of duty.*”

1. *Root v. American Equity*

In opening, the *Root* court noted that “[t]his case involves one of the worst nightmares” faced by a professional under a malpractice policy.

These were the facts: A lawsuit was filed against Mr. Root, an attorney, shortly before expiration of his claims-made-and-reported policy. He was told about the lawsuit during a phone call he received from an employee of a legal journal, but he thought the call was a prank. When he discovered a few days later he had indeed been sued, he immediately reported the claim to his insurer. But by then his policy had expired, and his insurer denied coverage on the ground of late notice.

While clearly sympathetic to Mr. Root's predicament, the court was unpersuaded that the notice-prejudice rule should apply. The court nonetheless held that because the policy's reporting provision was a condition precedent, it was subject to California's common law of contracts that traditionally allows equity to excuse the non-occurrence of a condition precedent when it works a forfeiture. Importantly, the court noted that "[t]here is also a statutory basis for an antiforfeiture rule in section 3275 of the Civil Code."

Having recognized both the common law and statutory anti-forfeiture rules, the court proceeded to apply the common law rule to excuse Mr. Root's late notice. The court held that because Mr. Root had learned of the claim "under highly ambiguous circumstances" shortly before policy expiration, the "common law of contracts" operated to excuse his non-compliance with the policy's reporting condition.

The court, however, emphasized the "narrowness" of its decision, explaining that the rule "is not a bright-line test" and "most of the time" it will not be equitable to excuse the late reporting of a claim under a claims-made-and-reported policy. The court also noted that while application of the rule may make summary judgment more difficult for insurers, "that is a result that comes with California's common law rule that conditions can be excused if equity requires it."

Insurers have naturally seized upon these statements in *Root* to argue that relief from late notice under a claims-made-and-reported policy is reserved for unusual cases, and is inappropriate where an insured is unable to offer any excuse for delaying weeks or even months before reporting a claim outside the reporting period. However, this argument is valid only up to a point. The statements made in *Root* concerning the narrowness of its decision appear directed at the *common law* rule, not at the statutory rule embodied in section 3275.

Beyond acknowledging section 3275's relevance as an anti-forfeiture rule applicable to insurance contracts, the court in *Root* did not address how the statute specifically applied to Mr. Root's claim. It had no reason to do so since it relied upon the common law rule to excuse his late notice. Nor did the court offer any commentary on how the statute might apply in other similar cases. The *Root* decision left these questions unanswered.

2. Section 3275

Section 3275 provides: “Whenever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom, upon making full compensation to the other party, *except in case of a grossly negligent, willful, or fraudulent breach of duty.*” (Italics added).

Root is not the first case to opine that section 3275 has application to conditions in insurance policies. The California Supreme Court expressed the same view over seventy years ago in *O’Morrow v. Borad*, 27 Cal. 2d 794, 800 (1946) (holding that conditions in insurance contracts may be excused and citing section 3275).

If, as *Root* indicates, section 3275 applies to the reporting condition in a claims-made-and-reported policy, then policyholders should be entitled to avail themselves of the statute’s full protection. In this regard, section 3275 is far more specific than the common law equitable rule in directing when relief from forfeiture is available. The statute provides that a party may be relieved “except in case of a grossly negligent, willful, or fraudulent breach of duty.” Section 3275 has been applied by courts in California in other contexts to excuse contractual forfeitures based upon “simple negligence.” *See, e.g., Barkis v. Scott*, 34 Cal. 2d 116, 123 (1949).

In sum, “notice-prejudice” is not the only front on which late notice under a claims-made-and-reported policy can be fought. As recognized in *Root*, both the common law and statutory law of California may also provide relief to policyholders denied coverage under a claims-made-and-reported policy on the ground of late notice. In this regard, while relief under the common law may be limited, a policyholder may be entitled to broader relief under section 3275 for a negligent breach of a reporting condition.