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THE WRONG WAR, THE WRONG TIME, THE WRONG ENEMY: INSURERS' ALLEGATIONS OF LATE NOTICE ARE UNTIMELY WHEN UNDERLYING ACTIONS ARE PENDING

> [T]his strategy would involve us in the wrong war, at the wrong place, at the wrong time, and with the wrong enemy.
>
> -Omar Bradley, testifying before the Committee on Armed Services and Committee on Foreign Affairs, U.S. Senate, May 15, 1951. [1]

I. INTRODUCTION

When General Bradley spoke these words, his thoughts ran to national security and foreign relations; he certainly was not thinking about comparatively mundane issues, such as policyholders' rights under liability insurance policies. Nevertheless, General Bradley's remarks apply to the "mundane" issue of whether an insurance company has the right to refuse to defend a policyholder against an ongoing action on grounds that the policyholder failed to give timely notice of the claim. This issue actually is far from mundane; it affects every purchaser of liability insurance. This includes every person who purchases a standard automobile insurance policy, every company that purchases a commercial general liability (CGL) insurance policy, and every director who purchases a directors' and officers' (D&O) liability insurance policy. Given the size of many recent verdicts, and the constant threat of sizable defense costs, the issue has enormous financial implications.

Insurance companies routinely attempt to avoid all of their coverage obligations ***712** on grounds of late notice. [2] Every year, hundreds of millions of dollars of insurance coverage are forfeited because courts and insurance companies decide that the notice policyholders gave their insurance companies was late. [3] No sound reason exists, however, to punish automatically policyholders who give late notice with a total forfeiture of insurance coverage. [4]

The late notice dilemma is particularly acute when insurance companies refuse to defend their policyholders against ongoing actions on late notice grounds. Whenever an insurance company takes this approach, the policyholder is deprived of the essential benefits of a defense [5] at the very moment that the defense is needed. If the late notice assertion subsequently is found to lack merit, and the insurance company actually was obligated to provide a defense, the policyholder cannot be made whole. Even if a court awards the policyholder damages at a later date, it cannot turn back the clock and provide the policyholder with the benefits that should have come with an insurer's defense at a time of crisis.

The problem never should arise because late notice is not a defense to insureds' demands for the defense of ongoing actions. Late notice is a factual issue, and factual issues have no bearing upon the duty to defend ongoing actions. Rather, the duty to defend is a broad duty typically arising whenever the nature of third-parties' claims against policyholders potentially fall within the scope of the insurance policies at issue. [6]

When courts attempt to resolve late notice issues prior to determining insurers' duty to defend, they unfairly force policyholders to conduct a war on two fronts. ***713** The first front is defending against the ongoing action; the second front is proving as a factual matter that their insurance companies should be defending them. [7] To borrow from General Bradley, it is wrong in every respect to force policyholders to open this second front. First, the insurer is the "wrong enemy." An insurance company is supposed to protect its policyholder against the claims of third parties, not to become an additional adversary. [8] Second, it is the "wrong time" to burden a policyholder with a coverage dispute. The policyholder should be free to concentrate its energies on its defense against the ongoing action. The policyholder should not be distracted by a simultaneous, bitter, and expensive fight for insurance coverage. [9] Third, when an insurer claims that it is not obligated to defend because its policyholder provided late notice of the claim, it is the "wrong war." Factual issues regarding notice simply are not relevant to an insurer's duty to defend an ongoing action. [10]

Because late notice has no bearing upon an insurance company's duty to defend an ongoing action against the insured, there is no reason to address facts pertinent ***714** to notice until after the underlying action is resolved. Courts in at least five states understand this issue and correctly refuse to explore untimely allegations of late notice. [11] At least one court that addressed this issue has issued a contrary finding, but its reasoning was plainly and fatally flawed. [12]

Unfortunately, most courts ignore the threshold question of whether disputed allegations of late notice can be resolved appropriately when a policyholder is seeking a defense in an ongoing action. These courts simply assume that it is appropriate to address these allegations at this time, thereby launching into an analysis of whether there was late notice as a factual matter. [13] These courts fail to recognize that such an approach destroys the essential value of insurers' contractual duty to defend.

Courts never should address disputed allegations of late notice when underlying actions are pending. Instead, they should require insurers to defend or pay defense costs until those actions are resolved. Courts properly can address the various factual issues raised by the disputed allegations sometime thereafter. When courts attempt to resolve late notice allegations before deciding insurers' duty to defend ongoing actions, they nullify the essential value of the duty to defend. Even worse, such courts create an economic incentive for insurance companies to allege late notice whenever possible in order to delay, if not ultimately to avoid, their duties to defend. [14]

II. HISTORICAL DEVELOPMENT OF RELEVANT POLICY LANGUAGE

A. *Antitrust Exemption for the Insurance Industry*

To interpret liability insurance policies, it is necessary to understand that insurance policies are standardized. [15] Insurance industry service organizations draft standard ***715** policy forms, which then are sold by individual insurance companies. [16] Thus, the exact policy language examined in this article is found in liability insurance policies sold throughout the United States by different insurance companies. [17] The insurance industry is free to promulgate standardized insurance policies because the industry is regulated exclusively by state law and is exempted from standard federal antitrust laws. [18] The insurance industry is thus unique among the country's major financial institutions. [19]

The law responsible for the extraordinary status of the insurance industry is the McCarran-Ferguson Act. [20] Congress enacted the McCarran-Ferguson Act in 1945 in response to intense lobbying by both the insurance industry [21] and state governments. [22] ***716** Both of these groups were strongly opposed to the Supreme Court's 1944 decision in *United States v. South-Eastern Underwriters Association*, [23] in which the Court abandoned a precedential decision establishing that insurance regulation was a state function. [24] *South-Eastern* established instead that insurance transactions are subject to federal regulation under the Commerce Clause, [25] specifically including the Sherman Act. [26]

Three principal rationales were offered to support exempting the insurance industry from federal regulation. First, the exemption facilitates the economically efficient sharing of information, thus permitting insurance companies to evaluate risk and price insurance accurately. [27] Second, the exemption allows the use of standard policy forms that supposedly serve several social

goals, including the facilitation of comparison shopping by insurance consumers, compilation of data necessary to achieve accurate risk assessments, and an opportunity to achieve precision in the language of insurance policies. [28] Third, the exemption fosters a competitive atmosphere in which even small insurance companies can survive. [29]

The McCarran-Ferguson Act was designed to reinstate the state regulatory scheme that existed prior to *South-Eastern*. [30] The Act empowered the states to regulate the business of insurance without federal interference, so long as Congress does not specifically legislate in that field. One significant effect of the Act was to establish that the insurance industry is exempt from standard federal antitrust laws. [31]

***717** The insurance industry's exemption from federal regulation became controversial in the 1980s [32] when a national liability insurance crisis and the failures of several major insurers sparked renewed and critical interest in the McCarran-Ferguson Act. [33] Within the past eight years, Congress has introduced several bills proposing to repeal or modify the Act. [34] No action has been taken, however, and therefore the structure permitting standardized insurance policy language remains fully in effect. [35]

B. *Practice of Interpreting Ambiguities in Favor of Coverage*

Another critical step to interpreting liability insurance policies is to understand that any doubt regarding the scope of coverage is to be interpreted in the policyholder's favor. This approach developed as a direct result of the standardization of liability insurance policies.

Because insurance policies are standardized, policyholders seeking to purchase insurance are deprived of the normal opportunities to participate in drafting that they otherwise would enjoy when entering into contractual relationships. In effect, insurance policies essentially are adhesion contracts. An adhesion contract is formed when the more powerful of two bargaining parties writes contract terms that meet its own needs and offers them to the weaker party on a "take it or leave it" basis. [36]

Because insurance policies are executory contracts, ambiguities in contract terms can raise serious problems. Simply stated: "The need for clear terms is particularly ***718** compelling in the insurance industry due to the danger of opportunistic behavior in contract interpretation by both the insured and the insurer at the time a claim is made." [37] Thus, the insurance industry carries a heavy burden of avoiding ambiguities when it drafts standard-form insurance policies.

To protect policyholders from the inherent inequities of the drafting process, courts often invoke the doctrines of waiver, estoppel, reformation, and rescission. [38] Courts also rely upon the doctrine of contra proferentem, [39] which establishes that all ambiguities in written contracts should be interpreted most strongly against the person who selected the language. [40] Since insurance companies are the principal policy drafters, they must not be permitted to benefit from any ambiguity in those policies. [41] As the North Carolina Supreme Court explained in colorful terms:

> When an insurance company, in drafting its policy of insurance, uses a "slippery" word to mark out and designate those who are insured by the policy, it is not the function of the court to sprinkle sand upon the ice by strict construction of the term. All who may, by any reasonable construction of the word, be included within the coverage afforded by the policy should be given its protection. If, in the application of this principle of construction, the limits of coverage slide across the slippery area and the company falls into a coverage somewhat more extensive than it contemplated, the fault lies in its own selection of the words by which it chose to be bound. [42]

This historical background demonstrates that any doubt about whether late notice excuses insurers' obligations to defend their policyholders against ongoing actions should be decided against the insurance companies and in favor of policyholders.

III. PURPOSE AND IMPORTANCE OF THE DUTY TO DEFEND

Liability insurance policies are designed to protect individuals and businesses allegedly responsible for causing injury to others, or for damaging the property of others. ***719** Liability policies contain two separate and distinct contractual obligations: a duty to defend and a duty to indemnify. Standard CGL policies provide in pertinent part:

> The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of
>
> A. bodily injury or
>
> B. property damage
>
> to which this insurance applies, caused by an occurrence, and *the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage, even if any of the allegations of the suit are groundless, false or fraudulent*, and may make such investigation and settlement of any claim or suit as it deems expedient, but the company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgments or settlements. [43]

The duty to defend obligates insurance companies to defend their policyholders at the insurer's expense when the policyholders are sued by third parties. [44] Liability insurance has been aptly described as "litigation insurance." [45]

The duty to indemnify, in contrast, obligates insurers to pay for all sums that policyholders are obligated legally to pay to third parties as a result of third-party actions that fall within the scope of the liability insurance policies. [46] The duty to defend is independent of, and much broader than, the duty to indemnify. [47] For example, insurance companies have a duty to defend whenever the underlying action alleges any facts that might fall within coverage. [48] The duty to indemnify, ***720** however, usually rests upon the actual facts. [49] Thus, an insurance company may be obligated to defend its policyholder in a case in which it ultimately does not owe a duty of indemnification. [50]

The duty to defend is, in certain respects, the most valuable feature of a liability insurance policy. As an economic matter, the duty to defend potentially is unlimited in amount. Notably, the duty to defend obligates an insurer to spend all resources necessary to the policyholder's effective defense. [51] Typically, the duty to defend is in addition to-not part of-the actual monetary limits of the insurance policy. [52] In standard CGL policies, the policy limit applies only to amounts paid by the insurance company in indemnification. [53]

In practical terms, the insurer's duty to defend can double or triple the value of a liability insurance policy. For example, if a liability insurance policy has a policy limit of $10 million, an insurer may be required to pay $10 million in defense costs, or $20 million, or more. These payments are in addition to the $10 million in indemnification that the insurance company also would be obligated to pay.

The monetary value of the duty to defend has escalated dramatically in recent years, in accordance with well-known increases in plaintiffs' proclivity to file tort lawsuits, [54] and in the cost of legal services. [55] Accordingly, policyholders pay large premiums in return for insurers' duties to defend. [56]

The duty to defend also is valuable from an emotional perspective. Policyholders who purchase an insurer's defense are purchasing peace of mind. [57] Indeed, as one court noted, " t he whole point to the insurance coverage duty to defend is to afford

insureds some security and peace of mind when suits such as these are ***721** brought." [58] Policyholders expect that if they are sued, and especially if the actions are "groundless, false, or fraudulent," their insurance companies will assume their defense in the actions. Policyholders also expect that they will not be forced to bear crippling litigation costs. [59]

These expectations are particularly important because insurance companies are in the business of litigation, and generally possess resources in this area beyond the reach of many policyholders. [60] When policyholders purchase liability insurance policies that include a defense obligation, therefore, they purposefully are purchasing the benefits of their insurance companies' resources. [61] Policyholders do not expect to have to sue their insurers to obtain the defense for which they bargained.

As the Supreme Court of Colorado recognized, the essential value of the duty to defend is defeated when policyholders must engage in litigation to enforce it:

> Requiring the average auto accident victim, or the average home owner to bear the onerous financial burden of proving that they are entitled to a defense from liability claims asserted against them would deny the insured the protection afforded by a liability policy. [62]

Whether an insurance company has a duty to defend its policyholder in a particular case traditionally is determined by a very simple test: the comparison of the underlying pleadings with the applicable insurance policy. [63] To avoid giving the third-party plaintiff inappropriate control over the determination of the duty to defend, the pleadings are to be interpreted liberally in favor of coverage. [64]

The simplicity of this test is mandated by the nature of the duty. Timing is critical in connection with the duty to defend because the duty can have its intended ***722** value only when the underlying action is ongoing. [65] The imposition of an immediate duty to defend is necessary to afford the policyholder what it is entitled to-the full protection of a defense on its behalf. [66] Because timing is a critical factor, the existence of this duty must be easily ascertainable. [67] Unless the test is simple, thereby rendering disputes about the duty subject to expeditious resolution, the value of the duty to defend may be destroyed.

Because the test for determining a duty to defend generally requires nothing more than a comparison of the pleadings in the third-party action to the relevant insurance policy, the existence of a duty to defend should not raise genuine disputes of material fact. Thus, the duty to defend should be capable of resolution by partial summary judgment as a matter of law. [68] Partial summary judgment is appropriate because the duty to defend can, and should, be resolved at the outset of the third-party action.

IV. ATTEMPTS BY INSURANCE COMPANIES TO DEFEAT SUMMARY JUDGMENT ON THE DUTY TO DEFEND

Insurers routinely attempt to defeat summary judgment on the duty to defend by alleging, first, that their policyholders provided late notice and, second, that late notice is a factual issue that precludes summary judgment. [69] Insurance companies ***723** apparently hope that, at the very least, their assertion of factual issues will justify a delay. [70]

From 1966 to the mid-1980s, the standard notice provision in CGL policies provided:

> Insured's duties in the event of occurrence, claim or suit
>
> (A) In the event of an occurrence, written notice containing particulars sufficient to identify the insured and also reasonable obtainable information with respect to the time, place and circumstances thereof, and the names and addresses of the injured and of available witnesses, shall be given by or for the insured to the company or any of its authorized agents as soon as practicable. The named insured shall promptly take at his expense all reasonable

> steps to prevent other bodily injury or property damage from arising out of the same or similar conditions, but such expense shall not be recoverable under this policy.
>
> (B) If claim is made or suit is brought against the insured, the insured shall immediately forward to the company every demand, notice, summons or other process received by him or his representative.

The standard form CGL policy was revised in 1982 and 1984. As a result, the language of the notice provision was changed, although the overall effect remained the same. The revised notice provision provides:

> Duties in the Event of Occurrence, Claim or Suit
>
> (a) You must see to it that we are notified promptly of an "occurrence" which may result in a claim. Notice should include
>
> (1) How, when and where the "occurrence" took place; and
>
> (2) The names and addresses of any injured persons and witnesses.
>
> (b) If a claim is made or "suit" is brought against any insured, you must see to it that we receive prompt written notice of the claim or "suit."
>
> (c) You and any other involved insured must:
>
> (1) Immediately send us copies of any demands, notices, summonses, or legal papers received in connection with the claim or "suit."

The time elements of both notice provisions are similar in certain respects; the 1966 definition requires notice "as soon as practicable" and the subsequent definition requires that notice be given "promptly." Both provisions typically raise questions of fact.

***724** For example, an assessment cannot be made of whether notice of an occurrence was given either "as soon as practicable" or "promptly" typically requires an assessment of when the relevant event took place, when the policyholder became aware of it, and when it would have been reasonable for the policyholder to give notice. [71] Depending upon the policy language and the applicable law, other factual issues could include: (1) when the policyholder gave actual or constructive notice to its insurer; [72] (2) when the insurer actually learned of the accident, occurrence or lawsuit; [73] (3) whether the insurer was prejudiced by the timing of notice; [74] and (4) whether, if notice was not timely, the policyholder had a reasonable excuse. [75]

Prior to addressing such issues, a court also must decide what law governs the insurance coverage dispute. The law on late notice varies among jurisdictions. [76] The conflicting state laws can lead to "forum shopping," whereby each side tries to get

into court in a state with rules favoring its position, and to intense litigation regarding which law governs the action. [77] It is the rare case in which there are no genuine disputes between the policyholder and the insurer regarding at least some material facts regarding notice. [78] Far more often, many factual issues are in dispute and cannot be resolved without considerable discovery and lengthy trials.

Because allegations of late notice typically raise factual issues, it should seem plain that such allegations should not be addressed by a court attempting to determine whether an insurer has a duty to defend a policyholder in an ongoing action. Considering the high cost of honoring such duties, however, insurers have a profound economic incentive for arguing that allegations of late notice must be resolved ***725** before a court can determine the duty to defend a pending action. [79] Insurance companies therefore make this argument with regularity.

The force of this argument, from an insurer's perspective, is that a mere allegation of late notice can be sufficient to eliminate the duty to defend. If the factual issues regarding notice are sufficiently complex, the insurer may succeed in avoiding the determination of its duty to defend until after the subject action is resolved. However, this approach is antithetical to liability insurance. Policyholders are supposed to be defended whenever there is a possibility of coverage. Insurance companies should be able to defeat their duty to defend only when they can prove that there is no potential for coverage based on undisputed facts. [80] The burden should be on insurers to establish that there is no potential for coverage. [81]

Unfortunately, when insurers present courts with the argument that late notice precludes summary judgment on the duty to defend, many courts simply assume, without any examination, that late notice enables insurance companies to avoid their duties to defend. Even when third-party actions are pending, and the need for a defense is paramount, these courts nevertheless launch into analyzing whether there was late notice as a factual matter. [82]

These courts tend to approach late notice questions in different ways. [83] The most backward approach is to hold that timely notice is an absolute condition precedent ***726** to the duty to defend. Thus, if the policyholder actually provided late notice of the third-party claim, the policyholder forfeits its defense in the third-party action. [84]

Insurance companies typically rest the argument that timely notice is a condition precedent to coverage upon a policy provision known as the “no action” clause. [85] A typical “no action” clause provides:

> No action shall lie against the company unless, as a condition precedent thereto, there shall have been full compliance with all of the terms of this policy, nor until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company. [86]

In recent years, courts in a number of more advanced states have held that late notice waives an insurance company's duty to defend only when the insurance company can prove that it was prejudiced in its ability to provide a defense as a result of the timing of the notice. In accordance with the basic contractual principle that the law disfavors forfeiture, [87] these jurisdictions hold that absent demonstrable harm, late notice alone is not sufficient for an insurance company to avoid its duty to defend.

Unfortunately, all of these approaches effectively negate the value of the duty to defend ongoing actions. All of these approaches preclude a speedy, fact-free resolution of insurers' duty to defend.

V. ALLEGATIONS OF LATE NOTICE NEVER SHOULD DEFEAT SUMMARY JUDGMENT ON THE DUTY TO DEFEND ONGOING ACTIONS

The various issues discussed above converge upon a simple truth: allegations of late notice should not relieve insurance companies from their obligations to defend their policyholders against ongoing actions. This result is reflected in the plain language of liability insurance policies and basic principles of contract and insurance law, as well as equitable and economic considerations.

A. *Policy Language*

A careful reading of the plain language of standard liability insurance policies yields absolutely no support for the argument that late notice ever forfeits insurers' duty to ***727** defend ongoing actions. First, the insuring agreement in liability policies establishes a comprehensive obligation on the insurer's part to defend the policyholder against "any" suit seeking damages, regardless of its merits. [88] Some courts rely on this broad language to hold that late notice does not sever an insurer's duty to defend an ongoing action, especially in light of the doctrine of contra proferentem. [89]

Moreover, standard policy notice provisions do not state clearly and unambiguously that a failure to provide timely notice will void the insurer's duty to defend. Because standard liability policy notice provisions do not clearly and unambiguously spell out the possibility of forfeiture, timely notice cannot be interpreted as a condition precedent to the duty to defend. [90]

Looking beyond the insuring agreement, there is no other provision in a standard liability insurance policy that requires policyholders to prove timely notice in order to trigger an insurer's duty to defend ongoing third-party actions. Notably, the "no action" clause does not establish such a requirement. Based upon a superficial reading, the first part of the "no action" clause may appear to support the argument that a policyholder that wishes to sue its insurance company for coverage must, as a condition precedent, comply with all of its obligations under the insurance policy. The policyholder's obligations include providing the insurer with timely notice of the suit or claim. The second part of the "no action" clause, however, states that no action may be brought against the insurance company until the underlying action against the policyholder is resolved completely. This clause therefore establishes that notice is a condition precedent to a claim against an insurance company only after final resolution of the action against the policyholder. Based on its plain language, this clause does not establish compliance with policy terms as a condition precedent to the duty to defend an ongoing action. Nevertheless, insurance companies occasionally argue that no action clauses prevent policyholders from suing to enforce the duty to defend ongoing actions. [91] Most courts reject these arguments, offering a number of different explanations. [92]

***728** Many courts reason that by refusing to defend, insurers waive the right to argue that actions against them are barred by "no action" clauses. [93] Some courts reason that there would be an irreconcilable conflict between the insuring provision establishing the duty to defend and the "no action" clause, if they interpreted the "no action" clause as barring an action to enforce the duty to defend. Thus, they determine that the "no action" clause does not bar such an action. [94] Other courts reason that "no action" clauses apply only to direct actions against insurance companies by third parties seeking to recover damages owed to them by policyholders. [95] Among other things, these courts reason that "no action" clauses logically cannot apply to actions brought by policyholders against their insurers to recover defense costs. Specifically, when insurers refuse to defend, policyholders incur damages by retaining lawyers to defend them, among other things. Unless policyholders subsequently refuse to pay their lawyers' fees and thereby provoke lawsuits, there never could be "judgments" or "written agreements" for policyholders to enforce against their insurers as "no action" clauses require. [96]

***729** Other than the "no action" clause, insurers have no policy language support for the argument that allegations of late notice must be resolved as a factual matter prior to determining whether insurance companies are obligated to defend their policyholders against pending third-party actions.

B. *Basic Principles of Insurance Law*

Under basic insurance law principles, courts should not resolve allegations of late notice prior to resolving the duty to defend. First, construing an insurance policy in a manner that defeats the duty to defend violates the basic principle that insurance policies should be construed to effect coverage. [97] Second, construing an insurance policy in such a manner violates the basic principle that the law abhors forfeiture. Even the insurance industry appreciates this fact. [98] Third, addressing factual issues about late notice while underlying actions are pending defeats the basic principle that the duty to defend should rest on the nature of underlying actions, not upon actual facts. Finally, addressing such factual allegations while underlying actions are pending violates the principle that all doubts regarding insurance coverage are to be construed in the insured's favor.

C. *Equitable and Economic Considerations*

Sound equitable and economic considerations compel the conclusion that late notice allegations must not be considered when evaluating the existence of an insurer's duty to defend. First, from an equitable perspective, the efficacy of an insurance policy is put to the test when a policyholder first requests a defense. At that time, the insurer has the power to choose between honoring its defense obligation or refusing to defend. In short, the insurance company holds all the cards. When an insurer refuses to defend on grounds of allegedly late notice, and the issue is brought before a court, a choice must be made. If the allegations of late notice are addressed immediately, then the insurer is given the benefit of the doubt. If the duty to defend is imposed despite the unresolved nature of these allegations, the benefit is given to the policyholder.

As a matter of simple economics, it is unfair to favor insurers over policyholders. Policyholders pay substantial premiums in return for insurers' promised defense. When there is a dispute about the duty to defend, that dispute must be resolved in favor of the policyholders that paid the premiums, and against the insurers that ***730** received them. This approach makes good sense economically because insurance companies are, to a certain extent, in the litigation business. Thus, the burden to an insurer of providing a defense should be far less taxing than the burden to a policyholder of providing its own defense.

This approach also is appropriate because policyholders that are deprived of the duty to defend at the right time cannot be made whole by the eventual reimbursement of their defense costs. For policyholders, the issue is far more than money.

Theoretically, an insurance company that wrongly claims late notice could be subject to an action for bad faith, which could enable the injured policyholder to recover punitive damages.[99] Such advice, however, is small comfort for policyholders. Policyholders that purchase liability insurance policies are seeking protection in trying times-not more litigation opportunities. A bad faith action is a particularly unwelcome litigation opportunity, as it can be difficult, time-consuming, and expensive for a policyholder to prove that an insurance company deliberately alleged late notice in bad faith.[100] Also, courts tend to look with disfavor on bad faith actions, regardless of the facts.[101]

VI. COURTS THAT DECIDE THIS ISSUE REACH THE RIGHT RESULT

Courts in at least five states have recognized that factual issues regarding notice should not be considered when a policyholder seeks to compel its primary insurer to defend it in a pending action.[102] These decisions rest generally upon the breadth of the duty to defend, and also that notice is a fact-based issue that cannot be resolved by a review of the pleadings.[103] Notably, each of these courts examined liability insurance policies that contain policy language comparable to the policy language set forth in this article. Some of these courts viewed notice as a condition ***731** precedent to coverage under a liability insurance policy,[104] while others required a factual inquiry into whether late notice caused prejudice.[105] Each court decided the duty to defend by way of summary judgment.

At least one court that has considered whether late notice is relevant to the duty to defend has decided in the insurer's favor. This decision, however, reveals that the court did not consider this issue thoroughly. In short, the analysis is fatally flawed. In *Maryland Casualty Co. v. W.R. Grace & Co*.[106] the policyholder and its primary and excess liability insurers were engaged in active litigation regarding the insurers' coverage obligations while various environmental actions against the policyholder were pending. One of many disputes in the insurers' declaratory judgment action was whether the policyholder waived its right to a defense by ***732** providing late notice.[107] The parties agreed that summary judgment could not be granted on the duty to defend until after discovery regarding notice. The policyholder argued only that its insurance companies must pay defense costs for the environmental actions while this investigation proceeded.[108] In rejecting this argument, the *Grace* court held that "timely notice of occurrence and suit are conditions precedent to the duty to defend."[109] Because the third-party action at issue was ongoing, the court clearly was holding that timely notice was a condition precedent even when underlying actions were ongoing. The court, however, cited no policy language to support its holding.

The *Grace* court concluded that the policyholder was not entitled to a defense because of the policyholder's wealth:

> There is no logical reason why the insurers should be required to pay Grace's defense costs until the notice issue is resolved. Grace is perfectly able to pay those costs and, thus, the insurer's failure to pay defense costs now will not deprive Grace of a meaningful opportunity to defend itself. [110]

This approach offends the most basic principles of contract and insurance law. If the policyholder purchased a duty to defend, the policyholder is entitled to the benefit of its bargain. The financial health of the policyholder has absolutely no bearing upon its right to receive a benefit for which it contracted, and for which it no doubt paid a considerable premium. [111]

The *Grace* court went on to demonstrate a fundamental misunderstanding of the essence of the duty to defend:

> ***733** Of course, the end result of this suit may be that the insurers must reimburse Grace for defense costs incurred prior to the final determination of this suit, but it is true in most litigations that a person with a right to collect a sum of money must wait until that right was [sic] been established through the litigation process. It would serve no purpose to require the insurers to undertake a defense or bear the costs when they may very well secure a judgment at the end of the day which establishes that there never was a duty to defend. [112]

Of course, timing is essential in connection with the duty to defend. This duty is not satisfied by reimbursement of defense costs when the need for a defense is over. [113] The court in *Grace* missed this point entirely.

The final sentence of the quoted passage is particularly revealing. While it is true that insurers "may very well secure a judgment at the end of the day which establishes that there never was a duty to defend," the converse is equally true. Insurers may very well face an unwelcome judgment at the end of the day establishing that they were obligated to defend (but did not do so). Faced with a choice between protecting a policyholder or protecting the insurance companies, the *Grace* court should have favored the policyholder.

VII. CONCLUSION

The duty to defend is an important and valuable feature of liability insurance policies. Insurance companies, unfortunately, have in recent years engaged in a course of conduct that threatens the continued viability of this duty. Insurers' course of conduct includes: (1) refusing initially to defend their policyholders in pending actions; (2) forcing their policyholders to sue them to enforce the duty to defend; and (3) defeating the policyholders' summary judgment motions on the ***734** duty to defend ongoing actions by asserting the fact-specific coverage defense of late notice.

Courts must ensure that insurers do not succeed in preventing the duty to defend from having its intended meaning. Courts, however, have failed in many cases to examine this issue carefully. Due to inexact analysis, courts often fail to recognize that factual issues regarding late notice should not be considered when attempting to determine whether an insurance company has a duty to defend its policyholder in an ongoing action.

Analytically, this issue is far from complex. The conclusion that factual allegations regarding notice should not be considered in these circumstances is supported by the plain language of the insurance policies, by basic principles of contract and insurance law, and by equitable and economic considerations.

Footnotes

Note

1. *Rhonda D. Orin is a partner in the Washington, D.C., offices of Anderson, Kill, Olick & Oshinsky. The firm represented the policyholders in a number of cases cited in this article, including* Maryland Casualty Co. v. W.R. Grace & Co. *The author gratefully acknowledges the assistance of summer associate Halley Finkelstein*.

1 BARTLETT, FAMILIAR QUOTATIONS 685 (16th ed. 1992).

2 One insurance company recently admitted that liability insurers "spend (conservatively) a billion dollars a year in so-called 'coverage litigation,' typically in the form of declaratory judgment actions" against their policyholders. *See* Brief of Amicus Curiae American Insurance Association at 3-4, Affiliated FM Ins. Co. v. Constitution Reinsurance Corp., 626 N.E.2d 878 (Mass. 1993) [hereinafter AIA Brief]. As insurers are well aware, most policyholders cannot afford such coverage litigation. *See* Reply Brief of Petitioner National Casualty Co. at 9, National Casualty Co. v. Great Southwest Fire Ins. Co., 833 P.2d 741 (Colo. 1992) (arguing that policyholders "often lack the resources to wage these disputes"). Moreover, when insurers litigate coverage disputes, they do not necessarily pay all of their legal fees. Insurance companies routinely ask their reinsurers to pay part of the legal fees they spend battling their policyholders. *See, e.g.*, AIA Brief, at 13-14 (arguing that reinsurers should share in these fees because "[w]hen the [ceding insurance company] denies coverage, and that denial is sustained in a declaratory judgment action, the reinsurer necessarily benefits from that course of events"). Policyholders have no comparable alternative; they bear their costs alone. To compound the problem, insurers boast of their aggressiveness, including aggression against their policyholders. For example, Jeffrey W. Greenberg, then Executive Vice President of the American International Group (AIG), once described his company as being composed of "jungle cats." *See* Michael D. Silverman & Eugene R. Anderson, *Pussy Cats vs. Jungle Cats: An Insurance Company's Duty of Good Faith and Fair Dealing in Litigation*, MEALEY'S LITIG. REPORTS: INS., Feb. 8, 1994, at 16.

3 Bart Tesoriero et al., *The Draconian Late Notice Forfeiture Rule: "Off with the Policyholders' Heads,"* INS. LITIG. REP., Apr. 1993, at 113.

4 Eugene R. Anderson et al., *Calling Attention to the Late Notice Problem*, RISK MGMT., Nov. 1992, at 26, 27.

5 These benefits vary from the practical (the extensive litigation resources of insurance companies, for example) to the emotional (relative peace of mind).

6 *See* American Motorists Ins. Co. v. Republic Ins. Co., 830 P.2d 785, 787 (Alaska 1992); LaJolla Beach and Tennis Club, Inc. v. Industrial Indem. Co., 884 P.2d 1048, 1053 (Cal. 1994); City of Burlington v. National Union Fire Ins. Co., 655 A.2d 719, 721 (Vt. 1994).

7 *See* Gray v. Zurich Ins. Co., 419 P.2d 168, 170 (Cal. 1966) ("If [a policyholder] is to be required to finance his own defense and then, only if successful, hold the insurer to its promise by means of a second suit for reimbursement, we defeat the basic reasons for the purchase of the insurance."). Many courts unfortunately misunderstand this problem so completely that they advocate forcing policyholders to fight on two fronts. For example, the court in Petersen Sand & Gravel, Inc. v. Maryland Casualty Co., 881 F. Supp. 309 (N.D. Ill. 1995), held that "if an insurance company is uncertain as to its duty to defend, it must either seek a declaratory judgment as to its obligations and rights or defend under a reservation of rights." *Id*. at 8. While the latter alternative may be appropriate in certain circumstances, a declaratory judgment action proving factual issues regarding notice when the lawsuit against the policyholder is ongoing is not appropriate.

8 The magnitude of this problem is discussed in Eugene R. Anderson et al., *Insurance Nullification by Litigation*, RISK MGMT., Apr. 1994, at 46. Those authors argue that insurers benefit by denying coverage and forcing their policyholders into litigation because: (1) insurance companies benefit from the time value of the money that they retain during the dispute; (2) many courts do not award prejudgment interest; (3) presettlement interest is virtually unknown; and (4) insurance companies typically fare well in litigation because they are much more experienced as litigants than most policyholders. *Id*. at 46-50.

9 On a practical note, many policyholders simply cannot afford to litigate against their insurers. Insurance coverage lawsuits are notoriously expensive. For example, Shell Oil Company spent more than $25 million litigating an environmental insurance coverage action. Tesoriero, *supra* note 3, at 120-21. Due to these high costs, many policyholders are unable to fight even patently wrongful denials of coverage. *See id*. at 120 n.38 ("When an insurance company denies a claim most policyholders simply give up"); Jonathan Laing, *"Are the Glory Years Over? Much Slower Growth Seems in the Offing for AIG,"* BARRON'S, July 8, 1991, at 9 [hereinafter *Glory Years*] ("Many claimants don't bother to sue or just plain give up.").

10 The "war" analogy unfortunately applies to how insurance companies perceive their obligations to their policyholders. For example, Laing wrote about Hank Greenberg, AIG's Chairman and Chief Executive Officer:
To Hank Greenberg, business is war. And sometimes, AIG can stretch the Geneva Convention in the heat of battle. *Glory Years, supra* note 9, at 9. The BARRON'S article noted that "few commercial insurers are said to resist major claims as vigorously as AIG" and that:
AIG seems to play hardball as a matter of deliberate corporate policy. The tactic can lead to expensive coverage disputes and sometimes punitive damages awards for bad faith on the part of AIG. You win some and you lose some. Usually, though, the insurer ends up saving money in out-of-court settlements. In the meantime, its reserves against future losses (incurred but not reported losses, in insurance jargon) build up tax-free, thus fattening company coffers.
Id.

11 *See, e.g.*, Resolution Trust Corp. v. Walker, Civ. No. 92-0430, 1994 U.S. Dist. LEXIS 8919 (W.D. La. Feb. 25, 1994); AMAX Research & Dev., Inc. v. Continental Ins. Co., Case No. 91CV3797 (D. Colo. Oct. 28, 1993) (*reprinted in* MEALEY'S LITIG. REPORTS: INS., Nov. 9, 1993, at A-1); M.A. Indus. v. Maryland Casualty Co., 1:92-CV-2659-HTW (N.D. Ga. July 1, 1993) (*reprinted in* MEALEY'S LITIG. REP.: INS., Nov. 9, 1993, at G-1); Vermont Gas, Inc. v. United States Fidelity & Guar. Co., 805 F. Supp. 227 (D. Vt. 1992); Upjohn v. Aetna Casualty & Sur. Co., 768 F. Supp. 1186, 1203 (W.D. Mich. 1990); *see also* Hirschberg v. Lumbermens Mut. Casualty Co., 798 F. Supp. 600, 602 (N.D. Cal. 1992). These cases are significant, even though all of them were decided by lower courts, because they represent the majority of the very few decisions that directly address the issue of whether disputed allegations of late notice can appropriately be resolved when a policyholder seeks its insurer's defense in an ongoing action.

12 Maryland Casualty Co. v. W.R. Grace & Co., 88 Civ. 4337, 1994 U.S. Dist. LEXIS 5505 (S.D.N.Y. 1994).

13 *See, e.g.*, Transamerica Ins. Co. v. Interstate Pollution Control, Inc., No. 92 C 20247, 1995 U.S. Dist. LEXIS 8413, at * 36 (N.D. Ill. 1995); Avondale Indus., Inc. v. Travelers Indem. Co., 774 F. Supp. 1415 (S.D.N.Y. 1991); Olin Corp. v. Insurance Co. of N. Am., 743 F. Supp. 1044, 1052 (S.D.N.Y. 1990); Greycoat Hanover F St. L.P. v. Liberty Mut. Ins. Co., 657 A.2d 764, 767 (D.C. 1995).

14 One caveat is worthy of emphasis. This article is limited to showing that late notice is not a defense to an insurance company's duty to defend when the third-party's action against the policyholder is ongoing. The article does not examine the assertion of late notice as a defense to the duty to defend after the action against the policyholder is resolved.

15 The liability insurance policy sold most commonly in the United States is the commercial general liability policy, which provides broad-based coverage for a wide variety of risks. Formerly known as the comprehensive general liability insurance policy, both types are identified by the same abbreviation: CGL. Although this article addresses CGL insurance policies in particular, the information is relevant to other types of liability insurance.

16 The insurance industry has developed formalized procedures for drafting standardized policies. Starting in the 1950s, there were two principal rating bureaus-the National Bureau of Casualty Underwriters, which became the Insurance Rating Board (IRB) in 1968, and the Mutual Insurance Rating Bureau (MIRB), which represented all of the mutual insurance companies. Affidavit of Eugene A. Graham, filed in Harford County, Md. v. Hartford Mut. Ins. Co., Case No. 11356-19/211 (Cir. Ct. Harford Cty., Feb. 15, 1991), at ¶ 5. In 1971, the IRB and the MIRB combined to form the Insurance Services Office, Inc. (ISO), which is the present rating bureau for the property casualty and surety insurance industry. *Id*. ISO, an association of approximately 1,400 domestic property and casualty insurance companies, is the almost exclusive source of support services in this country for CGL insurance policies. *See* Hartford Fire Ins. Co. v. California, 113 S. Ct. 2891, 2896 (1993). In addition to drafting policy forms, ISO supplies actuarial and rating information; collects, aggregates, interprets, and distributes data on the premiums charged, claims filed and paid, and defense costs expended with respect to each form, and on the basis of this data it predicts future loss trends and calculates advisory premium rates. *Id*. at 2896-97. ISO is the principal drafter of standard liability insurance policies today; most CGL insurance written in the United States is written on ISO forms. *Id*. at 2896.

17 In a brief filed in the Superior Court of California, two insurance companies advocated the practice of standardization:

Standardization enables [the insurance industry] to track the claims experience of the defined coverages nationwide which in turn enables insurers to set realistic premiums and reserves. This is possible only if the words have the same meaning in New York and Washington as they do in California.
Real Parties in Interest's Opening Brief on the Merits at 36, Bank of the West v. Superior Court, 833 P.2d 545 (Cal. 1992).

18 *See* Alan M. Anderson, *Insurance and Antitrust Law: The McCarran-Ferguson Act and Beyond*, 25 WM. & MARY L. REV. 81, 81 (1983).

19 For example, the banking industry has been subject to steadily increasing federal regulation following the adoption of the Banking Act in 1863 and the creation of a system of national banks. *See* Jonathan R. Macey & Geoffrey P. Miller, *The McCarran-Ferguson Act of 1945: Reconceiving the Federal Role in Insurance Regulation*, 68 N.Y.U.L. REV. 13, 20 n.20 (1993). While the securities industry was essentially unregulated at the federal level until 1933, Congress, the courts, and the Securities & Exchange Commission have steadily increased federal oversight ever since. *See id*. The federal government's decision expressly to declare a policy of not regulating the business of insurance is particularly extraordinary because the insurance industry in the United States is the largest insurance industry in the world, receiving over $561 billion in premium volume in 1993, and representing 35.64% of the total insurance premium volume worldwide in 1992. *See* Insurance Information Institute, THE FACT BOOK 1995-PROPERTY/CASUALTY INSURANCE FACTS (1995) [hereinafter FACT BOOK].

20 15 U.S.C. §§ 1011-1015 (1976).

21 Anderson, *supra* note 18, at 85. Notably, the insurance industry has been extraordinarily successful at influencing legislative behavior. *See* Jay Angoff, *Perspectives on the Insurance Crisis: Insurance Against Competition: How the McCarran-Ferguson Act Raises Prices and Profits in the Property-Casualty Insurance Industry*, 5 YALE J. REG. 397, 399 (1988). For example:
[T]he West Virginia legislature passed a bill in March 1986, effective in June of the same year, that capped damages, required insurer data disclosure, and prohibited mid-term policy cancellations. In May, three West Virginia malpractice insurers, led by the nation's largest, St. Paul Fire and Marine, notified all West Virginia doctors that their insurance would be cancelled effective May 31. The companies claimed that the new law's insurance reform provisions were too onerous and its tort reform provisions too weak. The legislature therefore came back into special session and weakened the insurance reform provisions by requiring less financial disclosure, while strengthening the tort reform provision by restricting joint and several liability.
Id. The insurance industry's influence over legislation no doubt was a factor in the passage of the highly favorable McCarran-Ferguson Act.

22 *Id*.

23 322 U.S. 533 (1944); *see* SEC v. National Sec., Inc., 393 U.S. 453, 458 (1969).

24 The long-standing practice of leaving insurance regulation to the states was founded upon the theory set forth in Paul v. Virginia, 75 U.S. (8 Wall.) 168, 183 (1868), that "[i]ssuing a policy of insurance is not a transaction of commerce." Based on this theory, the Supreme Court found that the Commerce Clause did not mandate that the federal government regulate insurance instead of the states. To the contrary, the Supreme Court found that insurance policies "are, then, local transactions and are governed by the local law. They do not constitute a part of the commerce between the States." *Id*. at 182-83.

25 U.S. CONST. art. I, § 8, cl. 3. The Commerce Clause gives Congress the power "to regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes." *Id*.

26 *South-Eastern*, 322 U.S. at 539-49. Two dissenting justices argued that Congress did not intend for the Sherman Act to apply to the insurance industry. *Id*. at 573-74 (Stone, C.J., dissenting); *id*. at 583-84 (Frankfurter, J., dissenting).

27 Macey & Miller, *supra* note 19, at 47.

28 *Id*. at 53.

29 *Id*. at 54-57.

30 *See* Securities and Exchange Comm'n v. National Sec., Inc., 393 U.S. 453, 459 (1969).

31 Theoretically, the states were free to impose state antitrust regulations upon the insurance industry. Many states, however, opted instead to pass "mini McCarran-Ferguson Acts," exempting the insurance industry from state regulation as well. *See* Macey & Miller, *supra* note 19, at 17.

32 *See* Macey & Miller, *supra* note 19, at 15. Between 1945 and 1977, the Supreme Court heard only three cases addressing the scope of this exemption: Securities and Exchange Comm'n v. National Sec., Inc., 393 U.S. 452 (1969); Securities and Exchange Comm'n v. Variable Annuity Life Ins. Co. of Am., 359 U.S. 65 (1959); FTC v. National Casualty Co., 357 U.S. 560 (1958).

33 Macey & Miller, *supra* note 19, at 15.

34 *See, e.g.*, S. 430, 102d Cong., 1st Sess. (1991) (modifying the antitrust exemption applicable to the insurance industry); H.R. 10, 102d Cong., 1st Sess. (1991) (same); S. 719, 101st Cong., 1st Sess. (1989) (same); S. 1299, 100th Cong., 1st Sess. (1987) (same); S. 804, 100th Cong., 1st Sess. (1987) (proposing Insurance Competition Act of 1987 to strike all deference to "insurance" in the McCarran-Ferguson Act); *see also The McCarran-Ferguson Act-State Antitrust Action Against Insurance Agencies: Hearings on S. 1299 Before the Senate Comm. on the Judiciary*, 100th Cong., 2d Sess. (1988); *To Repeal or Revise the McCarran-Ferguson Act: Hearings on S. 80 and S. 1299 Before the Senate Comm. on the Judiciary*, 100th Cong., 1st Sess. (1987). For a related discussion, see Willy E. Rice, *Federal Courts and the Regulation of the Insurance Industry: An Empirical and Historical Analysis of the Courts' Ineffectual Attempts to Harmonize Federal Antitrust, Arbitration, and Insolvency Statutes with the McCarran-Ferguson Act-1941-1993*, 43 CATH. U. L. REV. 399, 407 (1994).

35 There is a debate about whether a repeal of the McCarran-Ferguson Act would eliminate the insurance industry's practice of standardizing insurance policy language. One school of thought suggests that the practice is permissible even under existing antitrust law. *See, e.g.*, Macey & Miller, *supra* note 19, at 59 ("It also is unlikely that existing antitrust law would reach legitimately precompetitive information-sharing activities such as the preparation, dissemination, and filing of policy forms and classifications, participation in joint underwriting or pools for residual risks, sharing of information relating to fraudulent claims, or certain types of shared research and inspections for the purpose of risk classification.").

36 *See* Gray v. Zurich Ins. Co., 419 P.2d 168, 171-72 (Cal. 1996); Clifford A. Platt, Note, *The Insurer's Duty to Defend: New York Folds the Four Corners of the Complaint Rule in* Fitzpatrick v. American Honda Motor Co., 13 PACE L. REV. 141, 146 n.30 (1993).

37 Macey & Miller, *supra* note 19, at 54.

38 Platt, *supra* note 36, at 146 n.30.

39 BLACK'S LAW DICTIONARY defines this doctrine as one that is:
Used in connection with the construction of written documents to the effect that an ambiguous provision is construed most strongly against the person who selected the language.
BLACK'S LAW DICTIONARY 327 (6th ed. 1990).

40 For example, Chief Judge Learned Hand, then of the Second Circuit, wrote in Lee v. Aetna Casualty & Sur. Co., 178 F.2d 750 (2d Cir. 1949):
Finally, if there be an ambiguity in the language of the policy, since the choice is between imposing the burden of the defence upon the insurer or the insured, the canon contra proferentum must prevail, especially as the case involves construing an insurance policy.
Id. at *752-53; see also* Montrose Chem. Corp. v. Superior Court, 861 P.2d 1153, 1160 (Cal. 1993).

41 *See* Gray v. Zurich Ins. Co., 419 P.2d 168, 171 (Cal. 1966).

42 C.D. Spangler Constr. Co. v. Industrial Crankshaft & Eng'g Co., 388 S.E.2d 557, 569 (N.C. 1990). While this quotation specifically addressed ambiguity in the designation of the policyholder, the *Spangler* court made clear that the principle extends to any ambiguity in insurance policy language. *Id*.

43 7C APPLEMAN, INSURANCE LAW AND PRACTICE § 4682, at 22 n.9 (1979) (emphasis added).

44 *Id*. § 4683.01.

45 *See* Seaboard Sur. Co. v. Gillette Co., 64 N.Y.S.2d 304, 309 (App. Div. 1984); International Paper Co. v. Continental Casualty Co., 35 N.Y.S.2d 322, 326 (App. Div. 1974); *see also* City of Johnstown v. Bankers Standard Ins. Co., 877 F.2d 1146, 1148 (2d Cir. 1989); Hutchinson Oil Co. v. Federated Serv. Ins. Co., 851 F. Supp. 1546, 1552-53 (D. Wyo. 1994); Weitzman v. Blazing Pedals, Inc., 151 F.R.D. 125, 126 (D. Colo. 1993); Harristown Dev. Corp. v. International Ins. Co., Civ. No. 87-1380, 1988 U.S. Dist. LEXIS 12791, at * 33 (M.D. Pa. Nov. 15, 1988); Sea Ins. Co. v. Westchester Fire Ins. Co., 849 F. Supp. 221, 223 (S.D.N.Y. 1994); McCostis v. Home Ins. Co., 93 Civ. 1316 (LAP), 1993 U.S. Dist. LEXIS 9174, at * 7 (S.D.N.Y. July 6, 1993); National Grange Mut. Ins. Co. v. Continental Casualty Ins. Co., 650 F. Supp. 1404, 1407 (S.D.N.Y. 1986); Aetna Casualty & Sur. Co. v. Cochran, 651 A.2d 859, 865 (Md. 1995).

46 *See* Zurich Ins. Co. v. Raymark Indus., Inc., 514 N.E.2d 150, 163 (Ill. 1987).

47 *See, e.g.*, Montrose Chem. Co. v. Superior Court, 861 P.2d 1153, 1157 (Cal. 1993); Outboard Marine Corp. v. Liberty Mut. Ins. Co., 607 N.E. 2d 1204, 1220 (Ill. 1992); A.Y. McDonald Indus. v. Insurance Co. of N. Am., 475 N.W.2d 607, 627 (Iowa 1991); C.D. Spangler Constr. Co. v. Industrial Crankshaft & Eng'g Co., 388 S.E.2d 557, 569 (N.C. 1990); Allstate Ins. Co. v. Freeman, 443 N.W.2d 734, 737 (Mich. 1989).

48 *See, e.g.*, Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d 1083, 1089 (Colo. 1991); Hawaiian Ins. & Guar. Co. v. Blanco, 804 P.2d 896, 879 (Haw. 1990); Graber v. State Farm Fire & Casualty Co., 797 P.2d 214, 217 (Mont. 1990); *Zurich*, 514 N.E.2d at 168; Republic Vanguard Ins. Co. v. Buehl, 204 N.W.2d 426, 429-30 (Minn. 1973). As one federal court expressed:
There is no reason why the insured, whose insurer is obligated by contract to defend him, should have to try the actual facts in a suit against his insurance company in order to obtain a defense.
Independent Petrochem. Corp. v. Aetna Casualty & Sur. Co., 654 F. Supp. 1334, 1346 (D. D.C. 1986); *see also* Travelers Indem. Co. v. Dingwell, 414 A.2d 220, 227 (Me. 1980).

49 *See Dingwell*, 414 A.2d at 224; Lewiston Daily Sun v. Hanover Ins. Co., 407 A.2d 288, 291-92 (Me. 1979).

50 *See, e.g.*, Zurich Ins. Co. V. Raymark Indus., Inc., 514 N.E.2d 150, 163 (Ill. 1987); Allstate Ins. Co. v. Novak, 313 N.W.2d 636, 641 (Neb. 1981); Burnett v. Western Pac. Ins. Co., 469 P.2d 602, 605 (Or. 1970); 44 AM. JUR. 2d, *Insurance* § 1539, at 420-21 (1969).

51 Travelers Indem. Co. v. Insurance Co. of N. Am., 886 F. Supp. 1520, 1529 (S.D. Cal. 1995).

52 *Id*.

53 *Id*.

54 From March 1994 to March 1995, more than 238,068 civil cases were filed in the federal courts. Administrative Office of the United States Courts, Statistics Table for the Twelve-Month Period Ending March 31, 1995 (1995), at C-1. In contrast, from June 1970 to June 1971, approximately 93,396 tort cases were filed. Administrative Office of the United States Courts, Federal Judicial Workload Statistics (1994), at 2-7.

55 According to ISO, defense costs rose steadily in the thirty-five years from 1956 to 1991. In 1956, for example, insurance companies spent about twelve cents on defense costs for every dollar spent on indemnity. By 1991, the cost stood near forty cents. Also, ISO has estimated that defense costs for liability insurance policies increased 194% from 1982 to 1991, while losses through indemnification increased 143%. Thus, defense costs grew from 12% of losses to 14% of losses during those years. Insurance companies incurred legal defense costs of $15

billion in 1991. INSURANCE SERVICES OFFICE, LEGAL DEFENSES: A LARGE AND STILL GROWING INSURANCE COST, 1992, at 1.

56 Policyholders spent approximately $17 billion in premiums in 1993 for general liability insurance policies. *See* FACT BOOK, *supra* note 19, at 26.

57 *See* Love v. Fire Ins. Exch., 271 Cal. Rptr. 246, 252 (Ct. App. 1990); Ainsworth v. Combined Ins. Co. of Am., 763 P.2d 673, 676 (Nev. 1988), *reh'g denied*, 774 P.2d 1003 (Nev.), *cert. denied*, 110 S. Ct. 376 (1989).

58 Independent Petrochem. Corp. v. Aetna Casualty & Sur. Co., 654 F. Supp. 1334, 1346 (D. D.C. 1986).

59 Gray v. Zurich Ins. Co., 419 P.2d 168, 171 (Cal. 1996).

60 As one commentator aptly noted, "litigation is the bread and butter of insurance companies." Tesoriero, *supra* note 3, at 120.

61 As the California Supreme Court stated in Gray v. Zurich Insurance Co., 419 P.2d 168 (Cal. 1966):
In purchasing his insurance the insured would reasonably expect that he would stand a better chance of vindication if supported by the resources and expertise of his insurer than if compelled to handle and finance the presentation of his case. He would, moreover, expect to be able to avoid the time, uncertainty and capital outlay in finding and retaining an attorney of his own.
Id. at 178.

62 Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d 1083, 1090 n.11 (Colo. 1991).

63 Cincinnati Ins. Co. v. Lee Anesthesia, 641 So. 2d 247, 249 (Ala. 1994); Tri-State Ins. Co. v. Sing, 850 S.W.2d 6, 7 (Ark. Ct. App. 1993); Schwartz v. Stevenson, 657 A.2d 244, 246 (Conn. App. Ct. 1995); Hawaiian Holiday Macadamia Nut Co. v. Industrial Indem. Co., 872 P.2d 230, 233 (Haw. 1994); City of Idaho Falls v. Home Indem. Co., 888 P.2d 383, 387 (Idaho 1995); Dixon Distrib. Co. v. Hanover Ins. Co., 641 N.E.2d 395, 398 (Ill. 1994); Town of Ayer v. Imperial Casualty & Indem. Co., 634 N.E.2d 571, 572 (Mass. 1994); Peerless Ins. Co. v. Viegas, 667 A.2d 785, 787 (R.I. 1995); St. Paul Fire & Marine Ins. Co. v. Torpoco, 879 S.W.2d 831, 834-35 (Tenn. 1994); Brenner v. Lawyers Title Ins. Corp., 397 S.E.2d 100, 102 (Va. 1990); City of Edgerton v. General Casualty Co., 517 N.W.2d 463, 470 (Wis. 1994).

64 *See, e.g.*, National Union Fire Ins. Co. v. Thomas M. Madden & Co., 813 F. Supp. 1349, 1351 (N.D. Ill. 1993) ("The duty to defend hinges on a liberal reading of the underlying complaint"); Montrose Chem. Corp. v. Superior Court, 861 P.2d 1153, 1158 (Cal. 1993) ("the third party plaintiff cannot be the arbiter of coverage"). As stated in SL Industries v. American Motorists Insurance Co., 607 A.2d 1266 (N.J. 1992):
Insureds expect their coverage and defense benefits to be determined by the nature of the claim against them, not by the fortuity of how the plaintiff, a third party, chooses to phrase the complaint against the insured.
Id. at 1272. Moreover, there need not be an actual lawsuit for there to be an action that gives rise to coverage. For example, letters from federal and state governmental agencies notifying a party of potential environmental liability generally constitute suits triggering the duty to defend. *See, e.g.*, Michigan Millers Mut. Ins. Co. v. Bronson Plating Co., 519 N.W.2d 864 (Mich. 1994)(letter from EPA notifying policyholder of its potential liability signals initiation of legal proceeding functionally equivalent to traditional court action); C.D. Spangler Constr. Co. v. Industrial Crankshaft & Eng'g Co., 338 S.E.2d 557, 570 (N.C. 1990)(administrative actions brought under North Carolina Solid Waste Management Act requiring hazardous waste cleanup are "suits" giving rise to insurers' duty to defend).

65 If an insurance company does not acknowledge its duty to defend until after the underlying action is terminated, then the duty to defend is converted into a duty to reimburse the policyholder, after-the-fact, for defense costs that the policyholder incurred while defending itself against third-party claims. The duty to defend, however, is a much more valuable duty than a duty to reimburse defense costs in the future.

66 Montrose Chem. Corp. v. Superior Court, 861 P.2d 1153, 1153 (Cal. 1993).

67 If the test for determining the existence of a duty to defend were complicated, it could become too difficult for policyholders to prove that they are entitled to a defense in time to receive its benefits.

68 *See, e.g.*, Bracciale v. Nationwide Mut. Fire Ins. Co., Civ. No. 92-7190 1993, U.S. Dist. LEXIS 11606, at * 19 (E.D. Pa. 1993); Steyer v. Westvaco Corp., 450 F. Supp. 384, 391 (D. Md. 1978); Brown v. State Auto & Casualty Underwriters, 293 N.W.2d 822, 825 (Minn. 1980); Seaboard Sur. Co. v. Gillette Co., 476 N.E.2d 272, 274 (N.Y. 1984). Notably, in its reliance on the pleadings alone, this test underscores that actual facts are not relevant to the duty to defend when underlying actions are pending.

69 Insurance companies have no business making this argument because they fully appreciate that, in most cases, late notice is merely a technical breach that should have no effect upon coverage. One insurance company put it this way:
An insurance policy is not to be construed as a game of cat and mouse, in which the insurer (or reinsurer) can avoid liability if he succeeds in catching his insured in a technical breach.
Brief of Plaintiff-Appellee at 41, Hartford Accident & Indem. Co. v. Calvert Ins. Co., 826 F.2d 1055 (3d Cir. 1987).

70 The insurance industry fully appreciates the value of delaying payment of claims. In fact, AIG's Hank Greenberg has made a practice of it:
Around AIG, Hank Greenberg has long been known as the Paul Masson of the insurance industry. He pays no claim before its time.
Glory Years, supra note 9, at 9.

71 *See, e.g.*, Aurelio Argentina v. Otsego Mut. Fire Ins. Co., 1995 N.Y. LEXIS 2226 (N.Y. July 5, 1995); Haston v. Transamerica Ins. Servs., 1995 Ala. LEXIS 175 (Ala. Apr. 14, 1995); Pinson Truck Equip. Co. v. Gulf Am. Fire & Gas Co., 388 So. 2d 955 (Ala. 1980); American Liberty Ins. Co. v. Soules, 258 So. 2d 872 (Ala. 1972); Security Mut. Ins. Co. v. Acker-Fitzsimons Corp., 293 N.E.2d 76 (N.Y. 1972).

72 *See, e.g.*, L&H Transport, Inc. v. Drew Agency, Inc., 369 N.W.2d 608 (Minn. Ct. App. 1985), *aff'd*, 384 N.W.2d 435 (Minn. 1986); Mighty Midgets, Inc. v. Centennial Ins. Co., 389 N.E.2d 1080 (N.Y. 1979); Zukaitis v. Aetna Casualty & Sur. Co., 236 N.W.2d 819 (Neb. 1975); Lusch v. Aetna Casualty & Sur. Co., 538 P.2d 902 (Or. 1975); Bailey v. Universal Underwriters Ins., 482 P.2d 158 (Or. 1971); Close v. Tennessee Reagents, Inc., No. 01-S-01-9106-CV-00054, 1992 Tenn. LEXIS 21 (Tenn. Jan. 6, 1992), Putney Sch., Inc. v. Schaaf, 599 A.2d 322 (Vt. 1991).

73 *See, e.g.*, Weaver Bros. v. Chappel, 684 P.2d 123 (Alaska 1984); Kitching v. Century Ins. Co., 248 N.Y.S.2d 107 (App. Div. 1964); Schuck v. John Morell & Co., 529 N.W.2d 894 (S.D. 1995).

74 *See, e.g.*, Lindus v. Northern Ins. Co., 438 P.2d 311 (Ariz. 1968); Oullette v. Maine Bonding & Cas. Co., 495 A.2d 1232 (Me. 1985); Foundation Reserve Ins. Co. v. Esquibel, 607 P.2d 1150 (N.M. 1980); Brakeman v. Potomac Ins. Co., 371 A.2d 193 (Pa. 1977).

75 *See, e.g.*, Pan Am. Fire & Casualty Co. v. DeKalb-Cherokee Counties Gas Dist., 266 So. 2d 763 (Ala. 1972); Sutton Mut. Ins. Co. v. Notre Dame Arena, Inc., 237 A.2d 676 (N.H. 1968); Stonewall Ins. Co. v. Moorby, 298 A.2d 826 (Vt. 1972).

76 *See* Tesoriero, *supra* note 3, at 124-27 (chart comparing state rules).

77 *Id*. at 120.

78 An example of such a case is National Union Fire Insurance Co. v. Thomas M. Madden & Co., 813 F. Supp. 1349 (N.D. Ill. 1993). The *Madden* court held that the facts regarding notice were undisputed, and accordingly determined, on a motion for summary judgment, that notice was timely and the insurance company was obligated to defend an ongoing third-party action.

79 Theoretically at least, insurance companies create considerable financial risk for themselves when they refuse to defend, or to participate in the defense of, their policyholders against third-party actions. The risk is that they ultimately may be obligated to indemnify their policyholders for any losses incurred in those actions. *See* Note, *The Insurer's Duty to Defend Under a Liability Insurance Policy*, 114 U. PA. L. REV. 734, 734 (1966). Insurers can attempt to avoid this risk by offering to defend their policyholders subject to a reservation of rights. If policyholders accept such offers, insurers are able to honor the duty to defend at the appropriate time (i.e.,

while the third-party actions are pending), then address factual issues at the appropriate time (i.e., after the third-party actions are concluded). Nevertheless, the frequency with which insurance companies refuse to defend their policyholders on grounds of allegedly late notice suggests that the economic benefits of withholding a defense outweigh the risk that policyholders, motivated by the fear of an adverse judgment, will mishandle their own defenses.

80 When insurance companies cannot identify undisputed facts that eliminate any potential for coverage, they are obligated to defend. This obligation continues at least until insurance companies are able to set forth undisputed facts proving that they have no such obligation. *See* Polkow v. Citizens Ins. Co. of Am., 476 N.W.2d 382, 384 (Mich. 1991).

81 In *Montrose*, the Supreme Court of California expressly rejected a suggestion that a policyholder bears the burden of negating each reason asserted by an insurance company for denying a defense as a prerequisite to summary adjudication of the defense duty. Montrose Chem. Corp. v. Superior Court, 861 P.2d 1153, 1161, 1165 (Cal. 1993).

82 Often, the issue of late notice does not arise until after the third-party actions have been concluded. *See, e.g.*, Leadville Corp. v. United States Fidelity & Guar. Co., No. 94-1386, 1995 U.S. App. LEXIS 12389, at * 12 (10th Cir. 1995); American Employers Ins. Co. v. Metro Regional Transit Auth., 12 F.3d 591, 594-595 (6th Cir. 1993); American States Ins. Co. v. Hanson Indus., 873 F. Supp. 17, 27 (S.D. Tex. 1995); A.Y. McDonald Indus. v. Insurance Co. of N. Am., 842 F. Supp. 1166, 1177 (N.D. Iowa 1993); Correll v. Fireman's Fund Ins. Co., 505 So. 2d 295, (Ala. 1986); Select Ins. Co. v. Superior Court, 276 Cal. Rptr. 598, 599 (Ct. App. 1990); Standard Oil Co. v. Hawaiian Ins. & Guar. Co., 654 P.2d 1345, 1347 (Haw. 1982). There, it is entirely proper to examine the factual issues pertinent to late notice, as there is no longer a need for a defense and the policyholder is not being forced to litigate simultaneously on two fronts.

83 *See* Tesoriero, *supra* note 3, at 117-19.

84 *See, e.g.*, McPherson v. St. Paul Fire & Marine Ins. Co., 350 F.2d 563, 565 (5th Cir. 1965). This is the rule that the Insurance Environmental Litigation Association, an insurance industry trade association, espoused in Halstead Oil Co. v. Northern Insurance Co., 579 N.Y.S.2d 266 (App. Div. 1991). *See* Brief of the Insurance Environmental Litigation Association at 9-10, *Halstead*.

85 *See, e.g.*, Marez v. Dairyland Ins. Co., 638 P.2d 286, 288 (Colo. 1981); *McPherson*, 350 F.2d at 563.

86 1 THE UMBRELLA BOOK, ANALYSIS OF COMMERCIAL GENERAL, UMBRELLA AND EXCESS LIABILITY FORMS 88 (1994).

87 Generally, courts will construe the provisions of a contract so as to avoid a forfeiture. *See* Insurance Co. v. Norton, 96 U.S. 234, 242 (1878); Ross v. United Servs. Auto. Ass'n, 899 S.W.2d 53 (Ark. 1995); Albertson v. Leca, 447 A.2d 383, 387 (R.I. 1982); Von Uhl v. Trempealeau County Mut. Ins. Co., 146 N.W.2d 516, 520 (Wis. 1966). *See also* 2 COUCH ON INSURANCE § 15.95 n.15 (Rev. ed. 1984).

88 Notably, courts across the country recognize that the duty to defend is a broad duty, not a narrow one.

89 *See, e.g.*, AMAX Research & Dev., Inc. v. Continental Ins. Co., Case No. 91CV3797 (D. Colo. Oct. 28, 1993).

90 *See, e.g.*, National Am. Ins. Co. of Cal. v. Certain Underwriters at Lloyd's, No. 94-555047 (9th Cir. June 30, 1995).

91 *See, e.g.*, Paul Holt Drilling, Inc. v. Liberty Mut. Ins. Co., 664 F.2d 252, 254 (10th Cir. 1981); Dryden v. Ocean Accident & Guarantee Corp., 138 F.2d 291 (7th Cir. 1943); Scott v. Inter-Insurance Exch., 186 N.E.2d 176, 179 (Ill. 1933); Ratner v. Canadian Universal Ins. Co., 269 N.E.2d 227, 229 (Mass. 1971); Satterwhite v. Stolz, 442 P.2d 810 (N.M. 1968); Gulf v. Parker Prods., Inc., 498 S.W.2d 676, 679 (Tex. 1973). Of course, insurance companies are quick to argue that "no action" clauses are inapplicable when they wish to sue other insurance companies or reinsurance companies.

92 Some courts, on the other hand, have held that "no action" clauses do prevent policyholders from suing their insurance companies for breach of the duty to defend until after the third-party actions are resolved. *See* Ginn v. State Farm Mut. Auto. Ins. Co., 417 F.2d 119, 122 (5th Cir. 1969); Gilbert v. American Casualty Co., 219 So. 2d

84, 86 (Fla. Dist. Ct. App.), *cert. denied*, 225 So. 2d 920 (Fla. 1969); *see also* 18A COUCH ON INSURANCE 2D § 75:111 (Rev. ed. 1984); 20A APPLEMAN. INSURANCE LAW AND PRACTICE § 11614 (1980). Many courts completely avoid tangling with the "no action" clause by relying on basic principles of contract law to decide when policyholders may sue for breach of the duty to defend. For example, in Oil Base, Inc. v. Continental Casualty Co., 76 Cal. Rptr. 594 (Ct. App. 1969), the court held that the duty to defend was a continuing executory contract.

In the case of a continuing executory contract, if the parties do not mutually abandon and rescind it, it is optional with the plaintiff to sue immediately upon the breach or to wait until the expiration of the time designated in the contract before commencing his action.

Id. at 598. Thus, the court held that policyholders may sue for breach of contract when the insurance companies first refuse to defend, or may wait until the third-party action is resolved to do so. *See also* Israelsky v. Title Ins. Co., 261 Cal. Rptr. 72, 75 (Ct. App. 1989). This approach fully protects the rights of policyholders because it permits them to attempt to enforce the duty to defend at the time that they need it, so as to receive the full value of the duty. Alternatively, if the policyholders prefer to avoid a two-front war, it permits them to delay litigation without encountering problems with the statute of limitations.

93 *See, e.g.*, Scott v. Inter-Ins. Exch., 186 N.E.2d 176, 178-79 (Ill. 1933); Ratner v. Canadian Universal Ins. Co., 269 N.E.2d 227, 228 (Mass. 1971); Gulf v. Parker Prods., Inc., 498 S.W.2d 676, 679 (Tex. 1973). *See also* Cross-Petition for Certification and Brief in Opposition to Defendant-Appellant Petition for Certification at 8, Fireman's Fund Ins. Co. v. Security Ins. Co. of Hartford, 367 A.2d 864 (N.J. 1976) ("Similarly, as the Appellate Division noted above, the breach of fiduciary duty by the insurer to its insured nullifies and voids the "no action" clause in the policy.").

94 *See, e.g.*, Dryden v. Ocean Accident & Guarantee Corp., 138 F.2d 291, 295 (7th Cir. 1943).

95 *E.g.*, Paul Holt Drilling, Inc. v. Liberty Mut. Ins. Co., 644 F.2d 252, 254 (10th Cir. 1981). *See also* Fireman's Fund Insurance Company's Cross-Petition for Certification and Brief in Opposition to Defendant-Appellant Petition for Certification at 8, Fireman's Fund Ins. Co. v. Security Ins., 367 A.2d 864 (N.J. 1976) ("The "no action" clause has no application to this case as well because it is directed to the third parties who have been injured by actions of the insured and it is not directed to the insured itself. That is, it is to prevent an injured party from suing an insurance company directly.")

96 *See Paul Holt*, 664 F.2d at 254-55; Duke Univ. v. St. Paul Mercury Ins. Co., 384 S.E.2d 36, 40-41 (N.C. 1989). As stated in *Paul Holt*:

If the no action clause applies to the insureds' claims, when would it no longer bar suit to recover for legal expenses they bear when the insurer wrongfully refuses to defend? Unless insureds refuse to pay their attorney, no judgment for those fees will ever be entered against them. There will never be a written agreement of "the insured, the claimant and the company" with respect to the attorneys' fees and litigation costs. Additionally, "claimant" in this context obviously refers to a third party claiming against the insured.

664 F.2d at 254-55.

97 *See* Ritchie v. Anchor Casualty Co., 286 P.2d 1000, 1008 (Cal. Ct. App. 1955).

98 For example, two insurance companies recently characterized the forfeiture rule as a "triumph of form over substance" arrived at through a "17th century type of analysis." *See* Appellant's Reply Brief at 7, New England Reinsurance Co. v. National Union Fire Ins. Co. 654 F. Supp. 742 (C.D. Cal. 1986), *rev'd*, 822 F.2d 887 (9th Cir.), *vacated and reh'g granted*, 829 F.2d 840 (9th Cir. 1987). Those insurance companies also recognized that there is a "need to protect an insured from the severe consequences of a forfeiture of a rightful payment, based upon technical grounds...." Appellant's Opening Brief at 12, New England Reinsurance Co. v. National Union Fire Ins. Co., 654 F. Supp. 742 (C.D. Cal. 1986), *rev'd*, 822 F.2d 887 (9th Cir.), *vacated and reh'g granted*, 829 F.2d 840 (9th Cir. 1987).

99 *See* Travelers Indem. Co. v. Insurance Co. of N. Am., 886 F. Supp. 1520, 1526 (S.D. Cal. 1995) (noting that "by refusing either to defend or to prove that no potential for coverage exists once a potential for coverage has been shown, the insurer exposes itself to liability for bad faith"). In Montrose Chemical Corp. v. Superior Court, 861 P.2d 1153 (Cal. 1993), one insurer argued that insurers can refuse to defend their policyholders "at their own risk" because, if they are wrong in believing that they have no defense obligations, policyholders may be made whole through bad faith actions. The Supreme Court of California rejected this argument in its entirety, holding that

the existence of an eventual remedy for an insurance company's bad faith denial of a defense does not support restricting the duty to defend. *Id*. at 1163.

100 As discussed previously, late notice is such a fact-intensive issue that, in most cases, some facts probably would exist that could support a prima facie claim of late notice. Even proof that notice ultimately was found to be timely would not necessarily prove that the allegation of late notice was made in bad faith.

101 In *Montrose*, the California Supreme Court expressly rejected an insurance company contention that an action by a policyholder for bad faith was an appropriate remedy for an insurance company's failure to defend its policyholder while the underlying action was pending. *Id*.

102 *See* cases cited in *supra* note 13.

103 In Resolution Trust Corp. v. Walker, No. 92-0430, 1994 U.S. Dist. LEXIS 8919 (W.D. La. Feb. 25, 1994), the U.S. District Court for the Western District of Louisiana held:
With respect to the issue of notice, this court has not been cited to a single Louisiana case in which the insured's failure to give proper notice under the policy vitiates the insurer's initial duty to defend under the policy. Rather, all of the cases in this area unequivocally state that the determination of the existence of a duty to defend involves only a comparison on the allegations of the plaintiff's pleadings and the terms of the insurance policy.
Id. at * 5. In *AMAX*, the court held:
Defendants contend that Plaintiffs' tardy notice would defeat Plaintiffs' claim of duty to defend. The Court disagrees. The language in the policies (sic) defense clauses (Eg. "Continental shall have the right and duty to defend any suit against the insured seeking damages on account of such personal injury or property damage, even if any of the allegations are groundless, false or fraudulent...." Policy L-3 32 08 62, page 1) sets forth a comprehensive obligation. Since Continental drafted the policies, any doubts as to interpretations are resolved against Continental (or INA as to the INA policies, all of which contain similar language).
Amax Research & Dev. v. Continental Ins. Co., Case No. 91-CV-3797, at 2 (D. Colo. Oct. 28, 1993). In *Vermont Gas*, the court held:
Whether circumstances in this case might excuse VGS's delay [in giving notice] is a fact-specific inquiry which is beyond the scope of the present motion. This issue accordingly awaits future resolution.
In the meantime however the question of whether the defendant USF&G has a duty to defend is before the court. While the court agrees with the proposition that if VGS cannot prove timely notice its coverage will be forfeited without regard to prejudice, that does not resolve the pending motion. At this juncture the court is in no position to rule as a matter of law that no coverage will be available when the issue is fully developed. In other words, a possibility of coverage exists until such time as the notice issue is resolved, even though notice is a condition precedent to coverage.
Vermont Gas Inc. v. United States Fidelity & Guar. Co., 805 F. Supp. 227, 232 (D. Vt. 1992). In *M.A. Industries*, the Northern District of Georgia held:
In addition, defendants contend that the issue of late notice is relevant to its duty to defend. The court finds, however, that this too is a factual issue beyond the allegations of the underlying complaint, and the possibility of late notice simply does not relieve the insurer of its duty to defend.
M.A. Indus. v. Maryland Casualty Co., 1:92-CV-2659-HTW, at 22 (N.D. Ga. July 1, 1993). In *Upjohn*, the Western District of Michigan held:
I agree with plaintiffs that Aetna's arguments here on late notice "badly miss the mark." In assessing the duty to defend, facts outside the allegations that might negate coverage are not properly considered. Moreover, the duty to defend is triggered where the allegations in the relevant complaint "even arguably" fall within the ambit of the policy language. The late notice facts are thus inappropriate to a discussion of the duty to defend-they certainly go beyond the allegations and policy language.
Upjohn v. Aetna Casualty & Sur. Co., 768 F. Supp. 1186, 1203 (W.D. Mich. 1990).

104 *See, e.g., Vermont Gas*, 805 F. Supp. at 232.

105 *See, e.g., Upjohn*, 768 F. Supp. at 1203 n.21.

106 No. 88 Civ. 4337, 1994 U.S. Dist. LEXIS 5505 (S.D.N.Y. Apr. 28, 1994).

107 *Id*. at * 1.

108 *Id*. at * 12.

109 *Id*. For support, the *Grace* court cited Avondale Industries, Inc. v. Travelers Indemnity Co., 774 F. Supp. 1416 (S.D.N.Y. 1991). The court's reliance was misplaced, however, because the *Avondale* court never addressed whether the insurance policies permitted such an examination. That court simply conducted a factual inquiry into late notice while underlying actions were pending without addressing the threshold question of whether such an inquiry was permissible. The *Grace* court also erroneously cited *Avondale* as support for the following proposition:

Since the duty is never triggered if notice to insurers is late, the insurers have no obligation to incur defense costs pending the judicial determination of whether timely notices of suits and occurrences were provided to the insurers.

Grace, 1994 U.S. Dist. LEXIS, at * 12. *Avondale*, in fact, held to the contrary. In *Avondale*, the court held that, in normal circumstances, when an insurance company is relieved of the duty to defend by a judicial determination, "the insurer nonetheless is liable for the defense costs incurred in the underlying action up until the time of the judicial determination." *Avondale*, 774 F. Supp. at 1426. The court held that a case must present "special circumstances" for this rule to change. *Grace*, 1994 U.S. Dist. LEXIS, at * 12.

110 Id. at * 14.

111 This approach is comparable to an argument that insurance companies make when attempting to avoid the consequences of the doctrine of contra proferentem. The argument, known as the "sophisticated policyholder defense," is that contra proferentem should be disregarded when a sophisticated policyholder purchases an insurance policy. Essentially, the insurance companies argue that large sophisticated policyholders have leverage to dictate the terms of their insurance policies and should not have the same difficulties as laymen in understanding their insurance policies. *Id*. This argument is incorrect because contra proferentem is not based on a difference in negotiating power or expertise; rather, it is based on the fact that the insurance industry drafts the policy language. *Id*. The size of the policyholder does not change that ultimate fact. Accordingly, the overwhelming trend is for courts to reject this defense. *See, e.g.*, New Castle County v. Hartford Acc. & Indem. Co., Nos. 89-3814, 90-3012, 90-3030 (3d Cir. Apr. 30, 1991); AIU Ins. Co. v. Superior Court, 799 P.2d 1253 (Cal. 1990); Minnesota Mining & Mfg. Co v. Travelers Indem. Co., 457 N.W.2d 175 (Minn. 1990); Boeing Co. v. Aetna Casualty & Sur. Co., 784 P.2d 507 (Wash. 1990).

112 *Grace*, 1994 U.S. Dist. LEXIS, at ** 14-15.

113 Comparable issues were discussed in Commercial Union Insurance Co. v. International Flavors & Fragrances, Inc., 822 F.2d 267 (2d Cir. 1987), also cited in *Grace*, but the *Commercial Union* facts were distinguishable. There, the underlying action was concluded and the policyholder was litigating with its insurance companies regarding their coverage obligations. The relevant issue regarding the duty to defend was only whether the policyholder was entitled to reimbursement of defense costs. The Second Circuit held that the policyholder was not entitled to reimbursement because it had provided late notice of the underlying claim.

The *Commercial Union* court stated that the policyholder's "compliance with the notice requirement, however, was a condition precedent to all of [the insurance company's] duties under the policy, including the duty to defend." *Id*. at 273. This statement was consistent with the plain language of the standard no action clause, because there already had been a final determination of the underlying action "by judgment against the insured after actual trial."

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