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Recent Developments: Sherwood Brands, Inc. v. Great Am. Ins. Co.: Under Section 19-110 of the Maryland Insurance Article, an Insurer Must Show Actual Prejudice in Order to Deny Coverage When an Insured Breaches the Policy's Claim Notice Provision

Jeffrey R. Maylor

RECENT DEVELOPMENT

SHERWOOD BRANDS, INC. V. GREAT AM. INS. CO.: UNDER SECTION 19-110 OF THE MARYLAND INSURANCE ARTICLE, AN INSURER MUST SHOW ACTUAL PREJUDICE IN ORDER TO DENY COVERAGE WHEN AN INSURED BREACHES THE POLICY'S CLAIM NOTICE PROVISION.

By: Jeffrey R. Maylor

The Court of Appeals of Maryland held that Maryland Insurance Article section 19-110's requirement that an insurer must show prejudice in order to disclaim coverage on a claims-made policy applies when the act triggering coverage occurs during the policy period, and the insured breaches the policy's notice provision. *Sherwood Brands, Inc. v. Great Am. Ins. Co.*, 418 Md. 300, 13 A.3d 1268 (2011). Specifically, the court held that notice provisions in liability policies are to be treated as covenants, rather than conditions precedent. *Id.* at 333, 13 A.3d at 1288. As a result, under section 19-110, any breach of the notice provision must have prejudiced the insurer for it to disclaim coverage, regardless of the policy language. *Id.*

Sherwood Brands, Inc. ("Sherwood") obtained an Indemnity Insurance policy ("the Policy") from Great American Insurance Company ("Great American") for the period of May 1, 2007 through May 1, 2008. On October 17, 2007, a claim was filed against Sherwood in the Tel-Aviv Jaffo (Israel) District Court. On December 11, 2007, a former employee sued Sherwood in the Plymouth County Superior Court of Massachusetts. Sherwood did not notify Great American of either claim until six months after the expiration of the Policy. Great American refused coverage on both claims because Sherwood failed to comply with the Policy provision requiring the insured to give notice to the insurer of a claim as soon as practicable and in no event later than ninety days after the end of the policy period.

On February 10, 2009, Sherwood filed a complaint in the Circuit Court for Montgomery County against Great American claiming breach of contract and seeking declaratory relief. The circuit court granted Great American's cross-motion for summary judgment, holding that the Policy was a claims-made policy with a reporting period and, therefore, the defendant was not required to show actual prejudice to deny coverage for the claims. Sherwood appealed the decision to the Court of Special Appeals of Maryland. The Court of Appeals of Maryland issued a writ of certiorari on its own initiative before the Court of Special Appeals of Maryland decided Sherwood's appeal.

The court began by examining the origin of section 19-110 of the Maryland Insurance Article. *Sherwood*, 418 Md. at 310, 13 A.3d at 1274. The Court of Appeals of Maryland ruled in *Watson v. United States Fidelity & Guaranty Co.* that an insurer was within its rights to deny coverage, and did not need to show prejudice, when the insured breached the notice provision of an insurance policy. *Id.* at 311, 13 A.3d at 1275 (citing *Watson v. U.S. Fid. & Guar. Co.*, 231 Md. 266, 272, 189 A.2d 625, 627 (1963)). Immediately following the *Watson* decision, the Legislature passed former Maryland Code section 482, which nullified the decision in *Watson* since it required an insurer to show by a preponderance of affirmative evidence that a lack of notice or cooperation resulted in actual prejudice to the insurer to deny coverage. *Sherwood*, 418 Md. at 312, 13 A.3d at 1275 (citing MD. CODE ART. 48A, § 482 (1957, 1972 Repl. Vol.)).

Later, in *St. Paul Fire & Marine Insurance Co. v. House*, Chief Justice Murphy's dissent proffered that the purpose of a notice requirement was to protect the insurer's interests from being prejudiced; therefore, an insurer cannot disclaim coverage without demonstrating it was prejudiced by the breach of the notice provision. *Sherwood*, 418 Md. at 315, 13 A.3d at 1277 (citing *St. Paul Fire & Marine Ins. Co. v. House*, 315 Md. 328, 346-47, 554 A.2d 404, 413 (1989)(Murphy, C.J., dissenting)). Chief Justice Murphy's dissent became the majority opinion in *T.H.E. Insurance Co. v. P.T.P. Inc.*, where the Court of Appeals of Maryland concluded that section 482 was not intended to revive a lapsed insurance policy but was intended to confront notice-prejudice issues related to claims filed during the policy period. *Sherwood*, 418 Md. at 320-21, 13 A.3d 1280-81 (citing *T.H.E. Ins. Co. v. P.T.P. Inc.*, 331 Md. 406, 415-16, 628 A.2d 223, 227-28 (1993)).

Similarly, section 19-110 was passed by the Maryland General Assembly to apply to a new type of insurance policy, the claims-made policy. *Sherwood,* 418 Md. at 323, 13 A.3d at 1282. A claims-made policy deals with situations where the exact time of the negligent act is difficult to pinpoint. *Id.* at 316, 13 A.3d at 1277-78 (citing *House*, 315 Md. at 349, 554 A.2d at 414 (Murphy, C.J., dissenting)). In a claims-made policy the claim must be made during the policy period, but the insured need only report it to the insurer promptly, although not necessarily during the policy period. *Sherwood*, 418 Md. at 316, 13 A.3d at 1277-78 (citing *House*, 315 Md. at 349, 554 A.2d at 414 (Murphy, C.J., dissenting)). A claims-made and reported policy requires the claim be made against the insured and reported to the insurer during the policy period, or an extended reporting period. *Sherwood*, 418 Md. at 323, 13 A.3d at 1282.

Sherwood argued before the Court of Appeals of Maryland that section 19-110 applied to all liability policies, regardless of whether deemed claims-made policies or claims-made and reported policies. *Sherwood*, 418 Md. at 324, 13 A.3d at 1283. Sherwood further asserted that, according to *T.H.E.* and *House*, section 19-110 applies when the claim was made during the policy period. *Id.* at 324-25, 12 A.3d at 1283. Accordingly, section 19-110 applied to both claims because they were filed against Sherwood when the Policy was in effect. *Id.* at 325, 12 A.3d at 1283. Alternatively, Great American argued that Maryland courts have held that the statute does not apply to claims-made and reported policies like the policy at issue. *Id.* at 325, 13 A.3d at 1283. Great American further argued that a majority of other jurisdictions have held that the prejudice rule does not apply to claims-made and reported policies. *Id.* at 325-26, 13 A.3d at 1283-84.

The court relied on the text of section 19-110 to conclude that Sherwood's failure to give timely notice of both claims must result in a breach of the Policy. *Sherwood,* 418 Md. at 329-30, 13 A.3d at 1286. Accordingly, the notice provision must be considered a covenant rather than a condition precedent so that the failure to give notice constitutes a breach. *Id.* at 330, 13 A.3d at 1286. The court concluded that even though Great American labeled its notice provision as a condition precedent to coverage, the legislative intent of section 19-110 was that the notice provision of the Policy be treated as a covenant, not a condition precedent. *Id.* Specifically, section 482, the precursor to section 19-110, was enacted to overrule the holding in *Watson*, and make notice provisions covenants and not conditions. *Id.* at 331, 13 A.3d at 1287 (citing *Sherwood Brands, Inc. v. Hartford Accident & Indem. Co.*, 347 Md. 32, 42, 698 A.2d 1078, 1082 (1997)).

The court rejected Great American's contention that section 19-110 did not apply to claims-made and reported policies. *Sherwood*, 418 Md. at 333, 13 A.3d at 1288. Instead, the court interpreted section 19-110 to apply to claims-made policies in which the act triggering coverage occurs during the policy period, but the insured does not comply with the policy's notice provisions. *Id.* Sherwood breached the Policy by not providing the notice required under the Policy, and consequently, section 19-110 was invoked requiring Great American to show how it was prejudiced by Sherwood's delayed notice. *Id.* The court vacated the judgment of the circuit court and remanded to that court for further proceedings. *Id.* at 334, 13 A.3d at 1289.

In *Sherwood*, the Court of Appeals of Maryland continued to clarify the types of policies subject to section 19-110. Maryland practitioners involved in late-claim suits must determine whether the claim was filed against the insured during the period when the policy was in force and if

the insured's delayed notice prejudiced the insurer. Practitioners representing insurers must make sure that the company has the financial records and evidence needed to prove actual prejudice from the insured's breach of the notice provision. An insured filing suit against an insurer when coverage is repudiated based on the insured's late notice must be prepared to rebut the prejudice evidence that may be presented by the insurer. Also, insurers cannot circumvent the legislative intent of section 19-110 by labeling their notice provision as a condition precedent.