In Maryland, Insurers Cannot Rely on Self-Serving Label of 'Condition Precedent' in their Insurance Policy to Deny Claim Based on Late Notice

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In *Sherwood Brands, Inc. v. Great American Ins. Co.*, No. 62 (Md. Feb. 24, 2011), the Maryland Court of Appeals re-affirmed Maryland's long-standing public policy - embraced by both the courts and the legislature since 1964 - that an insurer cannot deny coverage based on late notice, unless the insurer can prove that it was prejudiced. Maryland's prejudice rule places it among the vast majority of states (i.e., 38 of 50, plus two territories, according to the decision), and the rationale for the majority rule is obvious - an insurer should not be allowed to void such an important contract based on a technical breach, unless it can prove genuine harm. The most interesting aspect of this decision was the Court openly stating its willingness to ignore a label, "condition precedent," that the insurer had added to the contract in an effort to circumvent the prejudice rule. The Court's unwillingness to give meaning to the written term "condition precedent" demonstrates the importance that Maryland attaches to the prejudice rule, and the deep-rooted policy of protecting policyholders against forfeiting coverage based upon their own technical breaches.

Maryland's "prejudice rule" is codified in Insurance Article 19-110, which the Court observed places Maryland among three states, along with Massachusetts and Wisconsin, to implement the "prejudice rule," by statute (the Court surprisingly failed to mention a fourth state, New York, which passed a similar statute in 2008). And, even among states where prejudice is required by statute, the Court concluded that Maryland's statute is unique because it applies only to instances where the policyholder has "breached the policy" by failing to provide timely notice.

While the prejudice requirement typically applies both to so-called "occurrence" and "claims made" policies, the fact that Sherwood Brands' policy happened to be "claims made" contributed to the complexity of this case. A claims made policy is activated when a claim or suit is made against the policyholder during the policy period. This particular policy contained a requirement, which the policy deemed a "condition precedent," that notice must be provided to the insurance carrier "as soon as practicable," and in any event during the policy period itself, or during a 90 day grace period after expiration date. Three claims were filed against Sherwood Brands during the policy period, which activated the policy, but Sherwood Brands failed to provide notice to the insurer until more than 90 days after the policy period. The insurer therefore denied coverage based on late notice.

In finding that the insurer must show prejudice as part of a late notice defense, and that therefore late notice did not defeat coverage, the Court drew a distinction between a "condition precedent" and a "covenant." It defined the former as something that must happen before the insurer's coverage obligation can exist at all, and the latter as a requirement that, if breached by the policyholder, would excuse the insurer's obligation to provide coverage. The case, therefore, turned on whether or not the requirement of giving notice within a certain period was a "condition precedent," which would mean no coverage for Sherwood Brands, or a "covenant." If the requirement was viewed as a covenant, then a breach of the covenant would activate Insurance Article 19-110, and bring the prejudice requirement into play.

The Court acknowledged that the insurance contract expressly stated that the notice provision was a "condition precedent" to coverage, yet chose to look beyond the label, and see the notice requirement for what it really was - a requirement that the policyholder take a certain action after a claim is made against it, which the policyholder in this case allegedly breached. Based on the important public policy reasons underlying the prejudice rule - i.e., preventing unjustified windfalls to insurers, avoiding unreasonable forfeitures based on technical irregularities, and leaving victims of accidents uncompensated, the Court held that Article 19-110 applied. Because the insurer had not proven prejudice, the Court found that it could not deny the claim based on late notice.

While the decision acknowledged that its analysis was "quite a workout," turning on subtle interpretations of contractual language, caselaw, and the Maryland statute, the takeaways for businesses in Maryland are simple. First, the decision's willingness to elevate public policy concerns and the wording of the Insurance code over an express, written, term in the parties' own contract demonstrates how strongly Maryland frowns on insurers who claim "gotcha" based on late notice when they cannot demonstrate prejudice. Second, even when a business has failed to provide timely notice and appears to have violated a clear term of the policy, it should not be discouraged from exploring its options, and perhaps pursuing coverage for the claim in spite of its failure to provide earlier notice. And third, even though coverage can often be obtained when express notice provisions have been violated, it is not without added cost, delay, and aggravation to cure the self-inflicted wounds of late notice. The policyholder in this case, Sherwood Brands, had earlier litigated and prevailed in another late notice case before the Court of Appeals. See *Sherwood Brands, Inc. v. Hartford Accident & Indemnity Co.*, 347 Md. 32 (1997). These victories, however, were not without their associated costs of taking a case from trail to the highest court of the state. Therefore, in spite of the policyholder-friendly holding and reasoning of Sherwood Brands, businesses should consult their policies closely in the event of a loss or claim, and, with the advice of counsel if needed, promptly place all appropriate insurers on notice.