



## Insured's Failure to Timely Report Claim Eliminates Coverage

A recent federal court decision, applying California law to directors and officers liability policies, addressed two important issues: the importance of a policyholder's strict compliance with a claims-made-and-reported policy's notice provision, and the importance of accurate representations in an insurance application.

In *US HF Cellular Communications, LLC, et al. v. Scottsdale Insurance Company*,<sup>1</sup> the court concluded that Scottsdale Insurance Company ("Scottsdale") did not owe a duty to defend under two Business Management and Indemnity Insurance policies it issued to two sets of policyholders: (1) ShipCom, LLC, US HF Cellular Communications, LLC, and Virsenet, LLC (collectively referred to as "US HF Cellular Policyholders"), and (2) Global Wideband HF Net LLC ("Global")<sup>2</sup>. The US HF Cellular Policyholders and Global sought coverage from Scottsdale with respect to a lawsuit filed by minority shareholders of ShipCom on May 29, 2015. The shareholder lawsuit alleged claims for breach of fiduciary duties, self-dealing/usurpation of corporate opportunity, unjust enrichment, squeeze out, conversion, negligence, fraud, state law trademark infringement, and state law deceptive trade practices against ShipCom, Virsenet, US HF Cellular, and Mr. Edward Bayuk, among others. The minority shareholders' third amended complaint added Global as a defendant.

Scottsdale issued three consecutive policies to the US HF Cellular Policyholders beginning on July 31, 2013 and renewing annually until July 31, 2016. Scottsdale also issued a policy to Global beginning on September 24, 2015 and ending on September 24, 2016. Each of the policies had an identical duty to defend provision and notice provision, and certain identical exclusions. The policies only covered claims "first made against the insured and reported to the insurer pursuant to the terms of the relevant coverage section...." That section in each policy required that an insured give Scottsdale written notice of any "Claim" as soon as practicable, "but in no event later than sixty (60) days after the end of the respective Policy Period."

Scottsdale denied coverage to the US HF Cellular Policyholders alleging, among other things, that the claim was not timely reported. The court found that the US HF Cellular Policyholders first reported the shareholder lawsuit to Scottsdale on or around January 8, 2016, nearly eight months after the lawsuit was filed and four months after the policy's 60-day reporting deadline. Therefore, the claim was not timely reported. The court noted that under California law an insurer "need not show prejudice from an insured's delayed reporting in order to reject coverage for claims not timely reported." Furthermore, the court concluded that the renewal of a policy does *not* extend a policy's reporting period. Therefore, even though the US HF Cellular Policyholders consecutively renewed their policy with Scottsdale, they still had to comply with the policy's strict 60-day reporting period.

Scottsdale denied coverage to Global alleging that the policy's Application Exclusion barred coverage as a result of misrepresentations on the Global policy application. The "Prior Activities" question on Global's insurance application asked if:

the Applicant or any person proposed for this insurance in his or her capacity as an employee, officer, or director of the Applicant or *another entity* [has] been the subject of or involved in any...litigation [within the last three years].

<sup>1</sup> 2:17-cv-261 (S.D. Ohio June 12, 2018)

<sup>2</sup> The policies that covered Global also provided coverage to Jon Richmond, Global's Chief Operating Officer, and Edward Bayuk, a director.

Mr. Bayuk filled out the application on behalf of Global and answered the question in the negative, despite the fact that the shareholder lawsuit had been filed against US HF Cellular and Mr. Bayuk months prior.<sup>3</sup> The court concluded that Mr. Bayuk, as CEO of both US HF Cellular and Global, constituted “a person who was proposed for insurance” under the Scottsdale policy issued to Global and that Mr. Bayuk was involved in a lawsuit within the last three years “in his capacity as an officer of another entity – US HF [Cellular].” The court found, under the plain, unambiguous language of the policy, that “another entity”<sup>4</sup> means “any other entity – not just one applying for insurance under the Application.” Therefore, because Mr. Bayuk made a material misrepresentation in Global’s insurance application, the Scottsdale policy’s Application Exclusion barred coverage for Global in the shareholder lawsuit.

This decision is an important reminder to policyholders nationwide to ensure that they promptly report claims to their directors and officers insurers as soon as practicable, and to negotiate extended reporting periods. Policyholders should also take care to ensure that the answers in their insurance applications are thorough and accurate, as an omission could end up costing them valuable coverage.

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<sup>3</sup> The shareholder lawsuit was filed on May 29, 2015, while Mr. Bayuk signed and dated the insurance application on August 31, 2015.

<sup>4</sup> “Another entity” was not defined in the policy or in the insurance application. Global argued that “another entity” referred to an entity who was applying for insurance under the application and since no entity applying for insurance was involved in litigation, the statement was truthful. The court rejected Global’s argument stating that such a reading of the policy language would render the definition of “Applicant” superfluous. “Applicant” was defined to include “all corporations, organizations or other entities set forth in Question 1. of the General Information section of this Application, including any subsidiaries, proposed for this insurance.”