

Insurance Coverage for Lawsuits:

Recent years have seen a proliferation of lawsuits involving intellectual property and other issues for which it is uncertain whether insurance coverage will be available. Because the possibility for insurance coverage, which may provide for a defense and indemnification of a portion or all of a settlement or judgment, is not obvious, it is often overlooked at the early stages of litigation. If the possibility for coverage is identified later, it may be too late to successfully tender defense to the insurance carrier. In several instances when this situation has happened, finger-pointing unfortunately has ensued, in some cases resulting in malpractice claims against outside counsel.

Indeed, in several recent reported decisions, courts have wrestled with the issue of whether, in the absence of a clear agreement regarding who should be responsible for seeking insurance coverage, it is malpractice for outside counsel to fail to do so. Likely many other such claims have not resulted in reported decisions.¹

It is not a coincidence that many of these cases arise out of intellectual property lawsuits. Copyright and trademark lawsuits often are defended by general commercial litigators or by intellectual property specialists who may be unaware of the existence of insurance coverage under the advertising injury sections of general liability policies. See the sidebar on page 62 regarding personal and advertising injury coverage.

The purpose of this article is not to debate the merits of such malpractice claims. Rather, we suggest ways to avoid having to consider a malpractice claim in the first place.

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Allocate Responsibility and Avoid Malpractice Claims

By Deidra D. Gold and Kenneth S. Ulrich



Deidra D. Gold is senior vice president, general counsel, and corporate secretary of United Stationers Inc., a broad line wholesale distributor of business products and a provider of marketing and logistics services to resellers, with annual sales of approximately \$3.7 billion, in Des Plaines, IL. She also has served as a senior corporate officer of three other public companies and a corporate mergers and acquisitions and securities partner in two law firms. She is available at dgold@ussco.com.



Kenneth S. Ulrich is a principal with Goldberg Kohn Bell Black Rosenbloom & Moritz, Ltd., in Chicago. He focuses his practice on complex commercial litigation, including representing policyholders in insurance coverage disputes. He is available at kenneth.ulrich@goldbergkohn.com.

Today's in-house counsel spend more time and energy analyzing relationships with outside counsel than ever before. Many of you have developed sophisticated guidelines designed to ensure that your company has access to appropriate expertise at appropriate cost. Such guidelines, together with engagement letters with outside counsel, help define the role of your outside counsel. One topic that is typically overlooked in guidelines and engagement letters, however, is allocation of responsibility for identifying and pursuing insurance coverage in connection with defense of a lawsuit.

Why is this area overlooked? Traditionally, responsibility for identifying and pursuing such insurance coverage has rested with in-house counsel. Indeed, having in-house counsel be responsible for seeking coverage often makes sense, either when it is clear that coverage exists or when in-house counsel has appropriate coverage expertise. For example, in a typical product liability or other negligence lawsuit, where it is clear that there is insurance coverage, in-house counsel or a corporate risk manager often will tender defense of the suit directly to the company's general liability insurer. The carrier will typically assume control of the defense and retain outside defense counsel to represent the policyholder. In these circumstances, coverage matters are often addressed before retention of outside defense counsel, and neither defense counsel nor in-house counsel need be concerned about coverage issues as the case moves forward unless the claim exceeds policy

limits. In fact, it is typically inappropriate for defense counsel retained by the carrier to be involved with coverage issues on behalf of the corporate client.

The purpose of this article is to help you see the importance of including this topic in your guidelines and engagement letters and to give you some pointers on how to allocate the responsibility for identifying and pursuing insurance coverage in connection with defense of a lawsuit so as to avoid the need for instituting malpractice claims.

PROBLEMS WITH FAILURE TO ALLOCATE RESPONSIBILITY FOR SEEKING INSURANCE COVERAGE

When the underlying lawsuit does not present such an obvious right to insurance coverage, failure to allocate responsibility for seeking coverage can lead to disastrous results. *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison*,² for example, is a painful illustration of what can go wrong when neither in-house nor outside counsel assume responsibility for seeking coverage. *Jordache* is the first of several cases addressing the malpractice liability of outside counsel for failure to address coverage issues. *Jordache* had retained the Brobeck firm to defend it in a lawsuit that included claims that *Jordache* had marketed knockoffs of Guess? apparel. Two weeks after the lawsuit had been filed, *Jordache* contacted its insurance broker, which advised *Jordache* that there was no coverage for the lawsuit. Neither *Jordache* nor its broker put *Jordache's* insurance carriers on notice of the lawsuit. *Jordache* did not ask the Brobeck firm for advice regarding coverage, and Brobeck did not offer any such advice. Three years into the lawsuit, *Jordache* retained new defense counsel, which advised *Jordache* that there was potential insurance coverage for the lawsuit. *Jordache* then tendered defense of the lawsuit to its liability insurance carriers. After the carriers had denied coverage, *Jordache* sued the carriers, seeking reimbursement of \$30 million in defense costs and the profits that *Jordache* would have earned on the funds spent on attorneys' fees. After the trial court had found that whether the late notice had substantially prejudiced the insurer was a triable issue of material

fact, Jordache settled its coverage lawsuit for \$12.5 million.

Thereafter, Jordache sued Brobeck, alleging that Brobeck had committed legal malpractice by failing to tender defense of the underlying action to Jordache's carriers or to otherwise alert Jordache to the possibility of insurance coverage. Brobeck moved for summary judgment on statute of limitations grounds, and the trial court granted Brobeck's motion. The appellate court reversed, holding that the statute of limitations had not begun to run until after Jordache had settled its action with its insurers for less than full coverage. The issue before the California Supreme Court was whether the statute of limitations had been triggered when Jordache discovered Brobeck's alleged negligence or when Jordache settled the coverage action on unfavorable terms. The California Supreme Court reversed the appellate court, holding that Jordache had suffered actual injury when it first discovered Brobeck's negligence. Implicit in the opinion, however, is that Jordache's complaint against Brobeck for failure to promptly advise Jordache of its insurance claims stated a plausible cause of action.

That reading, at least, is how the trial court interpreted *Jordache* in *Darby & Darby v. VSI International*,⁵ another example of failure to allocate responsibility for seeking insurance coverage. In *Darby*, the defendant VSI, a sunglass and reading glass wholesaler, retained the Darby firm as its patent and trademark counsel. One year later, VSI asked Darby to represent it in a lawsuit accusing VSI of patent, trademark, and trade dress infringement in connection with the design of hangers that VSI used to display its reading glasses. When VSI stopped paying most of Darby's invoices during the third year of the litigation, Darby withdrew as counsel and sued VSI for approximately \$200,000 in fees. VSI filed a counterclaim, alleging that Darby had committed legal malpractice by having failed to advise VSI of the possibility of coverage under VSI's general liability policies. VSI alleged that Darby's replacement as defense counsel had done so immediately upon being retained, resulting in VSI's carrier agreeing to cover the costs of the intellectual property lawsuit on a going forward basis, but denying coverage for all litigation expenses that VSI had incurred before tender of the

claim. The trial court, citing *Jordache*, denied Darby's motion to dismiss, stating:

The plaintiff's failure to investigate the defendant's insurance coverage or alert them to the potential availability of insurance to cover their litigation expenses may have constituted legal malpractice. The issue of whether the plaintiff committed legal malpractice raises numerous questions of fact, including but not limited to, the sophistication of each party regarding potential insurance coverage and the scope of the plaintiff's engagement. It is particularly noteworthy

PERSONAL AND ADVERTISING INJURY INSURANCE COVERAGE

Most people don't know what personal and advertising injury insurance coverage involves. Here's what you need to know about insurance coverage for intellectual property ("IP") disputes:

- Personal and advertising injury insurance coverage is important because it involves a broad duty to defend if any claim may trigger duty to indemnify.
- Advertising insurance coverage typically appears in standard form commercial general liability ("CGL") policies.
- Basic coverage typically includes language similar to the following:

We will pay those sums that the insured becomes legally obligated to pay as damages because of "advertising injury" to which this insurance applies. We will have the right and duty to defend any "suit" seeking those damages. . . .
- Advertising injury is caused by an offense committed in the course of advertising your goods, products, or services and is defined as follows:
 - Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services.
 - Oral or written publication of material that violates a person's right of privacy.
 - Misappropriation of advertising ideas or style of doing business.
 - Infringement of copyright, title, or slogan.

thy that counsel which succeeded the plaintiff promptly pursued the insurance issue to the defendant's substantial benefit.⁴

On appeal, the New York Supreme Court, Appellate Division, reversed, holding that the case did not present a situation that would require litigation counsel to advise its client regarding potential insurance coverage. Nevertheless, the appellate court recognized that such circumstances might exist:

There may be particular circumstances, such as personal injury actions arising out of automobile collisions, in which an attorney who is retained to defend an action has an obligation to bring to the client's attention the possible existence of an insurance policy applicable to the claim. However, we find no support for the proposition that an attorney who was retained to defend a business client in intellectual property litigation has a duty to inquire into the existence, nature and scope of insurance policies previously procured by the client, and to determine whether any such policy provides the client with any entitlement in relation to the claim being litigated. . . . Nor does a lawyer's duty to advise his client as to all available causes of action or avenues of defense translate into a broad duty to inquire into all the client's insurance coverage.⁵

Notably, on further appeal, New York's highest court affirmed the Appellate Division's holding, but on different grounds. Rather than reiterating the Appellate Division's skepticism about the viability of VSI's legal theory, the New York Court of Appeals held merely that the insurance claim that Darby had failed to tender was too "novel and questionable" to give rise to any duty.⁶

In an example of the results of failure to allocate responsibility for seeking insurance coverage outside of the intellectual property context, the Supreme Judicial Court of Maine in *Larochelle v. Cyr*,⁷ upheld jury verdicts finding two attorneys liable for malpractice. The first attorney had failed to tender defense of the underlying trespass action to the client's insurance carrier on the attorney's assumption that such an unintentional tort would not be covered by insurance. The second attorney, who had replaced the first, had relied on the first counsel's statement to him that no coverage was available. The jury in the malpractice case found that the client's intentional

conduct would have precluded coverage regardless of the attorney's negligence. Again, however, implicit in the court's decision was the assumption that the failure of defense counsel to evaluate the potential for insurance coverage could constitute legal malpractice.

These cases illustrate the need for the involvement of counsel with insurance coverage expertise, regardless of the subject matter of the underlying litigation. Allocation of responsibility for seeking insurance coverage should be done early and should be clear; we suggest addressing the issue in your engagement letters with outside counsel. See the sidebar below for sample language to use in your engagement letters and guidelines in hiring outside counsel.

HOW TO ALLOCATE RESPONSIBILITY FOR SEEKING INSURANCE COVERAGE AND DEALING WITH INSURANCE COVERAGE ISSUES

To allocate responsibility for seeking insurance coverage, you need to know two things: (1) what steps to take to seek insurance coverage and (2) who should best take each of those steps. First, see the sidebar on page 64 for a checklist of appro-

SAMPLE ENGAGEMENT LETTER LANGUAGE

As outside counsel retained to defend the company in connection with the above referenced matter, the company expects that you will promptly investigate the availability of insurance coverage for defense and indemnification of the company in connection with this matter. It is your responsibility to seek from the appropriate representative of the company the insurance related materials that you need in order to determine whether it is appropriate to tender defense of this matter to one or more of the company's insurance carriers. The company expects that, if appropriate, you will tender defense to the appropriate insurance carrier or carriers and will take appropriate steps thereafter to secure coverage.

appropriate steps for in-house counsel to take to ensure coverage. We discuss each of those steps in detail below. Second, at least four different kinds of attorneys could be involved in a lawsuit against your company: in-house counsel, outside defense counsel litigators that you and your company choose, insurance defense counsel that you do not get to choose, and coverage counsel that you may choose to help you sort out what you need to know.

Step 1. Identify and Analyze Insurance Coverage Issues and Policies

When a complaint is first served—indeed, in many instances, even before service of a complaint, depending on the nature of the prefiling demand—it is critical to analyze the insurance coverage issues immediately in order to determine which policies may potentially provide coverage. Those policies may include commercial general liability (“CGL”),

directors and officers (“D&O”), errors and omissions professional liability (“E&O”), and employment practice liability insurance (“EPLI”). If the alleged injury took place over an extended period of time, this analysis can be complicated by the fact that most CGL policies are written on an occurrence rather than on a claims made basis. Accordingly, the coverage analysis may involve determining when the occurrence that formed the basis of the complaint took place and analyzing the law of the relevant jurisdiction because approaches to this determination vary among jurisdictions.⁸ This determination may involve examination of policies that have been in place over many years, and some of these old policies may have used policy forms that are substantially different from the CGL policy forms that are prevalent today.

Once you have identified the appropriate policies, you must review them in light of the allegations of the complaint in order to determine whether to tender defense and, if so, pursuant to which policies. You may find it helpful at this point to hire outside counsel to advise you and your company about coverage even before you hire outside counsel to respond to the lawsuit.

Step 2. Tender Defense

If you decide to tender defense, you must do so promptly in order to preclude an argument by the carrier that the tender of defense by your company the policyholder was untimely.⁹ Further, in many jurisdictions, the carrier’s obligation to pay for defense costs is triggered by the tender of defense, not by service of the complaint.¹⁰ In order to maximize the likelihood that your carrier appropriately reviews your tender, you should identify all policies that could provide coverage, in order to avoid a waiver claim, and reference coverage under those policies both generally and by reference to specific policy provisions that may provide a basis for coverage. Here, again, coverage counsel can help you make sure that you have identified to your insurance carrier everything that might apply to the case.

Step 3. Demand Prompt Response to Tender of Defense

You should make sure that your carrier fulfills its obligation to respond promptly to your tender of

CHECKLIST OF STEPS TO ENSURE COVERAGE

Use the following checklist to make sure that you have arranged for insurance coverage to kick in as soon as possible:

- Identify and analyze all potential insurance policies, including commercial general liability (“CGL”), directors and officers liability (“D&O”), and errors and omissions professional liability (“E&O”) policies during the period of alleged injury or misconduct.
- Tender defense as soon as possible under all policies that provide the potential for coverage.
- Demand a prompt response from the insurance carrier to the tender of defense.
- Promptly analyze the carrier’s response, including any reservation of rights.
- Where reservation of rights creates conflict, insist on independent counsel of your choosing and on the right to control the litigation.
- Evaluate what documents to share with the carrier and others.

*From this point on . . .
Explore information related to this topic.*

ONLINE:

- ACCA's committees, such as Law Department Management Committee, Small Law Departments Committee, Litigation Committee, Intellectual Property Committee, and Insurance Staff Counsel Committee, which have listservs to join and other benefits. If you have questions about these or other ACCA committees, contact the chairs (listed in each issue of the *ACCA Docket*), or contact Staff Attorney and Committees Manager Jacqueline Windley at 202.293.4103, ext. 314, or windley@acca.com, or visit ACCA OnlineSM at www.acca.com/networks/ecommerce.php.
- Chubb Executive Risk <http://csi.chubb.com>.
- Richard M. Gibson, "Employment Practices Liability Insurance: A Corporate Counsel's Buying Guide," *ACCA Docket* 18, no. 6 (June 2000): 76–89, available on ACCA OnlineSM at www.acca.com/protected/pubs/docket/jj00/liability.html.
- "Liability and Insurance for In-house Lawyers," in *The Law of Inside Counsel*, materials provided by Saul, Ewing, Remick & Saul LLP for ACCA's New Jersey ("NJCCA") Chapter program, available on ACCA OnlineSM at www.acca.com/protected/legres/program/newjersey/liability.html.

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defense. Often, the process of resolving whether the carrier will accept tender of defense and select defense counsel or instead will reserve its rights and your company as policyholder will select defense counsel takes place during the initial stages of the litigation. Unless you are able to secure a sufficiently long extension of the deadline to respond to the complaint to permit these issues to be resolved before defense counsel has to file an appearance and a response to the complaint, you will need to retain defense counsel without knowing what the coverage outcome will be. If your carrier selects defense counsel, the carrier can have that attorney substitute in for the defense counsel that you have selected, or depending on how long it takes to resolve the issues of the carrier's duty to defend, the carrier may agree to have your defense counsel, who may have become immersed in the case by then, continue in place. As you can see, it is in the best interest of your company as policyholder to cause the insurance carrier to respond promptly to your tender of defense.

Step 4. Analyze Your Carrier's Response, Especially Regarding Reservation of Rights

Once your carrier has received your tender of defense, the carrier has several options: (1) it can accept the defense outright, (2) it can defend subject to a reservation of rights, (3) it can seek a declaration that it has no duty to defend, or (4) it can reject the tender. First, if your carrier accepts the defense outright, the carrier typically has the right to control the defense, assuming that the policy is a defense and indemnification policy as opposed to just an indemnification policy. Second, if your carrier agrees to provide a defense under a reservation of rights, the carrier funds the defense but reserves its right to deny its duty to indemnify your company as policyholder, depending upon how the facts unfold during discovery and trial of the matter. Such a reservation of rights often triggers your company's right to select defense counsel and to control the defense, because your carrier's reservation of rights creates a conflict of interest between your company as policyholder and the carrier. Your company's interests are in a finding of no liability, but your carrier's interests may be served either by a finding of no liability or by a finding of liability under circumstances in which there is no cover-

age.¹¹ Third, your carrier may choose to file a declaratory judgment action, seeking a determination that it has no duty to defend or indemnify. If the carrier does not seek such a declaration, it risks waiving its rights to raise policy exclusions.¹² If the carrier does not seek a declaration or if there is concern that the carrier may file in a less favorable jurisdiction, your company as policyholder may choose to file a declaratory judgment action immediately upon receipt of the carrier's rejection. Fourth, your carrier can also reject the tender outright, meaning that the carrier refuses to provide any defense. Coverage counsel can help you and your company figure out how to respond in each of these situations.

Step 5. In Conflict, Insist on Independent Counsel and Right to Control Litigation

If your carrier's reservation of rights response to your tender of defense creates a conflict between your company as policyholder and the carrier, you should insist upon your company's right to select defense counsel of your choosing and on the right to control the litigation. Accordingly, it is important to analyze the reservation of rights letter promptly and to determine whether such a conflict exists. It is also important to analyze your carrier's position in order to decide whether to attempt to convince the carrier to withdraw its reservation or at least to persuade the carrier that it has a substantial exposure in terms of its duty to indemnify. This analysis may be important during future settlement discussions to persuade the carrier that it should fund all or part of a settlement. Counsel with appropriate coverage expertise is also critical for settlement discussions, especially in cases in which there is an issue of whether the carrier has a duty to settle the case or at least to make a substantial contribution toward a settlement, at the risk of a bad faith claim. It may be advantageous to have your carrier participate directly in the settlement discussions. Sometimes, carriers insist on direct participation. Often, however, it is best if the carrier remains behind the scenes. Which method is more advantageous for you and your company depends on the particular facts and circumstances.

When your company as policyholder selects defense counsel, the carrier may raise issues concerning the scope of its obligation to fund the

defense. Carriers often attempt to impose maximum hourly rates for defense counsel. These rates may be based on what the carrier pays its panel insurance defense counsel, based on volume discounts for a large docket of negligence cases, for example. Your carrier's obligation, however, is to provide a defense to your company as policyholder, which means that the carrier should pay the reasonable cost of defense based on the hourly rates of attorneys with the appropriate expertise in the jurisdiction in which the case was filed.

COUNSEL WITH APPROPRIATE COVERAGE EXPERTISE IS ALSO CRITICAL FOR SETTLEMENT DISCUSSIONS, ESPECIALLY IN CASES IN WHICH THERE IS AN ISSUE OF WHETHER THE CARRIER HAS A DUTY TO SETTLE THE CASE OR AT LEAST TO MAKE A SUBSTANTIAL CONTRIBUTION TOWARD A SETTLEMENT, AT THE RISK OF A BAD FAITH CLAIM.

Carriers often seek to impose additional restrictions based on their own litigation guidelines. Such guidelines typically provide that defense counsel may not perform certain tasks without prior approval by the carrier or that the carrier will not pay for certain tasks. Such guidelines are designed for insurance defense counsel when the carrier has fully accepted tender of defense and therefore has the right to control the defense. They may not be appropriate in cases in which the carrier is defending under a reservation of rights or in cases in which there otherwise is a perceived conflict of interest between your company and its carrier. Issues regarding the scope of the carrier's obligation to provide for a defense are typically negotiated; if an agreement is not reached, it may be appropriate to file a declaratory judgment action. Here again, it is helpful to have experienced coverage counsel involved.

Step 6. Evaluate What Documents to Share with Your Carrier and Others

Although, as the policyholder, your company has a duty to cooperate with its insurance carrier, in cases in which your carrier has reserved its rights to deny coverage, there are limits on what you need and should provide to the carrier. For example, sharing attorney-client privileged material may result in a waiver of the privilege.

In federal court, the mandatory disclosure requirements of Rule 26 of the Federal Rules of Civil Procedure requires the production of “any insurance agreement under which any person carrying on an insurance business may be liable to satisfy part or all of a judgment which may be entered in the action or to indemnify or reimburse for payment made to satisfy the judgment.” If your company is sued in state court, depending on the jurisdiction, such disclosure may not be required. You may nevertheless want plaintiff to know that insurance coverage is available to reinforce that your company will not settle for nuisance value in order to avoid defense costs. On the other hand, depending on the financial circumstances of your company, you may not want plaintiff to know that insurance proceeds may be available to fund a portion or all of a settlement or a judgment.

CONCLUSION

You must make it clear who is responsible for each of the tasks discussed above: in-house counsel, outside counsel that you hire to defend the lawsuit, outside counsel that the insurance company hires to defend the lawsuit, or separate insurance coverage counsel that you hire. The best place to allocate those responsibilities for seeking insurance coverage and dealing with insurance coverage issues is in your company’s engagement letters and guidelines for working with outside counsel. Thus, in selecting a law firm to defend a case, if you do not have appropriate coverage expertise in-house, it is critical to determine whether that firm has sufficient insurance coverage experience and will assume responsibility for coverage matters. If it does not, it may be advisable to retain separate coverage counsel early on. Regardless of who is responsible, it is critical that claims for coverage be pursued promptly. ■

NOTES

1. Attorney Liability Assurance Society, a mutual insurance organization that provides malpractice insurance for approximately 53,000 attorneys, has reported that there have been several claims made against its insured law firms involving the alleged failure by outside counsel to ascertain that a claim was covered by insurance and to timely notify their client’s carrier. 20 ALAS LOSS PREVENTION J., no. 1, at 22 (Jan. 1999).
2. *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison*, 76 Cal. Rptr. 2d 749, 18 Cal.4th 739 (1998).
3. *Darby & Darby v. VSI International*, 178 Misc.2d 113, 678 N.Y.S.2d 482 (1998).
4. *Darby*, 178 Misc.2d at 117–18.
5. *Darby & Darby, P.C. v. VSI International, Inc.*, 268 A.D.2d 270, 271–72, 701 N.Y.S.2d 50, 51 (2000) (internal citation omitted).
6. *Darby & Darby, P.C. v. VSI International, Inc.*, 95 N.Y.2d 308, 314, 739 N.E.2d 744, 748 (2000).
7. *Larochelle v. Cyr*, 707 A.2d 799 (Maine 1998).
8. In cases of latent disease or environmental contamination, courts have employed four theories of when coverage is triggered: (1) when the insured is “exposed” to the injury, *see Commercial Union Ins. Co. v. Sepco Corp.*, 765 F.2d 1543 (11th Cir. 1985); (2) when the injury first “manifests” itself, *see Eagle-Picher Indus. v. Liberty Mut. Ins. Co.*, 682 F.2d 12 (1st Cir. 1982); (3) “multiple” or “continuous” triggers, including when the insured was exposed, during the latency period, and when the disease manifested, *see Keene Corp. v. Ins. Co. of North America*, 667 F.2d 1034 (D.C. Cir. 1981); and (4) when the insured suffered an “injury-in-fact,” *see Maryland Casualty Co. v. W.R. Grace & Co.*, 23 F.3d 617 (2d Cir. 1993).
9. In some jurisdictions, untimely notice is a bar to coverage; other jurisdictions require a showing that late notice caused prejudice to the carrier; Illinois looks at whether the notice was “reasonable,” with timeliness being one of the factors. *See Mitchell Buick & Oldsmobile Sales, Inc. v. National Dealer Services, Inc.*, 138 Ill. App. 3d 574, 581, 485 N.E.2d 1281, 1286 (2d Dist. 1985).
10. *See Winklevoss Consultants, Inc. v. Federal Ins. Co.*, 11 F. Supp. 2d 995 (N.D. Ill. 1998) (liability insurers’ duty to defend amended complaint did not relate back to inception of suit, but rather arose only upon tender); *Oscar W. Larson Co. v. United Capitol Ins. Co.*, 845 F. Supp 458 (W.D. Mich. 1993), *aff’d*, 64 F.3d 1010 (6th Cir. 1995) (duty arose on date of tender rather than later date of amendment in case in which complaint stated claim potentially covered by policy).
11. *See Maryland Casualty Co. v. Peppers*, 64 Ill. 2d 187, 197–98, 355 N.E.2d 24, 30 (1976).
12. *See, e.g., Chandler v. Doherty*, 299 Ill. App. 3d 797, 804–805 (4th Dist. 1998); *Murphy v. Urso*, 88 Ill. 2d 444, 451 (Ill. 1981).