

Texas Supreme Court Holds Prejudice Required for Late Notice Defense Under Claims-Made Policy

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The Texas Supreme Court has held that where an insured fails to provide notice of a claim "as soon as practicable" under a claims-made policy but nonetheless before the end of the policy term or other reporting period, the insurer must demonstrate prejudice from the delay to deny coverage. *Prodigy Commc'ns Corp. v. Agric. Excess & Surplus Ins. Co.*, 2009 WL 795530 (Tex. Mar. 27, 2009), and *Fin. Indus. Corp. v. XL Specialty Ins. Co.*, 2009 WL 795529 (Tex. Mar. 27, 2009).

Prodigy involved a claims-made directors and officers liability insurance policy that afforded specified coverage for claims first made against an insured during the "Discovery Period" of May 31, 2000 to May 31, 2003. The policy provided that, "as a condition precedent" to coverage, the insureds must give the insurer written notice "as soon as practicable of any Claim first made against the [insureds] during the . . . Policy Period or Discovery Period (if applicable), but in no event later than ninety (90) days after the expiration of the Policy Period or Discovery Period."

The insureds in *Prodigy* were served with a class action complaint on June 20, 2002 and provided written notice of the suit to the insurer on June 6, 2003. The insurer denied coverage on the ground that the insureds breached the policy's notice provision by failing to provide notice as soon as practicable. In the coverage litigation that followed, the insurer argued that the insureds' breach provided an absolute defense to coverage and, therefore, it was irrelevant that the insurer was not prejudiced by the delayed notice. The Texas Supreme Court disagreed.

The court's discussion began with its recent decision in *PAJ, Inc. v. The Hanover Insurance Co.*, 243 S.W.3d 630 (Tex. 2008). That case involved an occurrence-based policy, and the court held that a showing of prejudice was required to deny coverage based on late notice because the obligation to provide timely notice was not "an essential part of the bargained-for-exchange" under the policy at issue. According to the court, in that situation, the insured's breach alone was immaterial and could not defeat coverage.

The court next addressed the distinctions between occurrence-based policies, on the one hand, and claims-

made and claims-made-and-reported policies, on the other. As to the latter policies, the court noted that they limit coverage to claims asserted during a defined period of time, which, in turn, allow insurers to calculate risks with greater precision and issue policies at reduced premiums. The court then further distinguished claims-made policies from claims-made-and-reported policies. In the court's view, the requirement that insureds provide notice "as soon as practicable" under claims-made policies serves to enhance the insurer's ability to investigate the claim, set reserves or participate in negotiations. By contrast, a claims-made-and-reported policy requires notice within a specific time frame in order to allow an insurer to know definitively when the possibility of liability under a policy ends and therefore when to "close its books" on the policy. Notice requirements under such policies obligating the insured to provide notice within a defined period of time are "considered essential to coverage." Accordingly, the court noted, most courts do not require insurers to demonstrate prejudice in order to deny coverage when insureds do not provide coverage within the time frame. However, the court held that when insureds do provide coverage within the reporting deadline, even if not "as soon as practicable," a showing of prejudice is required because the insurer nonetheless obtained the main benefit of the policy. Because the insureds in *Prodigy* provided notice within the 90-day period after the Discovery Period terminated, and the insurer admitted that it was not prejudiced by the delayed notice, the court entered judgment in favor of the insureds.

The companion case, *Financial Industries*, involved a claims-made policy (as opposed to the claims-made-and-reported policy in *Prodigy*), requiring written notice of a claim "as soon as practicable after it is first made" but without a specified reporting deadline. The policyholder was sued for breach of contract early on during the policy period but only provided notice of the suit seven months after it was filed; nonetheless, the policyholder's notice came within the policy period. The parties stipulated that the insured did not provide notice "as soon as practicable" but that the insurer was not prejudiced by the delay. Answering a certified question from the Fifth Circuit, the court held that an insurer under this scenario also must demonstrate prejudice in order to deny coverage for the insured's failure to provide prompt notice. The court explained that the reasons for requiring an insurer to show prejudice remained the same as in *Prodigy*: Because the policyholder provided notice "within the policy's scope of coverage"—before the insurer could "close its books" on the policy—the insurer was not "denied the benefit of the claims-made nature of its policy" despite the untimely notice.