

Tennessee Federal Court Requires Showing of Prejudice for Late Notice Defense

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The United States District Court for the Eastern District of Tennessee has held that, under Tennessee law, an insured's late notice of claim made and reported during the existing period of a claims-made policy does not bar coverage absent evidence of prejudice to the insurer. *Fulton Bellows, LLC v. Fed. Ins. Co.*, 2009 WL 3065056 (E.D. Tenn. Sept. 21, 2009).

The insured manufacturing company purchased a claims-made directors and officers liability policy covering the initial period of August 6, 2004 to August 6, 2005. The insurer subsequently renewed the policy for one-year periods on August 6, 2005 and August 6, 2006. The policy provided coverage for "Employment Practices Liability" claims. The policy's "Prior Acts Exclusion" precluded coverage for any "Claim based upon, arising from, or in consequence of any Wrongful Act committed . . . prior to August 6, 2004." The policy also required "as a condition precedent" that the insured provide "written notice as soon as practicable of any Claim."

The manufacturing company purchased the assets of the bankrupt predecessor entity on August 3, 2004. The predecessor entity terminated all of its employees on August 3, 2004. On August 4, 2004, the insured placed advertisements for employment in local newspapers encouraging former employees of the predecessor entity to apply, and commenced hiring shortly thereafter. On May 28, 2005, former employees of the predecessor entity filed charges against the insured with the Equal Employment Opportunity Commission (EEOC) alleging that the insured failed to hire former employees over the age of 40 in violation of the Age Discrimination in Employment Act. The charges asserted that "[t]he unlawful employment practice charged herein—age discrimination—took place on either August 2, 2004 or August 3, 2004" On August 29, 2005 the EEOC dismissed the charges and issued a Notice of Right to Sue. The former employees filed suit in the Eastern District of Tennessee on November 23, 2005, and asserted the same general acts of discrimination as in the EEOC charges.

The insured provided the insurer with notice of the lawsuit on May 2, 2006. On June 16, 2006, the insurer disclaimed coverage because the complaint alleged wrongful acts that arose prior to August 6, 2004. The manufacturing company then filed suit against the insurer. It asserted claims for breach of contract, bad faith refusal to pay a claim, and violations of the Tennessee Consumer Protection Act.

The court first held that the Prior Acts Exclusion did not bar coverage because a question of fact existed as to whether the claims "arose from" a Wrongful Act committed prior to August 6, 2004. Although the EEOC charges and the lawsuit placed the first date of the alleged discriminatory action at August 2, 2004, that date related to the predecessor entity's firing of the employees, not the insured's discriminatory failure to hire the former employees. The suit alleged that the failure to hire occurred sometime "thereafter" over a period of several months. Citing Tennessee case law, the court declined to find that the discriminatory hiring claims "arose from" the discriminatory firing claims simply because the discriminatory "chain of events" began with the employees' termination.

The court then held that notice to the insurer five to six months after the federal lawsuit was filed, and approximately one year after EEOC claim was filed, did not constitute notice "as soon as practicable," which was a condition precedent to coverage under the policy. Nonetheless, the court found that late notice would not preclude coverage under the policy absent a showing of prejudice to the insurer. The court noted that Tennessee courts previously had applied the notice-prejudice rule to occurrence policies, but had declined to do so with respect to claims-made policies where notice was given after the policy expired. Relying on the analysis of two recent Texas Supreme Court cases, the court reasoned that "the Tennessee Supreme Court might . . . require a showing of prejudice for denial of coverage in a claims-made policy or a hybrid policy when[, as here,] the notice of the claim is untimely but still provided during the policy period." Finding a question of fact whether the insurer was prejudiced by the late notice, the court denied the insurer's motion for summary judgment.