

Insured's Failure to Provide Timely Notice of a Potential Claim Defeats Coverage

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Applying Pennsylvania law, the United States District Court for the Eastern District of Pennsylvania has held that an insured's failure to notify its insurer of a potential claim violated the notice provision of the policy. *Pelagatti v. Minn. Lawyers Mut. Ins. Co.*, 2013 WL 3213796 (E.D. Pa. June 25, 2013). In so doing, the court held that the insurer was not required to show that it was prejudiced by the late notice and that whether the insured's failure to provide timely notice negates coverage is determined under a "hybrid subjective/objective test."

The insured lawyer represented a father in a wrongful death action against Ocean City, New Jersey, concerning the drowning of the client's son at a beach in 2006. The insured lawyer filed a complaint against Ocean City within the statutorily prescribed period, but failed to file a "Notice of Claim" with the city within 90 days of the accident, as required by the New Jersey Tort Claims Act (NJTCA). For this reason, the court dismissed the plaintiff's complaint in 2007. All attempts by the lawyer seeking relief to file a late Notice of Claim were denied. In 2010, the client filed a legal malpractice claim against the lawyer based on his failure to comply with the NJTCA. Shortly thereafter, the lawyer reported the suit to its insurer, which had issued to the lawyer a claims-made-and-reported policy. The policy specified that a claim is made when "an INSURED first becomes aware of any act, error or omission by any INSURED which could reasonably support or lead to a demand for damages." The insurer denied coverage for the malpractice claim on the grounds that the claim was made in 2006 when the insured became aware that he had failed to file the Notice of Claim required by the NJTCA, and that notice of the matter was untimely under the 2010 policy.

In the coverage litigation that followed, the district court granted the insurer's motion for summary judgment. The court rejected the insured's argument that the phrase "reasonably support" in the policy is ambiguous, stating that "courts have consistently interpreted clauses such as those in the Policy to impose an objective standard on the insured." Applying an objective standard, the court held that the phrase "reasonably support" is not ambiguous.

The court then addressed whether the insured violated the terms of the policy by failing to notify the insurer of a potential claim. In this regard, the court noted that the insurer "is not required to show that it was prejudiced by [the insured's] failure to provide timely notice of a potential claim in order to deny coverage under the Policy." The court stated that:

Whether [the insured] violated the terms of the Policy by failing to timely report a claim is determined under a hybrid subjective/objective test. [The insurer] must establish two factors in order to satisfy this two-pronged test: 1. that [the insured] was aware of a given set of facts; and 2. that a reasonable attorney in possession of those facts would have believed that those facts could support or lead to a demand for damages. Under this two-pronged approach, the Court consider[s] the subjective knowledge of the insured and then the objective understanding of a reasonable attorney with that knowledge.

(Internal citations and quotations omitted.)

Applying this test, the court first held that the insured "was subjectively aware that [the underlying plaintiff's] initial suit and subsequent appeal were both dismissed on procedural grounds," making him subjectively aware of a potential claim at that time, prior to applying for his 2010 policy. Next, the court found that a "reasonable attorney would believe that failure to comply with a statute of limitations could be grounds for a legal malpractice claim." The court noted that the fact that the insured alleged that the underlying plaintiff told him she "had no intention of suing him" does not support the insured's argument that a "reasonable attorney would have been justified in failing to anticipate a future malpractice suit." The court therefore found that the insurer satisfied both the subjective and objective components of the two-pronged test and that the insurer "was not obligated to afford coverage" to the insured for the underlying plaintiff's suit.

Lastly, the court rejected the insured's argument that the insurer violated the Pennsylvania Bad Faith Statute by failing to indemnify him. The court stated that the burden is on the insured to show by clear and convincing evidence that the insurer had no reasonable basis for denying coverage for the claim. Because the insured "point[ed] to no evidence rebutting [the insurer's] reasons for denying him coverage," the court rejected the insured's bad faith claim.