visser shidlofsky llp

insurance law newsletter

July 16, 2007 volume 1, number 3

LEE H. SHIDLOFSKY
VISSER SHIDLOFSKY LLP
7200 N. MOPAC EXPY.
SUITE 430
AUSTIN, TEXAS 78731
512.795.0600
512.795.0632
LEE@VSFIRM.COM

IN THIS ISSUE:

PAST ISSUES OF THE INSURANCE LAW NEWSLETTER ARE ON OUR WEBSITE AT WWW.VSFIRM.COM

OUR WEBSITE ALSO INCLUDES LEGAL ARTICLES PUBLISHED BY OUR INSURANCE LAW PRACTICE GROUP.

The Notice Requirement: Must an Insurer Show Prejudice to Deny Coverage for Late Notice?

A. Application to "Property Damage" and "Bodily Injury" Claims in a CGL Policy

Most liability policies require that the insured provide notice of an occurrence "as soon as practicable." This condition is often coupled with a requirement that the insured must "immediately" forward any suit papers. The stated purpose of the notice requirements is to give insurers an opportunity to adequately investigate a claim. Although the notice requirements are seemingly straightforward, they have generated a significant amount of case law.

The notice provisions, at least in most policies, are a condition precedent to coverage. Accordingly, a breach of the notice provision may result in the forfeiture of coverage. The general rule for notice is:

> It is the service of citation upon the insured which imposes on the insured the duty to answer to prevent a default judgment. No duty is imposed on an insurer until its insured is served and sends the suit papers to the insurer. This action by the insured triggers the insurer's obligation to tender a defense and answer the suit.

Members Ins. Co. v. Branscum, 803 S.W.2d 462, 466–67 (Tex. App.—Dallas 1991, no writ). Stated otherwise, an insurer has no duty to defend *until* it has been put on notice. *See Travelers Indem. Co. v. Citgo Petroleum Corp.*, 166 F.3d 761 (5th Cir. 1999). Texas courts have consistently held that an insurer is not required to reimburse an insured for pre-tender defense costs. *See L'Atrium on the Creek I, L.P. v. Nat'l Union Fire Ins. Co.*, 326 F. Supp. 2d 787, 792 (N.D. Tex. 2004); *Kirby Co. v. Hartford Cas. Ins. Co.*, 2004 WL 2165367 (N.D. Tex. Sept. 23, 2004); *Amica Mut. Ins. Co. v. St. Paul Fire & Marine Life Ins. Co.*, 2003 WL 21281666 (N.D. Tex. May 29, 2003).

Although pre-tender defense costs may not be recoverable, the heart of the late notice debate is whether an insurer must demonstrate prejudice in order to rely on late notice as a *total* bar to coverage.

(continued on next page)

CASES TO WATCH:

***Lamar Homes v. Mid-Continent Cas, Ins. Co.*, 428 F.3d 193 (5th Cir. 2005) (certified to the Supreme Court of Texas and argued on February 14, 2006) (whether allegations of faulty workmanship constitute "property damage" and "occurrence" under a CGL policy as well as whether the "prompt payment of claims" act of the Texas Insurance Code applies to liability insurers)**

***Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc.*, 2005 WL 1252321 (Tex. May 27, 2005) (pending on rehearing) (whether Texas recognizes a right of recoupment by an insurer against its insured)**

***Fairfield Ins. Co. v. Stephens Martin Paving*, 381 F.3d 435 (5th Cir. 2004) (certified to the Supreme Court of Texas and argued on November 9, 2004) (whether an award of punitive damages is insurable under an employers liability policy)**

The law in Texas used to be that an insurer *did not* have to demonstrate prejudice in order to deny coverage for late notice. *See Members Mut. Ins. Co. v. Cutaia*, 476 S.W.2d 278, 279 (Tex. 1972) (holding that if an insured breached a condition precedent regarding notice, then "liability on the claim was discharged, and harm (or lack of it) resulting from the breach was immaterial"). That changed with the promulgation of a 1973 Mandatory Endorsement required by the State Board of Insurance. More specifically, in 1973, the State Board of Insurance (n/k/a the Department of Insurance), promulgated Board Order 23080 and required that it be applied to all CGL policies issued in the State of Texas. Board Order 23080 provides as follows:

> **As respects *bodily injury* liability coverage and *property damage* liability coverage, unless the company is prejudiced by the insured's failure to comply with the requirement, any provision of this policy requiring the insured to give notice of action, occurrence or loss, or requiring the insured to forward demands, notices, summons or other legal process, shall not bar liability under this policy.**

***State Bd. of Ins., Revision of Texas Standard Provision for General Liability Policies—Amendatory Endorsement*, *Order No.* 23080 (Mar. 13, 1973) (emphasis added). After the Board Order, "characterization of a notice provision as a condition precedent has become less significant in policies to which the Order applies." *Coastal Ref. & Mktg., Inc. v. USF&G Co.*, 218 S.W.3d 279, 285 (Tex. App.—Houston [14th Dist.] 2007, pet. filed). Interestingly, the Fifth Circuit has applied the prejudice requirement contained in Board Order 23080 to CGL policies issued by surplus lines carriers even though the Board Order is not required to be added to surplus lines policies. *See Hanson Prod. Co. v. Am. Ins. Co.*, 108 F.3d 627, 630 (5th Cir. 1997). *But see Chiles v. Chubb Lloyds Ins. Co.*, 858 S.W.2d 633, 635 (Tex. App.—Houston [1st Dist.] 1993, writ denied) (declining to apply prejudice requirement to homeowners policy because Board Order did not apply to homeowners policies).**

Whether an insurer is prejudiced by late notice is generally a question of fact. *See Struna v. Concord Ins. Servs., Inc.*, 11 S.W.3d 355, 359–60 (Tex. App.—Houston [1st Dist.] 2000, no pet.). Moreover, the burden is on the insurer to prove prejudice. And, it is a difficult burden for an insurer to overcome. *See Coastal Ref. & Mktg.*, *2*18 S.W.3d at 290–92 (setting forth in detail the requirement that an insurer demonstrate actual prejudice). While difficult, it is not impossible to prove prejudice. *See, e.g.*, *Filley v. Ohio Cas. Ins. Co.*, 855 S.W.2d 844 (Tex. App.—Corpus Christi 1991, writ denied) (affirming jury's finding of prejudice when the insurer was not notified of the claim until trial was imminent, the insured could not be located, and the insurer was put in the position of having to defend its insured without the benefit of having its insured assist in its defense). Likewise, an entry of a default judgment against the insured prior to notice ordinarily will establish prejudice as a matter

(continued on next page)

CASES TO WATCH: (continued)

***Ulico Cas. Co. v. Allied Pilots Ass'n*, 187 S.W.3d 91 (Tex. App.—Ft. Worth 2005, pet. granted) (argued on April 11, 2007) (whether Texas recognizes coverage by waiver and/or estoppel when an insurer undertakes the defense without adequately reserving rights)**

***American Home Assur. Co., Inc. v. Unauthorized Practice of Law Comm.*, 121 S.W.3d 831 (Tex. App.—Eastland 2003, pet granted) (argued on September 28, 2005) (scope of the tripartite relationship between insurer, insured, and defense counsel retained by insurer)**

NOTE:

The Supreme Court of Texas went on summer recess without issuing any significant insurance-related decisions. The Supreme Court likely will not issue any opinions until the end of August or early September.

of law. *See Liberty Mut. Ins. Co. v. Cruz*, 833 S.W.3d 164, 165 (Tex. 1993) (holding that delay until after default judgment is final, when insurer does not otherwise have actual knowledge of suit, prejudices insurer as a matter of law); *Ratcliff v. Nat'l County Mut. Fire Ins. Co.*, 735 S.W.2d 955 (Tex. App.—Dallas 1987, writ dism'd w.o.j) (holding that an insurer was prejudiced as a matter of law when its insured provided no notice of suit until default judgment became unappealable). Accordingly, the general rule is that an insurer "must demonstrate a material change in position to establish prejudice." *Coastal Ref. & Mktg.*, 218 S.W.3d at 288. Stated otherwise, a finding of prejudice must be based on evidence of "prejudice actually sustained, not on merely speculative or potential prejudice." *Id*. Even so, despite a long history of these extreme examples, the Dallas Court of Appeals recently presumed prejudice as a matter of law when the insured failed to present an adequate excuse for the delinquent notice. *See Blanton v. Vesta Lloyds Ins. Co.*, 185 S.W.3d 607, 612–13 (Tex. App.—Dallas 2006, no pet.) (noting that insured had no excuse for delaying notice for two and one-half years). Whether *Blanton* is an exception to the common rule or a new trend remains to be seen.

B. Application of Prejudice Requirement to "Personal and Advertising Injury" in a CGL Policy.

The courts have been less consistent in applying the prejudice requirement to Coverage B. *Compare PAJ, Inc. v. Hanover Ins. Co.*, 170 S.W.3d 258, 263 (Tex. App.—Dallas 2005, pet. granted) (treating a notice provision as a classic condition precedent without a prejudice requirement when the claim at issue was one of advertising injury rather than bodily injury or property damage), *with St. Paul Guardian Ins. v. Centrum G.S. Ltd.*, 383 F. Supp. 2d 891, 900–01 (N.D. Tex. 2003) (holding that prejudice is required irrespective of the nature of the claim). Suffice it to say that when it comes to whether a prejudice requirement exists in the context of "personal and advertising injury," the case law is decidedly split. *See Travelers Indemnity Co. v. Presbyterian Healthcare Resources*, 2004 WL 389090 (N.D. Tex. Feb. 25, 2004) (holding that prejudice must be shown); *Gemmy Indus. Corp. v. Alliance General Ins. Co.*, 190 F. Supp. 2d 915 (N.D. Tex. 1998) (holding that no prejudice must be shown), *aff'd without opinion*, 200 F.3d 816 (5th Cir. 1999). As the Supreme Court has granted the petition for review in *PAJ*, and oral arguments already have been heard, the issue of whether a prejudice requirement applies to "personal and advertising injury" claims and perhaps the extent of the prejudice requirement itself may soon be answered.

C. Application of Prejudice Requirement to Claims-Made Policies

The courts have been universal in rejecting a prejudice requirement in claims-made policies. *See, e.g.*, *Matador Petroleum Corp. v. St. Paul Surplus Lines Ins. Co.*, 174 F.3d 653, 659 (5th Cir. 1999); *Emcode*

(continued on next page)

Reimbursement Solutions, Inc. v. Nutmeg Ins. Co., 2007 WL 803965 (N.D. Tex. March 15, 2007); *Hirsch v. Tex. Lawyers' Ins. Exch.*, 808 S.W.2d 562, 565 (Tex. App.—El Paso 1991, writ denied) ("To require a showing of prejudice for late notice would defeat the purpose of 'claims made' policies, and in effect, change such a policy into an 'occurrence' policy.").

D. Application of Prejudice Requirement to First-Party Property Policies

The Board Order does not, by its own terms, apply to first-party property policies. Even so, the Fifth Circuit Court of Appeals has made an *Erie* guess that the Supreme Court of Texas would apply a prejudice requirement to a late notice defense under a commercial property policy. *See Ridglea Estate Condominium Ass'n v. Lexington Ins. Co.*, 415 F.3d 474, 480 (5th Cir. 2005). Recently, however, the Texarkana Court of Appeals held that the prejudice requirement applies to liability policies—not casualty insurance. *See Caddell v. Travelers Lloyds of Texas Ins. Co.*, 2007 WL 1574244 (Tex. App.—Texarkana June 1, 2007, no pet. h.). Other courts also have held that the prejudice requirement does not apply to claims under a homeowners policy. *See Flores v. Allstate Tex. Lloyds Co.*, 278 F. Supp. 2d 810 (S.D. Tex. 2003) (declining to apply a prejudice requirement in the context of a homeowners policy).

visser shidlofsky llp

Commentary:

Simply put, courts reach different results when it comes to applying a prejudice standard. "What constitutes a reasonable time within which notice must be given depends on the individual facts and circumstances of each particular case, including but not limited to age, experience, and capacity for understanding and knowledge that coverage exists in one's favor." *Blanton*, 185 S.W.3d at 611. Moreover, the type of coverage may play a role in whether a prejudice requirement even exists. For example, the case law is decidedly split as to whether a prejudice requirement applies to "personal and advertising injury." Likewise, it is less than clear whether a prejudice requirement applies to homeowners policies or first-party property policies. In fact, the only real consistency has been in the refusal of courts to apply a prejudice requirement to claims-made policies. Accordingly, until the Supreme Court clarifies these issues, insureds always should err on the side of providing notice as early as possible.

The Insurance Law Practice Group Handles:

- Commercial General Liability
- Commercial Property
- Commercial Auto
- Crime
- D&O
- Employment Practices Liability
- Fiduciary Liability
- Inland Marine
- Professional Liability
- Specialized Manuscript Policies

Timely Notice may be the Key to Insurance Money

GETTING TO KNOW LEE H. SHIDLOFSKY AND THE INSURANCE LAW PRACTICE GROUP ...

Lee Shidlofsky is a founding partner of Visser Shidlofsky LLP. His practice is devoted to representing and counseling corporate policyholders in the area of insurance law, risk management, contractual risk transfer, and extra-contractual issues. He holds council positions with the Insurance Law Section and the Construction Law Section of the State Bar of Texas. He is the author of numerous articles and seminar papers and is a frequent speaker at continuing legal education seminars in Texas and across the country. Mr. Shidlofsky has been named a "Super Lawyer" by Texas Monthly Magazine each year since 2004 and is ranked as a top insurance coverage lawyer by Chambers USA.

The Insurance Law Practice Group represents corporate policyholders that are in disputes with their insurance companies, provides advice to plaintiffs in complex litigation on how to best maximize an insurance recovery, and provides risk-management consultation in connection with a wide-variety of contractual risk transfer issues. The Insurance Law Practice Group handles first-party and third-party insurance claims in state and federal courts at both the trial and appellate court levels. The Insurance Law Practice Group is committed to practical and pragmatic solutions to insurance issues.

Serving Clients Across Texas and Nationwide

V | S

visser shidlofsky llp