

(April 27, 2008 ±)

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The court hearing the sexual harassment suit granted summary judgment to B&J, except for one count for negligent retention and supervision. Thereafter, the employee dismissed her suit. No settlement was reached with her, and no payment was made to her.

B&J and the supervisor filed a declaratory judgment action against Utica in a Maryland state court. Utica removed the case to U.S. district court on the basis of diversity jurisdiction.

The district court granted the insurer's motion for summary judgment. The court first concluded that Utica had no duty to defend the supervisor under the policy because he was not an "insured." The policy defined "insured" as an organization or its employees or managers, but only for acts within the scope of their employment or while performing duties related to the conduct of the employer's business. Employees were not considered insureds for bodily injury or personal injury to a co-employee while that co-employee was either in the course of his or her employment or performing duties related to the conduct of the insured's business. The court determined that the alleged sexual act and sexual harassment were not acts committed within the scope of the supervisor's employment. Although the acts were committed during the time or at the place related to the supervisor's employment, those acts were not the performance of a duty related to the conduct of B & J's business.

The court also determined that Utica had no duty to defend B&J because either the policy's employment-related practices exclusion or the employer's liability exclusion would apply. The employment-related practices exclusion provided that the policy did not apply to bodily injury or personal injury to a person arising out of an employment-related practice. The sexual harassment complaint alleged a bodily injury, physical battery leading up to a sexual act, that arose out of the supervisor's employment practices of harassment and humiliation, as well as B&J's employment related omission of negligent supervision of the supervisor. In addition, the employer's liability exclusion barred coverage for matters that would ordinarily be covered by workers' compensation laws, and specifically excluded bodily injury to any employee arising out of and in the course of employment. Here, but for the female employee's employment at B&J, the harassment would not have happened. // Holt

Notice/Claims-Made Coverage

Texas Supreme Court Applies Notice-Prejudice Rule to Claims-Made Policy Requirement of Notice "As Soon As Practicable"

Notice "As Soon As Practicable" Not an Essential Part of Bargained for Exchange

Prodigy Communication Corp. v. Agricultural Excess & Surplus Insurance Company, __ S.W.3d __, 2009 WL 795530 (Tex., March 27, 2009)

Financial Industries Corporation v. XL Speciality Insurance Company, __ S.W.3d __, 2009 WL 795529 (Tex., March 27, 2009)

Cases at a Glance

Even if a "claims-made" insurance policy states explicitly, as a condition precedent, that an insured must notify the insurer "as soon as practicable" of a claim, if the insured provides the carrier notice during a relevant period stated in the policy, the insurer must prove prejudice in order to deny the claim on the basis that the notice was not "as soon as practicable."

Summary of *Prodigy*

In *PAJ, Inc. v. The Hanover Insurance Company*, 243 S.W.3d 630 (Tex. 2008), the Texas Supreme Court clearly, and once again, decided that the "notice-prejudice rule" applies to occurrence-based insurance contracts, since timely notice provisions are "not an essential part of the bargained-for exchange." Hence, PAJ's untimely notice did not defeat coverage in the absence of prejudice to the insurer. In *Prodigy*, the supreme court decided that the same rule applies to a claims-made policy which explicitly states, as a condition precedent, a notice provision which required the insured to give notice to an insurer of a claim "as soon as practicable. . . but in no even later than ninety (90) days after the expiration of the Policy Period or Discovery Period."

There was a dispute in *Prodigy* as to whether notice had been given "as soon as practicable," but the insurer conceded that it had not been prejudiced

by the insured notice of claim, which was otherwise timely. The supreme court held that the “notice as soon as practicable” condition precedent was not “an essential part of the bargained-for exchange under the claims-made policy at issue,” so that—following *PAJ*—“in the absence of prejudice to the insurer, the insured’s alleged failure to comply with the provision does not defeat coverage.” The Court reversed the judgment of the court of appeals and rendered judgment that “the insurer may not deny coverage based on the fact that notice was not given ‘as soon as practicable[.]’”

Some Facts. Prodigy Communications merged with FlashNet Communications in May 2000. FlashNet had D&O coverage from Agricultural (AESIC). The premium was \$19,519 for the year ending on May 31, 2000. FlashNet bought a three year Discovery Period for \$93,750, which ran until May 31, 2003, which was extended by the 90 day extension period.

On November 28, 2001, FlashNet was named as a defendant in a class-action securities lawsuit, and was served on June 20, 2002. It notified the insurer nearly a year later, on June 6, 2003, a date which is plainly within the 90 day extension. Apparently assuming that AESIC was already aware of the underlying lawsuit, the June 6 letter requested AESIC’s consent to a proposed settlement agreement of the claims brought against FlashNet, rather than purporting to provide the initial notice of the claim. AESIC denied coverage on June 18, 2003. Prodigy provided formal written notice on June 26, 2003; AESIC continued to deny; and suit followed.

Prodigy’s suit contained the usual breach of contract and bad-faith type claims. There were cross motions for summary judgment. AESIC’s motions were granted, while Prodigy’s motion was denied. The trial court’s judgment was affirmed in the court of appeals.

The Supreme Court’s Reasoning. The majority’s discussion relies heavily on encyclopedic treatises and other cases. In summary, the court observes that “claims-made” policies are essentially different than “occurrence-based” policies. In essence, the former type of policy focuses on “retroactive coverage” without “prospective coverage,” while the opposite is true of the second type of coverage. This means that “the primary advantage of a claims-made policy ‘is to calculate risks and premiums with greater precision.’” In addition, “the elimination of exposure to claims

filed after the policy expiration date enable liability insurance companies to issue the claims made policies at reduced premiums.”

For this reason, the specific, and precisely determinable date-restrictions as to coverage and claims are essential to the very nature of the claims-made policy. Virtually no court and no informed person doubts this. Such dates are (almost) uniformly enforceable. However, the additional “as soon as practicable” is not essential to the nature of the policy in the same way as the “claims-made” date. To be sure, it is recognized that the “as soon as practicable” language serves “to maximize the insurer’s opportunity to investigate, set reserves, and control or participate in negotiations with the third party asserting the claim against the insured.” But it does not specify “temporal boundaries of the policy’s basic coverage terms.” In other words, it is not an essential part of the contract, and it does not determine the nature of the contract.

Consequently, reasoned the court, the “as soon as practicable” notice requirement in claims-made insurance contracts really has the same status as it has in occurrence-based policies, and so should be treated in the same way. The fact that it is called a “condition precedent” makes no difference whatever.

Concurring Opinion. The concurring Justice indicates that he dissented in *PAJ* and agrees with the dissenting Justices in this case, but recognized that *PAJ* is now established law. He declares that he joins the majority for that reason alone.

Dissenting Opinion. The dissenting justice rejected the majority’s reasoning for two reasons. First, courts should not change explicit contractual agreements, yet that is exactly what has happened here. If any one other than the sophisticated parties to the contract should be able to change the contract, it might be the legislature or the insurance regulatory body; it should not be a court. Second, the “as soon as practical” notice provision is an essential part of the contract of insurance because it is explicitly set forth in the insurance contract and because there was no evidence in the record so much as suggesting that it was not an essential part.

Summary of Financial Industries

Facts. XL issued a claims-made management liability policy to Financial Industries (FI) for one year ending on March 12, 2006; the premium was \$47,500;

securities claims were included; and there was a “general condition” requiring that “the insured shall give written notice to the Insurer of any Claims soon as practicable after it is first made.” FI provided notice to XL seven (7) months after suit was filed; the parties agreed that this was not “as soon as practicable” but they also agreed that XL suffered no prejudice thereby. The district court applying Texas law granted XL summary judgment, but the Fifth Circuit certified the question to the Texas Supreme Court.

Court’s Discussion. The Court observed that *Financial Industries* was only slightly different than *Prodigy*. In both cases, the insured reported the claim within the date which was essential to the nature of the policy. In both cases, the insurer’s essential need to be able to close its books at the end of the policy period was upheld. Therefore, “[b]ecause XL was not denied the benefit of the claims-made nature of its policy, it could not deny coverage based on FI[]’s immaterial breach of the policy’s prompt-notice provision.” It is perfectly appropriate, said the court, to base reasoning about the materiality of breaches upon “the extent to which the nonbreaching party will be deprived of the benefit that it could have reasonably anticipated from full performance.” *Hernandez v. Gulf Group*, 875 S.W.2d 691,693 (Tex. 1994).

Comment

Three points should be made. First, although the notice requirement is called a “condition precedent,” it does not meet the standard definition. “Conditions precedent are those which pertain to the attachment of risk and the inception of the policy.” They should come as events “before the insurance policy becomes binding.” Samuel Williston & William Lord, *A TREATISE ON THE LAW OF CONTRACTS*, §41:2 (4th Ed. 2000 & 2007). In the case of contracts of insurance, courts tend not to enforce them stringently or interpret them harshly. *Id.* at §38:6 n. 75

This principle favors the majority over the minority. For one thing, the relevant provision is not really a *condition precedent*. If it were, its violation would avoid the policy. For another thing, to do that, the requirement itself must be somehow very important to the policy, or *essential*. “Well, it’s not that!” said the majority, and they are right. Think about their decision this way: the majority has

adopted a new legal rule, some version of which has been in the works for a long time. Here it is: *In a contract of insurance, in order for a provision to be a condition—as opposed to a mere covenant—it must be essential to the nature of the insurance policy itself.*

Second, set aside the first and profound point, and think of the problem in a different—though related—way. Suppose, the policy requires that all claims must first—and at all times thereafter—be filed exactly on even numbered Tuesdays after the triggering event occurs. Thus, if the claim was filed on any Monday, any Wednesday, or any odd numbered Tuesday, the claim would be excluded. This fictional rule is completely silly, for precisely the reasons given by the Texas Supreme Court majority. Needless, unnecessary, silly rules, unrelated to the policy are easily conceivable by the hundreds. Why is a rule in a claims-made policy which requires that notice be given ASAP in a claims-made policy any different, except from the point of view of obviousness? Of course, if a “causes prejudice to the insurer” component were included, that would change everything.

Third, the language in the alleged actual “condition precedent” in the *Prodigy* policy is not a simple, straight forward “ASAP” condition. It says “ASAP, but in no event later than X.” One wonders what this means.

(i) Often the word “but” means “or.” Consider this: “You may only go out with girls named Lois, but under no circumstances can you go out with a girl named Matilda.” My son would take this to be some sort of nonsensical restriction; however, he would correctly take it to let him date various girls not named Matilda.

(ii) Sometimes the locution “but, under no circumstances anything other than” means “and,” and so forth. These linguistic facts make one thing obvious: “but in no event” is—on its face—ambiguous. Given this truth, it should be interpreted in ways that favor the policyholder, and that is exactly what the majority in the *Prodigy* case did.

(iii) Now consider the meaning of the phrase

“in no event” taken by itself. One plausible way to think about this is to say: “No matter what else has happened, the policyholder must give notice before X date.” If that is what the phrase means, then the policyholders not giving notice would not void the giving of notice. It would be a way of saying, “Please try to give notice ASAP.”

The dissenters are resting their case on the Free Society Theory of contract. It goes like this: Whatever two parties agree to in a contract that is not illegal and not the product of fraud, is what it is, and it would be contrary to the axioms of having a free society to try and change it using governmental authority—or, at least, judicial authority. Of course, this doctrine was formulated in ancient common law days before the dawn of millions of form insurance contracts which were mostly not to be negotiated except with respect to price. And, of course, it is unclear what would happen in a strictly common law court given that the language of the contract was said therein to be a “condition precedent,” when it clearly was not. Perhaps, on the very ground, it would be ignored entirely.

And things get worse. The common law rule of strict conformity came before the age of complex mergers and policy extensions. Remember, the original named insured here was FlashNet, and it was merged into Prodigy. *It would be interesting to know* here, who knew what and who read what.

The real issue here may actually complicate the situation. Arguably, the real issue here is the cost and difficulty of proving and disproving prejudice or its opposite. Arguably, the insurer is just trying to control its costs when it demands ASAP reporting of loss. Perhaps the insurer, which probably does not have a duty to defend, is simply trying to give itself plenty of time to follow the underlying case, so that when it is asked to pay a settlement, or judgment (if it is), there is plenty of time for it to think about what ought to be done or what it is obligated to do. Might this not actually be essential to a D&O, claims-made policy, where the essential nature of the policy is to enable cost control? In which case, one wonders, why was this not one of the issues developed in the case before it got to the Texas Supreme Court. // Quinn

Policy Limits

Fact Issue Existed Regarding Whether Insurer Issued One Policy or Two for Purposes of Determining Limits of Coverage Applicable to Accident

Insurer Covered Five Cars Using Two Documents with Different Policy Numbers

Progressive County Mutual Insurance Company v. Kelley, ___ S.W.3d ___, 2009 WL 795528 (Tex. March 27, 2009)

Case at a Glance

Progressive issued a family insurance on five cars. The coverage was issued on two documents; four cars were listed on one document, while the fifth was on another, and those documents had different policy numbers. After sustaining more than a \$1 million in medical expenses following an auto-animal accident, a daughter living with her named insured parents filed a UIM claim. Progressive paid limits under one \$500,025 policy, but refused to pay more. It claimed that it issued one policy. The injured insured claimed there were two policies, at least. The trial court and the court of appeal resolved the dispute over the number of policies as a matter of law, with the trial court ruling in the insurer’s favor and the court of appeal in the insured’s favor. The Texas Supreme Court reversed in a per curiam opinion without having heard oral argument and sent the case back to the trial court to actually be tried on at least the issue of how many policies there were.

Summary of Decision

Factual History. A car hit Regan Kelley (“Kelley”) while she was riding her horse. Her injuries triggered medical expenses of over \$1 million. She got \$100,000 from the insurance covering the driver. Thereafter she got \$500,025 in underinsured motorist benefits from Progressive, her family’s automobile insurer. There were five cars insured. Four of them were named in one two-page document, and a fifth was named in a