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Is Late Notice a Viable Defense to Coverage in Texas?

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A standard commercial insurance policy requires an insured to notify its insurer of a claim or suit "as soon as practicable." Texas courts and litigants struggled for years over whether an insured's late notice of a claim or suit barred coverage. In 2008 and 2009, the Texas Supreme Court squarely adopted the "notice-prejudice" rule. *PAJ, Inc. v. Hanover Insurance Co.* addressed late notice in the context of an occurrence-based policy and ruled that an insurer must show that it was prejudiced by untimely notice. 243 S.W.3d 630 (Tex. 2008). A little over a year later, the Court announced the same result for claims-made policies, so long as notice is received within the reporting period. *Prodigy Communications Corp. v. Agricultural Excess & Surplus Ins. Co.*, 288 S.W.3d 374 (Tex. 2009).

- ***PAJ, Inc.:*** **The Court Adopts Prejudice Rule for Late Notice in an Occurrence-Based Policy**

Some lower courts and federal courts assumed that Texas had decided this issue in 1994 when the Court held that an insurer could not deny an uninsured/underinsured claim for breach of the "settlement without consent" clause without showing that the insurer was prejudiced. *See Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691 (Tex. 1994). The Court analyzed the issue according to the fundamental contract law principle of material breach whereby a non-material breach does not excuse performance by the other party to the contract. *Id.* at 692. Whether a breach is material requires consideration of the extent to which the nonbreaching party will be deprived of the benefit that could reasonably have been anticipated by full performance. *Id.* at 693. What's more, the Texas State Board of Insurance had promulgated a mandatory endorsement in 1973 requiring an insurer to establish prejudice caused by an insured's failure to comply with a notice provision; the endorsement was limited, however, to bodily injury and property damage liability coverage. *PAJ, Inc.* 243 S.W.3d at 632. Enter PAJ, Inc., which sought coverage for alleged copyright infringement under the advertising injury provision of its commercial general liability ("CGL") policy.

The Court minimized the significance of whether the notice clause was a mere "covenant" (a material breach of which excused performance) or a condition precedent (breach of which excused performance regardless of prejudice). The Court noted that it had not distinguished between the two in *Hernandez* but would construe the notice clause as a covenant because doing so would avoid a forfeiture of coverage. *Id.* at 635. The Court instead focused on whether the notice provision was an "essential part of the bargained for exchange" and found that for an occurrence-based CGL as opposed to a claims-made policy, the event triggered coverage and notice was subsidiary. *Id.*

- ***Prodigy Communications:*** **Prejudice Required for Claims-Made Policies Too**

The Court soon had the opportunity to address this distinction in a case involving a claims-made policy. Prodigy Communications' policy required that it give notice of a claim "'as soon as practicable . . ., but in no event later than ninety (90) days after the expiration of the Policy Period or Discovery Period." 288 S.W.3d 374. The Court stated that there are really two notice provisions in a claims-made policy, the "notify us as soon as practicable" clause and the "reporting requirement" which requires an insured to report a claim before the expiration of the policy period or within a specified number of days thereafter. *Id.* at 379-80. Applying the same material breach analysis it employed in *PAJ, Inc.*, the court stated that the latter requirement is the essential part of the parties' bargain because it provided a date certain by which the insurer could "close its books" on the policy. *Id.* at 382.

Holding: "In a claims-made policy, when an insured gives notice of a claim within the policy period or other specified reporting period, the insurer must show that the insured's non-compliance with the policy's 'as soon as practicable' provision prejudiced the insurer before it may deny coverage." *Id.* The Court's opinion suggests that notice which occurs *after* the reporting requirement bars coverage irrespective of prejudice. *See id.* (agreeing with holding in *T.H.E. Ins. Co. v. P.T.P. Inc.*, 628 A.2d 223, 228 (1993) that notice-prejudice requirement did not apply to denial of coverage where claim made and reported after expiration of policy).