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NEWSLETTER

Court Holds That Texas Notice-Prejudice Rule Does Not Apply to Claims-Made Policies

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The United States District Court for the Eastern District of Texas, applying Texas law, has set aside a jury verdict and held that, under Texas law, an insurer does not need to demonstrate prejudice to deny coverage for late notice under a claims-made policy. *E. Tex. Med. Ctr. Reg'l Healthcare Sys. v. Lexington Ins. Co.*, 2007 WL 2048660 (E.D. Tex. July 12, 2007). The court also held that the insurer properly denied coverage when its insured failed to give timely notice of a lawsuit, even though the insured had previously notified the insurer of the claim that formed the basis for the lawsuit.

The insurer in the case issued a claims-made medical malpractice liability policy to a medical center. The policy provided coverage above a self-insured retention (SIR) of $2 million per claim. The medical center was required to provide written notice to the insurer of medical incidents, claims or lawsuits "as soon as practicable." For "claim[s] *or* lawsuit[s]," the insured also was required, as a condition precedent to coverage, to "immediately send [the insurer] copies of any demands, notices, summonses, or legal papers received in connection with the claim or suit."

The coverage dispute between the parties arose out of injuries an individual sustained in March 2003 at one of the insured's medical facilities. In April 2003, the medical center entered information about this claim in a loss-run spreadsheet that was provided to the insurer. Subsequently, just prior to the policy's expiration on June 8, 2003, the injured individual filed a medical malpractice lawsuit against the medical center. The medical center did not notify the insurer of the lawsuit at the time because it did not believe its liability for the claim would exceed its SIR. By the end of 2003, however, the medical center realized that its liability likely would exceed its SIR, and in mid-January 2004, the medical center gave written notice of the lawsuit to the insurer. Shortly thereafter, the insurer denied coverage for untimely notice as a result of the medical center's failure to "immediately send" the legal documents set forth in the policy's lawsuit notice provision. The medical center sued in federal court for breach of contract, and a jury returned a verdict in its favor.

On the insurer's renewed motion for judgment as a matter of law, the trial court set aside the jury verdict. The court held that the insured's seven-month delay in providing notice of the medical malpractice lawsuit was not "as soon as practicable," and, as such, the delay constituted a breach of a condition precedent to coverage under the excess policy. In so holding, the court rejected the medical center's argument that separate notice

of the lawsuit was unnecessary because it had previously provided notice of the claim from which the lawsuit arose via the loss-run spreadsheets it shared with the insurer. The court stated that the policy's use of the disjunctive in the notice provision applicable to "claim[s] *or* lawsuit[s]" could not "fairly be read as a release from any future duty [of the insured] to provide notice of a lawsuit where notice of a claim has already been given." Thus, even though the loss run may have served as sufficient notice of the claim in light of the course of dealings between the parties, the court ruled the medical center was still required to give the insurer separate notice of the lawsuit and immediately to send copies of legal documents related to the lawsuit as a condition precedent to coverage.

The court also reaffirmed the decisions it made at trial not to submit questions to the jury concerning whether the insurer was prejudiced by the late notice or whether it had waived the lawsuit notice provision. The court explained that "the notice provision in a 'claims-made' policy is an element of the covered risk, and to require an insurer to prove prejudice from untimely notice could result in an unbargained for expansion of coverage." The court disagreed with the medical center's argument that, under Texas law, the exception to the notice-prejudice rule for claims-made-and-reported policies should not be extended to claims-made policies. The court explained that there was no basis in Texas or Fifth Circuit case law for treating the two types of policies differently. The court concluded that allowing the insured to wait seven months to provide notice would not afford notice to the insurer within a "reasonable time" and would hinder the insurer's ability to know its potential costs and liabilities within a short period of time after the policy expired.