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Prompt Notice of Claims and the Requirement of Prejudice

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The purpose of the notice requirement is to enable the insurer to investigate the circumstances of the claim while witnesses' memories are fresh, to prevent fraud and collusion and to give the company time to prepare a defense. Among the circumstances that can be considered in determining whether notice was reasonable are the experience and understanding of the insured. It has been said that "reasonableness" becomes a question of law where only one reasonable inference can be drawn from the evidence, as where no circumstances tending to excuse the delay are shown. Nonetheless, such provisions are relative rather than precise and must be construed in favor of the insured.

A. Prompt notice and notice as soon as practicable

The terms "as soon as practicable", "prompt" and "immediate" in liability policies generally require only that notice be given within a "reasonable" time after suit is filed. *Stonewall Ins. Co. v. Modern Exploration Inc.*, 757 S.W.2d 432 (Tex. App. -- Dallas 1988, no writ) ("prompt" notice of occurrence meant reasonable time in excess umbrella policy); *Continental Savings Ass'n v. United States Fidelity & Guaranty Co.*, 762 F.2d 1239, 1243 (5th Cir. 1988); *Pioneer Cas. Co. v. Blackwell*, 383 S.W.2d 216 (Tex. App.--Waco 1964, writ ref'd n.r.e.) ("immediate" means reasonable in auto liability policy); *National Surety Corp. v. Wells*, 287 F.2d 102 (5th Cir. 1961) (same). This reasonableness standard invokes a standard of "ordinary prudence". *State Farm v. Plunk*, 491 S.W.2d 728 (Tex. App.--Dallas 1973, no writ). Whether suit papers and notice have been forwarded within a reasonable time is usually a question of fact depending on the circumstances of the case if the facts are disputed or the inferences from those facts

unclear. *Commercial Std. Ins. Co. v. Harper*, 103 S.W.2d 143, 146, 110 A.L.R. 529 (Tex. 1937) (auto theft); *Nat'l Surety Corp v. Diggs*, 272 S.W.2d 604, 607 (Tex. App.–Ft. Worth 1954, n.r.e.) (auto liability); *Stonewall*, 757 S.W.2d at 435 (liability policy); *Broussard v. Lumbermens Mut. Cas. Co.*, 582 S.W.2d 261, 262-63 (Tex. App.–Beaumont 1979, no writ) (general liability; “as soon as practicable” clause).

Some Texas cases have determined the reasonableness of delay in sending notice of a claim as a matter of law. For instance, in *Stonewall Ins. Co. v. Modern Exploration, Inc.*, 757 S.W.2d at 435, the court held that a six month delay was not necessarily reasonable as a matter of law, but raised a fact issue because the insurer did not argue it was unreasonable as a matter of law. In *McPherson*, 350 F.2d at 566, the Fifth Circuit held that, as a matter of law, a 54-day delay was unreasonable. Delays of from eighteen days to eight months have been held unreasonable as a matter of law. *See, e.g., Commercial Std. Ins. Co. v. Harper*, 103 S.W.2d 143, 146 (Com. App. 1937) (28 days); *National Surety Corp. v. Diggs*, 272 S.W.2d at 606 (104 days); *Smith v. Allstate*, 419 S.W.2d 455, 456 (Tex. Civ. App.–Texarkana 1967, writ ref'd n.r.e.) (eight months); *Trinity Univ. Ins. Co. v. Weems*, 326 S.W.2d 302, 304 (Tex. Civ. App.–Austin 1959, no writ) (3 1/2 months); *Houck v. State Farm Mut. Auto. Ins. Co.*, 394 S.W.2d 22 (Tex. Civ. App.–Beaumont 1965, no writ) (3 months though unclear whether matter of law or fact issue); *Aetna v. Durbin*, 417 S.W.2d 485 (Tex. Civ. App.–Dallas 1967, no writ) (4 months); *Norman v. St. Paul Fire & Marine*, 431 S.W.2d 391 (Tex. Civ. App.–Beaumont 1968, writ dism'd) (117 days); *Lane v. Anchor Cas. Co.*, 355 S.W.2d 90 (Tex. Civ. App.–Houston 1962 no writ) (18 days though unclear whether legal or fact issue); *Allen v. Western Alliance Ins. Co.*, 349 S.W.2d 590 (Tex. 1961) (107 days); *Klein v. Century Lloyds*, 275 S.W.2d 95 (Tex. 1955) (32 days); *Van Pendley v. Fidelity & Cas. Co. of New York*, 459 F.2d 251, 254 (5th Cir. 1972) (several months).

Reasons for a delay in tendering notice sometimes are merely considered in determining the reasonableness of the delay, but extenuating circumstances may convince the court to relax the notice requirement. *McPherson v. St. Paul Fire & Marine*, 350 F.2d 563, 567 (5th Cir. 1965). On the other hand, a failure to explain the delay often results in a finding that it was unreasonable. *Diggs*, 272 S.W.2d at 608; *Harper*, 103 S.W.2d 143, 146. More specifically, lack of knowledge of policy coverage and/or a mistaken belief that injury is not insured are insufficient, as a matter of law, to excuse failure to comply with the notice requirement. *Kellum v. Pacific Nat'l Fire Ins. Co.*, 360 S.W.2d 538, 542 (Tex. App.–Dallas 1962, n.r.e.); *McPherson*, 350 F.2d at 567. In *Kellum*, the court affirmed summary judgment for the carrier on this ground where this was the only excuse offered for the delay.

B. Prejudice

The notice provisions of the Standard Liability Policy are drafted as an express condition precedent to the insured's right to recover under the policy. Generally, liability policies provide that “[n]o person or organization has a right under this policy: . . . to sue . . . on this policy unless all of its terms have been fully complied with.” Texas law, however, does not favor forfeiture of contractual obligations due to breach of conditions precedent.

Criswell v. European Crossroads Shopping Ctr., Ltd., 792 S.W.2d 945, 948 (Tex. 1990). As a consequence, Texas courts avoid finding forfeiture of contractual obligations by condition precedent when another construction of the contract is possible. *Id.* (holding that provision was not condition precedent); *Group Hospital Services, Inc. v. One & Two Brookriver Center*, 704 S.W.2d 886, 891 (Tex. App.–Dallas 1986, no writ). If a condition would impose an absurd, unreasonable or impossible result, the agreement will be interpreted as creating a covenant rather than a condition. *Id.*; *Polland & Cook v. Lehman*, 832 S.W.2d 729, 739 (Tex. App. -- Houston 1992, writ denied)(provision was mere covenant where it would have undermined the very purpose of the contract); *Northwest Otolaryngology Assoc. v. Mobilease, Inc.*, 786 S.W.2d 399, 403 (Tex. App.–Texarkana 1990, writ denied)(requirement in auto lease that lessor “promptly” obtain highest available cash offer for vehicle at wholesale after repossession from lessee was mere covenant, not a condition precedent to right of lessor to sue lessee for default).

Nevertheless, Texas courts are willing to enforce conditions precedent, particularly where the condition is express and there has been palpable prejudice to the indemnitor. *See REA Express v. Missouri Pacific RR. Co.*, 447 S.W.2d 721 (Tex. App.–Houston 1969, writ ref’d n.r.e.) (indemnitor absolved of liability to indemnitee which had failed to give notice of the underlying claim where there was clear prejudice to the indemnitor caused by lack of notice). In *Filley v. Ohio Cas. Ins. Co.*, 805 S.W.2d 844 (Tex. App.–Corpus Christi 1991, writ denied), the court held that if the insurer is prejudiced by the failure of an insured to notify it of suit against the insured, suit against the insurer will be precluded. *Id.* at 847. The court recognized, however, that “little authority exists to explain what constitutes sufficient prejudice to relieve an insurer of liability.” *Id.* The Texas Supreme Court has recently held that “an insurer that is not notified of suit against its insured until a default judgment has become final, absent actual knowledge of the suit, is prejudiced as a matter of law.” *Liberty Mut. Ins. Co. v. Cruz*, 883 S.W.2d 164, 166 (Tex. 1993); *See also Harwell v. State Farm Mut. Auto. Ins. Co.*, 876 S.W.2d at 497 (insurer was prejudiced, as a matter of law, where insurer had no knowledge of service on insured until after judgment was final and time for filing motion for new trial or perfecting appeal had passed); *Kimble v. Aetna Casualty and Sur. Co.*, 767 S.W.2d 846, 851 (Tex. App.–Amarillo 1989, writ denied) (holding insurer prejudiced where no notice or knowledge of suit until after default judgment rendered, but before judgment became final); *Ratcliff v. Nat’l County Mut. Fire Ins. Co.*, 735 S.W.2d 955, 959 (Tex. App.–Dallas 1987, writ dism’d) (the failure to notify an insurer of a default judgment until that judgment has become final results in such prejudice to the insurer that it is entitled to the benefit of the failure of notice policy defense).

These cases do not support the proposition that prejudice is required, only that it is sufficient, to absolve the insurer of its obligations due to violation of an express notice condition. More recent cases construing notice conditions in insurance policies indicate that prejudice is not required under similar circumstances.

In *Laster v. American Nat’l Fire Ins. Co.*, 775 F.Supp. 985, 990-91 (N.D. Tex. 1991), the U. S. district court, construing Texas law, held that violation of a notice condition in a standard liability policy did not absolve the insurer of its duty to pay unless the insurer

was prejudiced by the lack of notice. *Laster* involved a standard liability insurance policy requiring the insured to notify the carrier of an occurrence likely to involve the policy. The court held that this provision was not an express condition precedent because “nothing in the . . . policy . . . defines the consequences of nonperformance of this notice requirement.” *Id.* at 989. Consequently, in order to refuse coverage, the insurer was required to make a showing of prejudice resulting from the late notice. *Cf. Maryland Cs. Co. v. W.C. Robertson & Co.*, 194 S.W. 1140, 1143 (Tex. Civ. App.—Dallas 1917, no writ) (late notice was no defense to coverage where notice provision did not “expressly stipulate that a failure shall work a forfeiture” and insurer was not prejudiced by delayed notice). The court viewed its holding as an application of the general rule that forfeiture by conditions precedent are to be avoided unless clearly demanded by rules of construction. *Id.* at 991; *see Hall’s Aero Spraying v. Underwriters at Lloyd’s London*, 274 F.2d 527, 529-30 (5th Cir. 1960) (warranty in insurance policy that insured would comply with regulations did not operate as condition where policy did not so provide); *Moulor v. American Life Ins. Co.*, 111 U.S. 335 (1884) (“unless clearly demanded by the established rules governing the construction of written agreements, such an interpretation [imposing a condition and forfeiture for breach] ought to be avoided”).

The *Laster* court noted in dicta that such notice provisions must be express conditions precedent in order to be enforceable without a showing of prejudice. In rejecting the carrier’s argument that it need not show prejudice, the court noted that those cases holding that prejudice was not required involved express conditions. *Id.* at 990. The cases cited were the Texas Supreme court cases of *Weaver v. Hartford Accident & Indemnity Co.*, 570 S.W.2d 367, 369 (Tex. 1978); *Dairyland County Mut. Ins. Co. of Texas v. Roman*, 498 S.W.2d 154, 156-57 (Tex. 1973); and *Members Ins. Co. v. Cutaia*, 476 S.W.2d 278 (Tex. 1972). *Cutaia*, a watershed case on this issue, involved an automobile insurance policy expressly providing that notice of any accident and forwarding of suit papers were conditions precedent to recovery under the policy. The Texas Supreme Court refused to imply a prejudice requirement in the policy, holding that recovery was barred despite the fact that the carrier had actual notice of the accident within two days. 476 S.W.2d at 280-81 (following *New Amsterdam Cas.Co. v. Hamblen*, 144 Tex. 306, 190 S.W.2d 56 (1945); and *Klein v. Century Lloyds*, 154 Tex. 160, 275 S.W.2d 95 (1955)). Though it recognized the injustice it was perpetrating in that case, the Court bowed to precedent and the express language of the policy and noted that changing the insurance policy is better left to the Board of Insurance or the Legislature. *Id.* at 281. *See also Lopez v. Royal Indemnity Co.*, 496 S.W.2d 942, 943 (Tex. App.—San Antonio 1973, no writ) (insured’s violation of express condition under auto policy barred recovery without regard to prejudice).

As the Houston Court of Appeals noted in *Chiles v. Chubb Lloyds Ins. Co.*, 858 S.W.2d 633, 635 (Tex. App. -- Houston 1993, writ denied), the State Board of Insurance responded to *Cutaia* almost immediately by promulgating amendatory endorsements applicable to general liability and auto policies explicitly requiring that the insurer be prejudiced by failure of the insured to give prompt notice of action, occurrence, loss, demand or legal process. The *Chiles* court refused to imply a prejudice requirement in a

homeowners' policy that did not contain an explicit prejudice provision relating to an express notice condition. 858 S.W.2d at 635.

A recent decision of the Texas Supreme Court in an automobile liability case has undermined the viability of this approach, however. In *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691 (Tex. 1994), the court held that an insurer that is not prejudiced by an insured's settlement of a claim against it may not deny coverage under a policy condition requiring the insured to obtain written consent of the carrier before settling. *Id.* at 693. This "settlement-without-consent" provision expressly precluded indemnity to an insured that failed to comply. The court applied general contract rules to the policy in holding that in order for the insurer to be discharged from indemnifying its insured, the insured's breach must be material. *Id.* at 692. The primary factor that determines materiality is "the extent to which the nonbreaching party will be deprived of the benefit that it could have reasonably anticipated from full performance". *Id.* at 693 (citing Restatement (Second) of Contracts § 241(a) (1981); *Advance Components, Inc. v. Goodstein*, 608 S.W.2d 737 (Tex. App.—Dallas 1980, writ ref'd n.r.e.)). Other factors that determine whether a breach is material include:

- i. the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
- ii. the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- iii. the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- iv. the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Id. at 693 n. 2. The court noted that in some circumstances, an insured's breach of a notice condition will deprive an insurer of the anticipated benefit of the contract. *Id.* at 693 (citing *Liberty Mut. Ins. Co. v. Cruz*, 883 S.W.2d 164 (Tex. 1993) (insured's breach of policy condition requiring notice of suit precluded recovery where policy explicitly required insurer to be prejudiced; entry of default judgment against insured prior to notice prejudiced insurer as a matter of law). The *Hernandez* court distinguished the case before it from that situation and held that "where the insurer is not prejudiced by the settlement . . . the insured's breach is not material."

Hernandez demonstrates the willingness of the Supreme Court to require that some harm or prejudice result from breach of an express condition before precluding recovery under a contract. The *Cutaia/Chiles* approach appears to be irreconcilable with that of *Hernandez*, although the *Hernandez* court's failure to cite either case is somewhat mysterious. The holding of *Chiles* arguably should be limited to cases in which the parties stipulate that the applicable contract does not require prejudice arising from breach of a condition precedent. 858 S.W.2d at 635-36. Otherwise, *Hernandez* requires that breach of such a condition be material before it precludes recovery.