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Supreme Court of Texas.
Prodigy Communications Corp., Appellant,
v.
Agricultural Excess and Surplus Insurance Company n/k/a Great American E and S
Insurance Company, and Great American Insurance Company, Appellees.
No. 06-0598.

April 1, 2008.

Appearances:
Werner A. Powers, Haynes and Boone LLP, Dallas, Texas, for petitioner.
Joseph J. Borders, Walker Wilcox Matousek, LLP, Chicago, Illinois for respondent.

Before:

Chief Justice Wallace B. Jefferson, Nathan L. Hecht, Harriet O'Neill, Dale Wainwright, Scott A. Brister, David Medina, Paul W. Green, Phil Johnson, and Don R. Willett, Texas Supreme Court Justices, en banc.

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COURT ATTENDANT: Oyez, oyez, oyez, the Honorable, the Supreme Court of Texas. All persons having business before the Honorable, the Supreme Court of Texas, are admonished to draw near and give their attention, for the Court is now sitting. God save the State of Texas and this Honorable Court.

CHIEF JUSTICE JEFFERSON: Thank you. Please be seated. Good morning. The court has three matters on its oral submission docket and in the order of appearance, they are: Docket No: 06-0598, Prodigy Communications Corporation versus Agriculture Excess & Surplus Insurance Company, from Dallas County and the Fifth Court of Appeals District; Docket No: 07- 1059, Financial Industries Corporation versus Excel Specialty Insurance Company, which is a certified question from the United States Court of Appeals for the Fifth Circuit and; 06-0911, Edwards Aquifer Authority versus Chemical Lime Limited from Comal County and the Third Court of Appeals District. The court has allotted 20 minutes per side in each of these cases, and we will complete all arguments before noon. We will be taking a brief recess between the arguments. These proceedings are being recorded, and the link to the argument should be posted on the court's website by the end of the day, today. The court is now ready to hear argument in 06-0598, Prodigy Communications Corporation versus Agricultural Excess & Surplus

Insurance Company.

COURT ATTENDANT: May it please the Court, Mr. Powers, will present argument for the petitioner. Petitioner reserve five minutes for rebuttal.

ORAL ARGUMENT OF WERNER A. POWERS ON BEHALF OF THE PETITIONER

MR. POWERS: May it please the Court, my worthy adversaries. Your Honor, in the PAJ, which I will call the "PAJ's decision", this Court held, and I quote, "We hold that an insurance failure, the time he notify its insurer of a claim or suit, does not defeat coverage, if the insurer was not prejudiced by the delay."

JUSTICE: Does it matter if its a claims made policy or standard CGL?

MR. POWERS: Your Honor, that issue was left opened by the majority opinion and in my view, it does not make a difference.

JUSTICE: Why not?

MR. POWERS: In other words, at the end of the day is chocolate milk, milk. The question of whether or not there is a material breach of a contract, should not hinged on whether is it a "claimed-made" policy or an "occurrence-based" policy. And, and, and I've the reason that I say that, your Honor, is, is focused on the language of the majority opinion. Ours is a claims-made policy that is true, however, the notice provision in our policy, like the notice provision in PAJ, is subsidiary to the main insuring obligation, that is a claims made, insuring clause. The notice provision is subsidiary; secondly, the notice provision in our policy is not essential to the bargain-for exchange just as the same, the same situation in PAJ.

JUSTICE O'NEILL: But now in PAJ, we very much based our analysis on the continuum from Chotia to the Board Order in Hernandez. And what we sort of said in Chotia, we said, this is up to the legislature or the Board of Insurance, and the Board of Insurance then acted, and we said on CGL policies where the boards acted, they've indicated this policy and we really tied it to what the leg-- the, the department have done, and they've not done that as to claims-made tight policies.

MR. POWERS: May I respond to that, your Honor. Two, two things-- first of all, why you did, you did in your majority opinions speak, speak in large measure about the board, the Board Order. You also, that was pointed out in the descent, that the Board Order did not deal with that type of insurance, that was the issue in PAJ. Okay, so ...

JUSTICE O'NEILL: Well, it dealt with CGL insurance.

MR. POWERS: That is true.

JUSTICE O'NEILL: Occurrence-based.

MR. POWERS: But, but to look for that kind of direction from the state, in our case, would be to look to in an impossible place. Understand that our policy, is what its known as a "surplus lines policy". By definition, it is not regulated by the State Board. By definition, it is not regulated as to form and not regulated as to rate.

JUSTICE: Well, if its not regulated, shouldn't we just look to the plain meaning of the language and determine whether or not there was a breach?

MR. POWERS: Looking to the plain meaning of the language, let's talk about that for just a moment. This Court in the PAJ decision, and

I think rightfully said, "One cannot blindly look to the plain meaning of the language. One must look to the economics of the bargain and to decide whether or not is something is truly a condition precedent or not a condition precedent", and that was kind of a corner stone of what I've thought was an enlightened view of the law of contracts in PAJ. Let me see if I can illustrate my point here, whether something is a condition precedent ...

JUSTICE WAINRIGHT: Well, then counsel, let me just be cleared ...

MR. POWERS: Yes.

JUSTICE WAINRIGHT: You don't dispute that the notice of provision here was a condition precedent.

MR. POWERS: I do.

JUSTICE: Even though the language says as a condition precedent.

MR. POWERS: I absolutely do and I'll tell you why, Justice Wainright, it is, is this-- if I ge-- I to-- last night, in my hotel room, with nothing better to do, I read the policy I brought with me ...

JUSTICE WAINRIGHT: You were really bored.

MR. POWERS: I was bored ...

JUSTICE BRISTER: Now it say something -

MR. POWERS: Say ...

JUSTICE BRISTER: -about the 90 day provision in there, doesn't it ...

MR. POWERS: Texas was out of the-- well anyway. But so I read the, read the, I read the policy and do you know, your Honor, that every undertaking, every covenant, every promise - no matter how small, no matter how diminimous, is a condition precedent in the coverage of the littlest the policy? Let me point something out to you, paragraph roman numeral VIII(C) of the policy. Action against the insurer, "No action shall be taken against the insurer, unless as a condition precedent thereto. There shall have been full compliance with all the terms of the their policy".

JUSTICE BRISTER: Imagine, imagine that ...

MR. POWERS: Imagine that, every policy ...

JUSTICE BRISTER: But you said both parties to leave up to both to their own promises in the contract, and of course, your guys signed the policy with their fingers crossed behind them 'cause you didn't intend to live up to your part.

MR. POWERS: Well, I don't know if that's the case, I think that if you looked real ...

JUSTICE BRISTER: But you're here arguing, you signed an insurance policy that said that a condition precedent to coverage is do notice and didn't do notice practicably-- as soon as practicably .

MR. POWERS: I think that any businessman who read this policy and purchased this policy in the market place, would not think that his premium was calculated based somehow on whether he gave notice as soon as practicable. That is-- that defies -

JUSTICE BRISTER: How much -

MR.POWER: -modern ...

JUSTICE BRISTER: -how much, how-- was th-- how much-- how big the policy prove term of would that be? What was the premium?

MR. POWERS: The exact amount of premium, your Honor, was $19,519.

JUSTICE BRISTER: And they-- we presumed they read the policy.

MR. POWERS: They're charged with read reading it.

JUSTICE BRISTER: And if you didn't want a policy that-- I agree as unusual, where you say, every line is condition precedent, but if you didn't want that, you should've gone to somebody else. Right?

MR. POWERS: Well, your Honor, to, to think that these are negotiated policies-

JUSTICE: Those are standard form.

MR. POWERS: -devise the market place.

JUSTICE: Those are standard form.

MR. POWERS: These are standard forms, these policies are, you know, while these are unregulated forms, these policies have their genesis in standardized forms that often are written by ISO and, and, and the, the market ...

JUSTICE BRISTER: So your position is, its these mean insurers who have gotten together and negotiated this standard policy, we're going to impose on everybody conditions precedent, all of your people wouldn't agree to that, but you have absolutely no choice.

MR. POWERS: Absolutely. I'm not anti-- attacking the character of the insurers. I'm only asking that the Law of Contracts be applied equally to all manner of kind and not favor of the insurers ...

CHIEF JUSTICE JEFFERSON: But there has -

MR. POWERS: It was has always been the po-- I'm sorry, your Honor.

CHIEF JUSTICE JEFFERSON: -there are circuits that make a critical distinction between "claims-made" and occurrence-- ma-- "occurrence" policies that-- how could decisions from the First Circuit, for example, says that the purpose of a notice requirement in claims-made policies is to ensure fairness and right setting if, that's a part of the reason the other claims-made policy. Why isn't that a, sufficient distinction between this case and PAJ?

MR. POWERS: If, if we are to make a distinguish-- distinction between a "claims-made" and, and "occurrence-based" policy with respect to the timeliness of notice, may I respectfully suggest that, that distinction depends on whether it is a claims-made and reported policy as opposed to a claims-made policy. In a claims-made and reported policy which it is not, and I'll explain that in a moment, in a claims-made and reported policy, one can legitimately say that part of the bargain for consideration, is that the only covered act will be a claim that is both made against the policy holder, and reported to the insurer within a specified period of time.

CHIEF JUSTICE JEFFERSON: But on the claims-made policy, couldn't the insurer after-- let say they know about the claims, this-- but you know, that the policy requires you to give notice. They may have actual notice but that requires you to give notice, and they know that the period of within which it was practical-- practicable to report the claim had expired. Why couldn't, at that point, they closed the books and use whatever reserves they have toward other claims? Why wouldn't that be a legitimate activity on part of the insurance company?

MR. POWERS: My response to that is that, from the underwriting stand point, the language, "as soon as practicable", is so vague and so amorphous, that you would never underwrite against such a term. Now, if, if in fact, you had a policy provision that said, "We only insurer claims made against the insured and reported within, say 60 days after the end of the discovery period." You had a bright line, where you could actually look and see, when did the time-- the deadline come to, to report a claim to the insurer. I could at least theoretically see, that you would have an underwriting changed. That's to say, "I could look to my book of business", and I could say, "Look, it is now 60 or 30 days past the end of the discovery period. I can close my books on that insured risk of period, and there, and thereby write due policies." But the, the language, which is the same language in PAJ, that to, that to give notice, as soon as practicable, is so vague and

so amorphous ...

JUSTICE MEDINA: That is, but it did, did it also says that's no later than "x" days. What if you had a claims-made policy with a tail or what if you had an excess policy with that same type of a language. Is there a distinction?

MR. POWERS: Well, your Honor, picked-up on, on some language in this policy, if I may answer-- I think I'm answering your question and tell me if I'm not. We did that. In this case, we-- the policy provision, the notes provision said, "Thou shall give notice, as soon as practicable, but it no event later than 60 or 90 days after the end of the discovery period". We did that, we gave notice within the safe harbor ...

JUSTICE MEDINA: In the 10 days -.

MR. POWERS: The-

JUSTICE MEDINA: -that is correct?

MR. POWERS: -so, so, so I'm-- I guess what I'm trying to say is, if you are to draw a distinction, you know, between an "occurrence" policy and a "claims-made" policy, as regards notice with respect to when did they close their books on that risk, we did that. We gave notice within the safe harbor provision of the policy, and if indeed there-- if we're going to divine some underwriting intent here that, that there was the ability to close the books, if there was no notice given to the insurer within 60 days after the end of discovery period, we did that.

JUSTICE MEDINA: Why should the Court look to underwriting intent?

MR. POWERS: Well, I think you have to is-- I think you have to start with the, with the proposition that, that acts on a material breach, and that's judged by the facts, acts on a material breach. The non-breaching party is never relieved of his, of his obligations. For, for example, Wiltemsen is a condition precedent that, thou shall give notice in green ink, and deliver it to a certain post office box. I don't care if you used the words condition precedent or not, we all know that no underwriter actually calculate the premium based on whether or not, green ink was used to give notice.

JUSTICE MEDINA: It doesn't seems to me that at being your benefit to, to look-- to try to forget the intent of an underwriter is, nor are we trying to figure out what the language of the policy is, and either your position make a consistent with PAJ or make it a distinction.

MR. POWERS: I'm actually-- I'm only advocating what this Court, I think did in PAJ, and that is, in order to decide whether the clause in PAJ, was in fact a condition precedent or a covenant. I think, if I read the court's opinion correctly, the court was tryi-- had to divine whether the notice provision was an essential part of the bargain-for exchange. Well, how does one do that, unless one tries to understand the economic reality of the contract in question, and to decide whether the conditioning question was truly essential to the underwriting risk that's being assumed, or essential to the transfer of risk being negotiated by the policy holder. If, if, and there were was I-- you have to divine with the, with the economics are of that contract. I mean, did it matter whether you gave notice in green ink, of course not.

CHIEF JUSTICE JEFFERSON: Should it have make any difference to us whether a prejudice requirement is part of an-- a majority trend across the country or not, and is it in claims-made policies.

MR. POWERS: I think that it is important because I think-- it, it, it recognizes an awakening of the courts to the realities of the market place with with respect to insurance. You know, we all say that

insurance contracts are just like the any other contracts and should construed just like any other contracts, but you know, we don't do that. I mean we don't do that. We recognize that there are public policy considerations at play, when your dealing with the insurance. For example, normal contracts, if there's a ambiguity in the contract, what happens? You allow parole evidence in, right, with respect to the intent of the parties. Not in insurance contracts, if there's an ambiguity in the contract, its construed against the insurance company. My point being that, that I think there is an awakening in the United States, that policies of insurance are different. They are in the nature-- well, for lack of a better term "gambling contracts", its a wager and you will-- you there-- you know, you putting down your premium, your wagering that, that, that the-- a sort of that will happen and my ma-- my premium will be less than the benefits that I receive under this contract.

JUSTICE HECHT: Let me ask you this -

MR. POWERS: Yes.

JUSTICE HECHT: -on this one ...

MR. POWERS: Yes.

JUSTICE HECHT: In a line of what you just said, if suppose that the claim had been made the last day of the policy provision, we'll just take a hard case -

MR. POWERS: Yeah.

JUSTICE HECHT: -but notice was not given until the 91st day, a number of reasons why-- I mean, sorry chain of events but anyway, just couldn't-- just didn't get to us until the 91st day. Would that be tallying notice or not?

MR. POWERS: Justice Hecht, if am I correct, that your positing that is given after the safe harbor.

JUSTICE HECHT: Yes.

MR. POWERS: One day after the safe harbor.

JUSTICE HECHT: One day after.

MR. POWERS: If you think that the notice provision, and indeed the safe harbor provision, was indeed essential to the bargain, then, then there is an argument that insurance that the coverage would fail..

JUSTICE HECHT: It's hard to see why the "safe harbor" and the "as soon as practicable" would be treated differently.

MR. POWERS: Well, the safe harbor is a, is a hard stop. The safe harbor is a hard stop in getting back to whether there is an economic basis, an underwriting basis for treating a claims-made policy differently than an occurrence-based policy, I think you'd have to spe-- do you see those two-- those two provisions very differently. As soon as practicable doesn't give you a hard stop, there's no way you can underwrite against that. A safe harbor arguably give you a hard stop.

JUSTICE JOHNSON: Well, how, how can you show prejudice if its given one day late?

MR. POWERS: Well, I, I was about to say that I think that the-- if you're going to make for distinction, that some courts might make, that would be the resolve. I, personally, do not sta-- I, I think you should have one rule and that is, you've got to show prejudice, you've got to show prejudice. Don't give a ...

JUSTICE JOHNSON: And that doesn't allow the insurer to close its books. Does it?

MR. POWERS: Well, ...

JUSTICE JOHNSON: Provide samples. I'll finds my books.

MR. POWERS: For example, if the insurer under-- if the insurer could say, you know what ...

JUSTICE JOHNSON: Wait, wait, wait a minute-- if, if it's prejudice, does it allows the insurer to close its books on a claims-made policy at the end of the discovery period or the recording period?

MR. POWERS: If it's prejudice ...

JUSTICE JOHNSON: That's if it distinct [inaudible]

MR. POWERS: That cou-- it could be prejudice if, if-- let me see if I'm saying this correctly, if I understand you correctly, that assume with me under Justice Hecht's hypothetical, that in fact, that the carrier did not close his books on the 90th day. Assume with me in fact, the carrier did it closes its books until the 95th day, notice is given on the 91st day, then the carrier was not prejudiced by that one day delay, so why have a different rule, why don't we just use and embrace Corban's Modern Economic Analysis of Contracts, and that is to say, Look to see whether it was in fact, any prejudice that occurred as a result to the late notice. Be it a claims-made policy be it occurrence policy, understand here there was a stipulation and no prejudice. They didn't come into court in say, "Your Honor, we had closed our books, we had closed our books", and this is a claims-made policy because ...

JUSTICE JOHNSON: I mean let's, let's, let's go back to the 90th day, the, the claims-made policy -

MR. POWERS: Okay.

JUSTICE JOHNSON: -which is reported the 95th day instead 90th day or the 100th day, and there is-- how can-- how's it ever going to be a showing of prejudice and the-- how is it, in the carrier on a claims-made policy that you agree, as I understand, is, is given for the purpose of their being able to close their books and say, that risk is gone now.

MR. POWERS: How did they do it?

JUSTICE JOHNSON: Then write some more. Yes-- isn't-- I understood that to be your position.

JUSTICE JOHNSON: Yes.

MR. POWERS: All right.

JUSTICE JOHNSON: But, but if we or going to say no prejudice, always keep-- we can always go the insurer to calls or not prejudiced, how wa-- difference is make, if they say 90 days or 100 days or whatever. You're going to, you're going to always assume and say they have been prejudiced by it, who cares if they closed their books.

MR. POWERS: Well, no, no, no, I think closing your books is a prejudice. I mean in other words, I, I think that prejudice can apply-- a pre-- you can be prejudiced by late notice in a number of ways, you can be prejudice because you are unable to, to a defend the case, you were ...

JUSTICE JOHNSON: You can, but we we're talking about a cut-off date.

MR. POWERS: But what I'm-- I'm guess wha-- the answer to your question, your Honor, if I may, if, if, if, if in, if, if the carrier comes in the court and says, "Look, I got this notice on the 95th day. I closed my books on the 91st day, therefore, I was prejudiced because I'd already closed my books." Okay. That could be done, that could be their showing of prejudice.

JUSTICE WAINRIGHT: What if they close their books on the 30th day?

MR. POWERS: If they, if ...

JUSTICE WAINRIGHT: And, and didn't gave notice till 35th day. Is there prejudice?

MR. POWERS: No. As they say, "Well, look, you didn't gave notices in this practical-- practicable ...

JUSTICE WAINRIGHT: Right.

MR. POWERS: We closed our books to on the 30th day and reliance upon, not having received a notice 'cause we think that would not be happened." Is there prejudice. As an abstract proposition, perhaps so as a realistic proposition, no way.

JUSTICE WAINRIGHT: So ...

MR. POWERS: Because no, no, no underwriters going to close their book on the, on the-- look ...

JUSTICE WAINRIGHT: Look, based on your discussion with Justice Johnson, and your answer now on that question, in the safe harbor period is not a hard stop because its flexible, it depends upon-- according to your construct desired, as I understand it. When there's prejudice, which is determine by when the insurer can close its books on the risk, so that maybe the 30th day, or maybe the 95th day, but the 90 day, safe harbor provision which you called a hard stop, doesn't seems to be a hard stop anymore.

MR. POWERS: I was, I was talking in terms of as an abstract proposition, I could see how an underwriter could use a date-certain as a hard stop for purposes of closing books and calculating whether to issue new policies because they think a risk has been closed. It is, it is-- if you put ten underwriters under oath, and you said, "Would you actually ever close your books because you think somehow those are-- there's a met-- a date out there where soon as practicable a claim would have been fraud, they would tell you that's silly." I mean, it would not happen, I mean, its to vague, its to remote, its to ...

CHIEF JUSTICE JEFFERSON: Counselor, I think the, the questions has been asked to be answered and we'll have an opportunity in another case and you will on rebuttal, so the courts now is ready to hear argument from the respondents.

COURT ATTENDANT: May it please the Court. Mr. Borders will present argument from the respondents.

ORAL ARGUMENT OF JOSEPH J. BORDERS ON BEHALF OF THE RESPONDENT

MR. BORDERS: Morning, may it please the Court. This Court's recent decision in PAJ or PAJ, does not control the outcome of this case for three reasons. First, as the majority in the PAJ noticed, there is a critical distinctions between the occurrence-based policy in PAJ and the claims-made policy like the one at issue here ...

JUSTICE O'NEILL: And let me ask you about that ...

MR. BORDERS: Yes.

JUSTICE O'NEILL: The critical distinction we drew was the underwriters ability to close its books to set future premiums?

MR. BORDERS: Correct.

JUSTICE O'NEILL: If and, and, and that was sort of the, the prejudice piece that if a-- notice is given beyond the claims-made period, then we sort of presume prejudice, but if the claim is made in a manner that doesn't preclude the underwriter from adjusting-- making future premium on current claims, then why didn't it fit the same construct as PAJ?

MR. BORDERS: I think ...

JUSTICE O'NEILL: I mean, we drew the distinction in PAJ clearly -

MR. BORDERS: Yes.

JUSTICE O'NEILL: -but it seems the subsitive basis we drew the

distinction on, wouldn't apply here.

MR. BORDERS: Well, your Honor, perhaps misspoke when I said about closing the books. The idea behind the claims-made policy is to-- is essentially to minimize the unknown, as much as possible, uncertainty is what drives up the price of insurance. When I started practicing D&O law 15 years ago, a company that have $40 million worth of the D&O insurance, was considered, perhaps overly insured. Today, companies that no one has ever heard of carry $200 million worth of D&O insurance, plus an additional-- that have insurance that covers only the directors and officers because of the inflation and different theories.

JUSTICE O'NEILL: I presumed the premiums is gone up accordingly as well.

MR. BORDERS: Well, yes and no. I mean the, the premiums haven't gone up as much as they could have, mainly because of the limited window that claims-made policies provide as far as when we can close their books that there's not the long tail coverage. I don't need to know whether a wrongful act or a claim that happened today. What are-- what's it going to cost me 15, 20 years from now, and so the critical distinction on the claims-made policy is that, as you're setting premiums, and your negotiating this policies, almost immediately after their issue. Do you starting to negotiate the policy for the following year. This policy at issue here was not a ISO form, it wasn't negotiated. There were 24 endorsements that were put on to this policy, one of which changed the notice provision in this policy, and so the notice provision of the policy its, its almost a continuum. On day one, there's a lot of uncertainty of the policy because you don't know whether any claims were coming on. Six months in to the policy, you have a pretty good idea if this a good risk, there's not been any claims, so if we were only talking about a bright line cut-off, after this 90 day period. In this particular case, it was a one year policy, with a three year recording provision, and policy said that, "Notice shall be provided as soon as practicable but in no event later than 90 days after expiration of the policy", so under this bright line ...

JUSTICE HECHT: That's an odd provision it seems to me, its ...

MR. BORDERS: Well, ...

JUSTICE HECHT: As soon as practicable, but in no event later than a year and a half ...

MR. BORDERS: Well, ...

JUSTICE HECHT: That-- I mean, it looks to me like if you are really serious about it you'd say, as soon as practicable, but in no event later than "X" days after the claim is made.

MR. BORDERS: Your Honor, I think the answer to that is, it depends on when the claim is made, the example was raised, what if the claim is made on the last day of the policy, and so the-- but in no event later than 90 days, was meant as a limiting factor because of courts-- there is some leeway on how courts have been determined -

JUSTICE HECHT: That's the court -

MR. BORDERS: - [inaudible] what as soon as practicable.

JUSTICE HECHT: The best of part I don't understand because I see why you would want a limiting factor at the end, but it's hard to see why you wouldn't want the same limiting factor at the beginning.

MR. BORDERS: Well, your Honor, the reason is it was negotiated the way. The original notice clause of this policy says, "Shall provide notice as soon as practicable-- in here if I can-- but in no event late-- no event later than 90 days after the claim is made." That was the original notice provision in the form policy, that was changed by

endorsement, and so the parties negotiated that we're going to limit it to ...

CHIEF JUSTICE JEFFERSON: All parties in this case negotiated?

MR. BORDERS: Yes, your Honor. Its a-- endorsement 15, I believed, to the policy, and so what the parties negotiated was, okay, well, we will stick to what's as soon as practicable in an, in an-- depending upon the state. Now, Texas, interprets the term "as soon as practicable" with a fairly short window, I believe 49 days was the shortest that I've run across below and older case, but certainly, six months is not as soon as practicable. Other states, you know, have looked at this and said, "Well, we think within a year is as soon as practicable."

JUSTICE MEDINA: What, what if it was not negotiated the way and this is a standard form language, does it matter?

MR. BORDERS: I don't believe so your Honor, because the nature the claims-made policy. The reason this policy is developed ...

JUSTICE O'NEILL: And that gets me back to my question -

MR. BORDERS: Yes.

JUSTICE O'NEILL: - and that is, you have stipulated no prejudice here.

MR. BORDERS: Correct.

JUSTICE O'NEILL: And that, that seems to be me by definition to mean, if you've stipulated and their prejudice, and it doesn't affect your ability to set rights. That distinguishes a "claims-made" policy from an "occurrence" policy.

MR. BORDERS: Well, your Honor, I think that to a certain extent vagues the question because with a condition precedent, its whether the noted-- whether the notice in this case in the condition precedent, is whether it is an essential part of the bargain-for exchange.

CHIEF JUSTICE JEFFERSON: Is every single acted required by the insured under in his policy, condition precedent, as your opposing counsel said.

MR. BORDERS: It is not, your Honor.

CHIEF JUSTICE JEFFERSON: I mean there's a pretty broad statement that every requirement under this policy shall be a condition precedent, or something and he [inaudible] ...

MR. BORDERS: There's a, there's a no action clause in the policy that says, as a condition precedent, the insured, as a condition precedent to bringing suit against the insurer. The insured shall meet all the conditions in terms of the policy, so I think as the, the descent pointed out in PAJ, what that means is okay. Now, we look at what was the term or whatever that wasn't satisfied by insured. Now, in this case, the condition precedent language, we're not relying on the no action clause, this isn't a case where you the risk in PAJ, where your boot scrapping everything. You'd have to be submitted on pink paper, I think was the, the example at was given or didn't send in a deposition note was the example that was given in PAJ, and therefore, the insurer can walk away. This insur-- this language of this clause is very specific in the-- or condition for term, condition precedent was used very judiciously. It says, "The insured shall, as a condition precedent to cover jam to this policy, provide notice in writing as soon as practicable, but in no event later than 90 days."

CHIEF JUSTICE JEFFERSON: And now, let me ask you ...

MR. BORDERS: If that ...

CHIEF JUSTICE JEFFERSON: It does it-- I asked this question to the other side, does it-- should it concern this Court to look at whether there's a majority trend on whether prejudice is, or required to

claims-made policy and is there a trend nationally on whether courts say that you have to show prejudice before you can decline coverage.

MR. BORDERS: In answer to, I think your first-- the first part of your questions, certainly, this Court can take some direction from courts throughout the nation, and determine and review these cases and determine which have been well-reasoned and which will enlighten the court in its decision. And as far as the trend is concerned, there are two trends at issue here: there's a trend nationwide and its a very strong trend, that in the occurrence-based policy, prejudice must be required for late notice; but in the claims-made context, the trend is to reverse. The trend is you don't need to prove prejudice in the claims-made policy.

JUSTICE O'NEILL: But that's when the notice comes outside the claims-made period.

MR. BORDERS: No your Honor.

JUSTICE O'NEILL: No. Okay.

MR. BORDERS: In those policies, the-- in many of those cases, the policy, whether it's a claims-made and reported or a claims or what he-- I believe opposing counsel is referring to is a general claims-made policy. Many of those cases involved notice of a claim given within the policy period. The claim made on the day one, notice given nine months later, and the courts have looked at that and said, "No coverage, it's a condition precedent, to coverage." Now, when were talking about the prejudice, I guess that would be, how is the insurer prejudiced by the that. And so it, we've already stipulated that we've warrant prejudice especially this isn't required on the Texas law, and certainly, looking at the cases that we have when we ...

JUSTICE JOHNSON: Counsel why, why is that provision in your policy.

MR. BORDERS: Which provision, your Honor?

JUSTICE JOHNSON: About reporting as soon as practicable?

MR. BORDERS: It's in the policy, your Honor.

JUSTICE JOHNSON: Is it made to the insurer?

MR. BORDERS: Because these are notice policies the entire idea behind the claims-made policy, is to limit the time from when the insured event occurs ...

JUSTICE JOHNSON: I understand that, but if, if you had, if you write for one year, and you have a 90-day extended reporting period. Is that, is that correct? Or you have an extended reporting period?

MR. BORDERS: We have an extended reporting period in this case, you Honor, because FlashNet went out of existence and they both run of the coverage.

JUSTICE JOHNSON: Okay, all right. Let's, let's take a situation where you have a one year policy, and you're allow reporting within 90 days after the la-- the end of the policy.

MR. BORDERS: Yes.

JUSTICE JOHNSON: Let, let's assume that to be the case. Why then-- what th-- what importance is it to the insurer that the claim be reported as soon as practicable within that period. Why do we even have that provision in the policy as far as the insurer was concerned.

MR. BORDERS: For a number of reasons, your Honor. One of the reasons is, as this policy-- this policies aren't underwritten on the 365th day of the policy. There-- the underwriting process continues throughout the year. I mean, it doesn't start necessarily on day one, sometimes it does, but it, it starts sometime into the policy, in, in, in order determine what limits an insurance company is willing to provide, what the amount of premium there is out there, whether or not

they're going to be able to get reinsurance for the policy. They're going-- they want to know the universe of claims that are there and the "as soon as practicable" language gives them some comfort, not much comfort is they'd like. In this case, we would have preferred 90 days after the claim was made, but some comfort knowing that, it's not infinite that this condition precedent, in this policy, says that you will give us notice as soon as practicable, so six months in to the policy if we've not received notice of the claim that occurred on day one, we have some confidence, not complete confidence, that no claim had been made. [inaudible] ...

JUSTICE WAINRIGHT: Counsel, what's, what's your best argument entering the question that even though I wasn't harmed, the court should enforce a provision that would eliminate coverage.

MR. BORDERS: I think because to impose a prejudice standard in a claims-made policy would extend coverage throughout us. To be insured of this case, that the insured bargain-for, a policy in which they said as-- they agreed as a condition precedent they'll give us notice as soon as practicable. If that can be ignored, then the whole purpose on a claims-made policy to eliminate tail coverage, to know when you can close your books, to know how negotiate your premiums, ceases to exist and so what the insurance industry will do, is either increase the premiums for the policy or in a case, such as FlashNet in this case, which was a very difficult risk to place in the first place, this simply refused to offer it at all, and so coverage to the insured will be very expensive. That's why claims-made policies evolved in the first place.

JUSTICE WAINRIGHT: If, if, if the term "as soon as practicable" is the operative requirement for providing notice and I see you say it is.

MR. BORDERS: It wa-- it's one of, one of two, your Honor ...

JUSTICE WAINRIGHT: And the other is.

MR. BORDERS: The 90-day cut-off.

JUSTICE WAINRIGHT: Do you think that's a hard stop?

MR. BORDERS: Yes, I do, your Honor. I think what that is intended to do is in those jurisdictions where a year can be soon as practicable, what we're saying is, yes, that's the case. But in this case, we're cutting it off, at-- its a limiting factor, that's why it's by the "no event later than." Its a limiting factor on what can be "as soon as practicable."

JUSTICE O'NEILL: Let me make sure I understand you in terms of the ability to set rates. Do I understand your argument to be that you look at that on an individual insured basis, and when your setting down with that insured, trying to decide whether then you negotiate another term on the claims-made policy. Its important to you on continuum whether claims have been filed as soon as practicable, so your argument is, your setting rates individually on an on-going basis as opposed to broad length?

MR. BORDERS: Correct, your Honor. You'll looking-- especially in directors' and officers' liability coverage, it is a very specific type of coverage and its-- the underwriting files on this things are, are fairly thick, you'll looking at their ten cage, your looking at their ten cues. The, the underwriters will be going on the internet to determine whether or not -

JUSTICE GREEN: So, so what, what ...

MR. BORDERS: - they made any public announcements.

JUSTICE O'NEILL: So your setting rates individually on this policies as opposed to ...

MR. BORDERS: Absolutely.

JUSTICE GREEN: Okay.

JUSTICE GREEN: So why wouldn't be simply enough, you know, to say in the sense that the claim comes in depending on what kind of claim is, how, how big it is. How would it affect things like setting limits and, and the premiums in obtaining reinsurances so good that you described. Why wouldn't it be pretty simple to say what this kind of claim, this is what was affected, in saying this sorts of things to show prejudice of the company.

MR. BORDERS: Your Honor, I reviewed the case law nationwide, has shown that a prejudiced standard isn't oftly onerous-

JUSTICE GREEN: They say learned it would be difficult.

MR. BORDERS: It its, its difficult as the term with prejudice is interpreted by the courts. A, a-- one court has done so far as to say unless the insurer can prove that it would've gotten a better result than the judgment that was entered against the insured in this case.

JUSTICE GREEN: So if we were to follow the PAJ ruling here, you're say it would be too difficult to show prejudice, and of course we haven't got another question of what-- how do you show prejudices in these kind of cases.

MR. BORDERS: Well, it would be certainly would be awfully difficult, your Honor, and I'm not saying it's insurmountable. We certainly have proven, and insurance companies have proven prejudice in those limited states where usually the legislature has imposed prejudice standard across the board on late notice poli-- on policies.

JUSTICE JOHNSON: But you stipulated no prejudice in this case.

MR. BORDERS: Absolutely, your Honor, we did. And I'm not arguing today that great America-- they're-- excu-- its great American in answer Agriculture lifestyle of it. Its is the current ...

JUSTICE JOHNSON: Let me, let me understand, as I understand what you've just told us, it seems like the underwriting is based upon every provision in the policy, whether its-- whether you were require to be submitted on pink paper, in green ink or whatever. A-- it-- does the underwriting go to that much detail, is that what your telling us that ...

MR. BORDERS: No, no, not at all, you Honor. What I'm saying is that the underwriting is based upon as much-- in this cases, because the risk are so high and the payments on this policies are so high. That information is key and uncertainty is what drives up the price of the policy.

JUSTICE JOHNSON: And on this policy, the premium that was discussed earlier, was an up front premium set for this policy, is not retral type of premium in any manners, its just a one premium for this period of time. Is that, is that correct or not?

MR. BORDERS: That is correct, your Honor, although I believed this policy was a renewal, because what ...

JUSTICE JOHNSON: But what I'm saying is, the claim during the policy period did not change the premium for that policy.

MR. BORDERS: Not for this policy ...

JUSTICE JOHNSON: Not for this period.

MR. BORDERS: It would however change the premium that would be charged for the extended reporting period that was placed on this policy, so hypothetically, had claims ...

JUSTICE JOHNSON: They've bought it.

MR. BORDERS: They did buy it.

JUSTICE JOHNSON: Okay, so you can change that premium, they bought it, at the premium for 19,000 or whatever?

MR. BORDERS: No, your Honor. They paid the premium for the policy-

- at the beginning of the policy, probably of the year-- in the-- sometimes in the year prior ...

JUSTICE JOHNSON: The 19,000, something we heard.

MR. BORDERS: Right and then, in the end of this policy, when they knew that FlashNet was no longer going to exist, and it was going to be subsumed by another company. They approached basic and they said, "Okay, we need an extended reporting period in case any claims come in when we were FlashNet." And so a premium was negotiated at that point for the run off coverage, during the course of this policy, and what I'm saying is, if a claim was sitting out there on-- say, the sixth-months period of this policy, as we're negotiating this extended reporting period. And so we don't know about it, they haven't told us about it, they ...

JUSTICE WILLETT: Mr. Borders. Eight -

MR. BORDERS: Yes.

JUSTICE WILLETT: - about eighteen minutes ago, you said that there were three reasons why PAJ is not controlling, you got at one of them and then you kind of got taken off course a little bit, but I want to make sure that I got the other two. I think we've probably kind of veered into them. I want to make sure I get all three. Okay.

MR. BORDERS: I'm sorry, I haven't finished answering your question, your Honors.

JUSTICE JOHNSON: Well, just go to Justice Willett, you ...

MR. BORDERS: The second reason is that in contrast to PAJ, the notice condition precedent in this policy, expressly stated that it's a notice condition precedent.

JUSTICE WILLETT: I have a feeling that was number two. What's number three?

MR. BORDERS: Well, if, if I may finish the thought on number two is, the problem in with PAJ, the green paper and everything is a condition precedent, was because there was a laundry list of items that appeared after that. In our notice provision is says, "Shall provide notice at-- as soon as practicable, and then its continues," "And shall gives reasonable cooperation that the insurer requires", so what I would argue is, the cooperation clause that stacked on at the end of this provision is a covenant because the condition precedent follows the-- you shall is a condition precedent give notice-- prompt notice, and you shall cooperate as we reasonably request, so on the third-- the third reason is the Board Order, in PAJ, applies only to th-- general liability policies, its doesn't apply to the directors' and officers' liability policies, such as the one that's issued here. And the interesting thing with the sort of the alternative argument that a Prodigy is making in this case, is that their setting up the problem that you've corrected in PAJ to occur here. In PAJ, the court was concerned that identical policy language, would be interpreted two different ways depending upon the type of the claim. What Prodigy is asserting here is, the notice provision, will have to be interpreted to different ways depending if notice comes 91 days after the end of extended reporting period or whether notice comes-- is just other wise not as soon as practicable, the, the results are still a eclipsed -

COURT ATTENDANT: Halt.

MR. BORDERS: -if I may finish my thought ...

CHIEF JUSTICE JEFFERSON: You might, yes, you may.

MR. BORDERS: Thank you, your Honor. Let's presume a claim is made on day one of policy The policy says, you gave notice as soon as practicable but no event later than 90 days after the expiration of the extended reporting period. Under the third positive by Prodigy, claim

made on day one and reported just under 3 years and 3 months later-- 3 years, 89 nine days later, that's okay, there is no prejudice standard because we didn't cross the bright line cut-off of 90 days. Now, a claim is made on the last day of the reporting period, and they gave notice 91 days later, bright line cutoff don't have to prove prejudice. Does this kind of anomaly, that this Court corrected in PAJ, that the parties to the insurance contract should be able to read the contract and, and know what it means and know what the standards are. And to apply different standard depending on wha-- whether its a notice under a claims-made or what they are calling a general claims-made or claims made and reported shouldn't risk-- shouldn't matter. And by the way, three courts have been looked at the language a very similar to this, where the notice provision wasn't in the insuring agreement, but was rather contained in a condition precedent and said, "But no event later than 90 days or 30 days." Those courts should've looked at that language and said, "That's a claims made and reported policy," not a claims made policy they-- looked at and said, "That's a claims made and reported policy."

CHIEF JUSTICE JEFFERSON: For the question, Justice Johnson.

JUSTICE JOHNSON: Counsel.

MR. BORDERS: Yes.

JUSTICE JOHNSON: On your underwriting for your renewable or tail periods.

MR. BORDERS: Yes, your Honor.

JUSTICE JOHNSON: The underwriting you said is based upon claims-made and reported during the period. Your-- you constantly doing that underwriting to figure out what you going to charge them if they want to buy an extended reporting period. And that ...

MR. BORDERS: Yes, your, you, you're constantly trying to determine what is the risk in this policy.

JUSTICE JOHNSON: Charge the premium up front and now you going to charge of the premiums at the back in if they purchased an extended reporting period, and that extended reporting period purchased is going to be based upon underwriting what happened during the primary period. Is that correct?

MR. BORDERS: Correct, your Honor, because ...

JUSTICE JOHNSON: So if you, if they don't report something to you, then they may have a lower premium that you have charged them for the extended reporting period based upon your underwriting of no reported claims.

MR. BORDERS: Yes.

JUSTICE JOHNSON: Okay. So you may-- in that case, you could show prejudice if there was a delay in reporting. Is that a correct statement?

MR. BORDERS: I, I, I think it would be evidence of prejudice.

JUSTICE JOHNSON: Thank you.

CHIEF JUSTICE JEFFERSON: Any further questions. Thank you, Counsel.

MR. BORDERS: Thank you.

REBUTTAL ARGUMENT OF WERNER A. POWERS ON BEHALF OF THE PETITIONER

MR. POWERS: May it please the Court. I have just a few comment-- a lot of comments that were made by my worthy adversary. First of all, I

think we heard 20 minutes of explanation outside the record of why there was prejudice here. I mean, 20 minutes, we heard about how there was an underwriting prejudice that took place, but there was no evidence of that underwriting prejudice ever offered in-- at trial. There was a stipulation of no prejudice.

JUSTICE O'NEILL: Well, to be fair, I think the argument went to whether the notice requirement goes to the bargain-for exchange, and so when you got an ongoing negotiation, its necessary to an extended reporting period. I think the argument is it goes to the bargain-for exchange between the parties in setting the rates and they're not going to get into the prejudice argument.

MR. POWERS: Well, a-- the only evidence of bargain-for exchange, we have in here as to the policy itself, and, and there is no evidence of what was truly bargained-for. If you look at the policy, itself, what is the bargain-for exchange, Section I is the insuring agreement; Section I says, what is the risk transfer; Section I says, it is insuring all claims made against the insured during the policy period, not claims-made and reported during the policy period.

JUSTICE O'NEILL: That, that doesn't take into account that the extended reporting period that was being negotiated.

MR. POWERS: No, your Honor, that is the, the-- actually the language is claim first made against the directors and officers for a wrongful act at a-- its either during the policy period or was called the discovery period, okay, which is what happened here. The, the claims was made during the discovery period, okay, and it was reported during the safe harbor provided in the notice provisions. But the ins-- what I'm saying here is that this is truly a claims made-- not a claims made and reported policy. The centrality of the bargain, is as you would expect in Section I of the, of the agreement, the notice clause doesn't appear until Section VII, and its under notice of claim, okay, this gets to whether it is subsidiary to the main insurance party ...

JUSTICE HECHT: In, in all matters is up to you.

MR. POWERS: Yes.

JUSTICE HECHT: Sometimes a-- as I say you could show prejudice but sometimes its hard, and if you look at the cases around the country, and in a global place, if you just wanted a, a bright line, if you just wanted to know on this day, that it has to be done or not. Can you put that in the policy, or is that just not something that should go on the policy?

MR. POWERS: I guess it goes to whether it is essential to the bargain. The answer to your question candidly ...

JUSTICE HECHT: Probably not.

MR. POWERS: But if it's not, if it is a notice provision, if argue-- its says like coming back to this Section VII, your Honor, if you read that, that Section VII, in its entirety-- its, its dealing with what, what do you do when you get sued. Section VII(C), talks about having to forward as soon as practicable notice-- copies of papers, investigations, pleadings, etc., I mean, under their construct as in PAJ, the failure to give a, a copy of a report as soon as practicable would forfeit your coverage. This is in PAJ, I notice-- the notice provision here is subsi-- I liked the word you used to your majority opinion, its subsidiary, subsidiary to the main insurance bargain. Well, ...

JUSTICE HECHT: But that's what I want to ask you about before your time expires.

MR. POWERS: Yeah.

JUSTICE: If at whatever reasons, somebody was building a house,

and they just don't want to ask that, they want to say, "If the carpet is not laid by 'X' days, I'm not going to pay you other than this or something going to make it not be a penalty." Can you do that in an insurance policy without notice?

MR. POWERS: Put it on the insurance clause, put it, put it into Section I to make it sure, your sure that's, that is the bargain-for consideration. I'm insuring only claims made during this policy period and reported to me by not later than, say, 30 days after the end of that discovery period. That makes it clear that, that's the bargain-for exchange, that makes it clear, that what your, what your, what you are selling here is not a claims made, but it is indeed a claims-made and reported policy, and that's the risk your underwriting, so that would be my response to that question. Want-- I'm almost out of time, I want to bring two questions though, three observations quickly together. First of all we had a concession by opposing counsel, that the words "condition precedent" do not mean condition precedent all the time, okay. You remember, you-- well that questions was asked by one of the pa-- one of the justices about, and you know, we are-- is every contract, is every provision of this contract that the condition precedent. My opposing counsel said, "No", even though the language in Section VIII(C) of the contract pulled it out, says, "No action shall be taken against the insurer unless as a condition precedent there shall be a full compliance with all the terms and condition of the policy." The admission made by my opposing counsel, is an admission to the obvious, calling something a condition precedent doesn't make it, so it has to truly central to the bargain and saying that it must done in green ink or something like that, doesn't make it truly essential to the bargain at main statement court admission by opposing counsel.

JUSTICE MEDINA: What would in fact, if any does your-- worthy opponent submission to know prejudice have on the bearing of this case?

MR. POWERS: I think that, that is the end of the argument. I fully expected my opposing counsel at trial to come forward with an affidavit from the underwriter to say, "Look, this delay hit us-- this notice here is late. We closed our books, we did something to suffer some adverse consequences a result of you not giving notice as soon as practicable." They didn't do it, and you know why they didn't do it because of the point that Justice Hecht made in his, in his quest-- he said, remember his question was, "Isn't this a rather odd provision". I mean, if you are really sincere about underwriting against a standard, as loose as, as soon as practicable, why didn't you say, you must give notice within 30 days. I, I am, after you've received notice. Why did you say, "But in no event later than 60 or 90 days after the end of the discovery period"?

CHIEF JUSTICE JEFFERSON: Are there any, any further questions? Thank you very much counsels ...

MR. POWERS: Thank you.

CHIEF JUSTICE JEFFERSON: The case is submitted and the court will take a brief recess.

COURT ATTENDANT: All rise.

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