Texas Court Considers Prior Knowledge Condition In D&O Policy

Friday, February 17, 2012

In the recent decision in *Deer Oaks Office Park Owners Ass'n v. State Farm Lloyds*, 2012 U.S. Dist. LEXIS 19240 (W.D. Tex. Feb. 15, 2012), the United States District Court for the Western District of Texas had occasion to consider a prior knowledge condition in a directors and officers liability policy.

The insured, Office Park, was "an office park condo association which owns, maintains and regulates the 'common areas' between fifteen unconnected office condos" in San Antonio, Texas. In 2007, it sold one of the condominium units to a doctor who intended to convert the unit for use in his medical practice. The doctor advised that being able to install an elevator into the unit was an important aspect and condition of his purchase. After the sale, however, the doctor was unable to obtain a permission from building maintenance to install the elevator. He subsequently complained to Office Park, and later commenced a lawsuit in Texas state court.

Office Park sought coverage for the suit under the directors and officers coverage of its policy with State Farm Lloyds, effective for claims first made during the period January 30, 2010 to January 30, 2011, which encompassed the period in which the doctor commenced suit. The policy's insuring agreement stated that coverage "applies to **'wrongful acts'** committed before this optional coverage became effective if the insured had no knowledge of a claim or suit at the effective date of this option and there is no other applicable insurance." State Farm Lloyds denied coverage for the suit on the basis that Office Park had knowledge of the doctor's claim prior to the policy's inception. Specifically, State Farm Lloyds relied on a September 23, 2009 letter from the doctor's attorney that "traced [the doctor's] multiple complaints about Office Park and attributed monetary losses to Office Park."

Office Park argued that the doctor's letter did not constitute a "claim" or notice of a "claim," because the letter did not specifically demand any monetary relief. In support of its position, Office Park pointed out that the State Farm Lloyds policy did not contain a definition of the term "claim," and that as such, under the Fifth Circuit decision in *Int'l Ins. Co. v. RSR Corp*., 426 F.3d 281 (5th Cir. 2005), the term "claim" must be narrowly construed as "a demand for money, property, or legal remedy." Office Park contended that because the doctor's September 23, 2009 letter did not actually seek monetary relief, it could not constitute a "claim" for the purpose of the policy's "knowledge of a claim or suit" condition to coverage.

The court disagreed with Office Park's restrictive reading of *RSR Corp*., finding that the term "claim" is not limited solely to demands for monetary relief, but instead encompasses any assertion of a legal right. Such an interpretation, the court explained, ordinarily is favorable to the insured, rather than the insurer, "because the construction gives the insured the right to seek coverage without waiting for the filing of a lawsuit." The court went on to conclude that the doctor's letter qualified as a "claim" because it clearly stated a legal demand for relief and advised of the potential for litigation should an accommodation not be made. As the court explained:

The only reasonable interpretation of the letter is that [the doctor] asserted a right to hold Office Park liable for all of the costs [he] had spent and lost because of Office Park's acts. The letter's bottom line was: If you do not comply with my demands, I will sue you. Under any construction, the letter constituted a claim.

As such, the court concluded that State Farm Lloyd's denial of coverage was correct and that it had no duty to defend or indemnify the doctor in connection with the underlying matter.