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Recent Developments in Insurance Law on Notice: The Continuing Trend Toward Requiring Prejudice

by
Brian Myers, Jennifer McAdam & Benjamin Hassebrock*

I. INTRODUCTION

Liability insurance policies generally require the insured to promptly notify its insurer of an event that may trigger the insurer's duty to defend or indemnify.[1] When an insured fails to notify its insurer in a timely manner, the insurer may assert a coverage defense of late notice. Because courts and legislatures around the country have adopted varying approaches to the late notice defense, it is imperative for coverage counsel and other claim professionals to know the applicable law when addressing this issue.[2]

This article focuses on recent developments in the law regarding the defense of late notice. The vast majority of states currently require that the insurer suffer prejudice as a result of its insured's late notice before that defense will act as a bar to coverage.[3] Recent legislation and court decisions demonstrate that the decades-old trend toward this majority position is continuing. In 2008, New York embraced the majority rule by adopting a statute requiring insurers to prove prejudice by an insured's late notice.[4] Moreover, courts in other states in the past

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[1] For a more general discussion of an insured's duty to provide timely notice of a triggering event to its insurer, *see* 22 Holmes' Appleman on Insurance 2d § 139.

[2] *See, e.g.*, Richard L. Suter, *Insurer Prejudice: Analysis of an Expanding Doctrine in Insurance Coverage Law*, 46 Me. L. Rev. 221, 222 (1994) ("Since the scope of the insurer prejudice rule appears to be expanding in Maine and elsewhere, it is increasingly more important for both insurers and insureds to understand the various aspects and implications of the rule.").

[3] *See* 22 Holmes' Appleman on Insurance 2d § 139.4[C]; Coop. Fire Ins. Ass'n of Vt. v. White Caps, Inc., 694 A.2d 34, 359 n. 1 (Vt. 1997) (collecting cases). *See generally* Charles C. Marvel, *Modern Status of Rules Requiring Liability Insurer to Show Prejudice to Escape Liability Because of Insured's Failure or Delay in Giving Notice of Accident or Claim, or in Forwarding Suit Papers*, 32 A.L.R. 4th 141; Chart, *Application of the Notice-Prejudice Rule by State*, http://www.abanet.org/litigation/prog_materials/2008_sectionannual/010.pdf (last visited March 26, 2009).

[4] *See* discussion below, Section III.

few years have issued decisions that affirm and clarify the notice-prejudice rule.[5] This article highlights the 2008 New York legislation and recent decisions from several jurisdictions concerning the late notice defense.

II. THE MODERN TREND TOWARD REQUIRING PREJUDICE

Liability insurance policies ordinarily contain notice provisions that require the insured to provide the insurer with prompt notice of every occurrence, accident, claim or suit that may trigger the insurer's obligation to defend or indemnify.[6] These provisions require the notice to be "prompt," "immediate," or "as soon as practicable," although courts have generally interpreted all of these terms to mandate notice within a reasonable time.[7] Insurers often rely on notice provisions to deny coverage when an insured fails to provide the requisite notice in a timely manner.[8] An insurer's notice-based denial of coverage is commonly referred to as the "late notice defense."

The general purpose of these notice requirements is to provide the insurer with an opportunity to investigate a potential claim at or near the time that the coverage-triggering event occurred, so as "to ensure that the insurer is not prejudiced in its ability to investigate and defend claims against its insureds."[9] This underlying rationale has led many courts to adopt a "notice-prejudice rule," which requires that the insurer suffer prejudice as a result of the delayed notice in order to deny coverage based on the insured's breach of the policy's notice provisions. Many courts and treatises have noted that the notice-prejudice rule has been adopted by an overwhelming majority of jurisdictions.[10] This modern trend toward a prejudice requirement is based on several important policy consider-

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[5] *See* discussion below, Section IV.

[6] *See generally* 22 Holmes' Appleman on Insurance 2d §§ 139.2–139.4. The type of notice required is established by the terms of the policy. Notice of an occurrence and notice of a lawsuit, for example, are separate requirements, and providing one type of notice will not necessarily relieve an insured of its obligation to provide notice of another event. Some courts have applied different rules to different types of notice, *see* Section IV.D. below, and the type of notice at issue in a particular case can be outcome determinative. For suggestions on how a policyholder should comply with notice requirements, *see* Marc S. Mayerson, *Perfecting and Pursuing Liability Insurance Coverage: A Primer for Policyholders on Complying With Notice Obligations*, 32 Tort & Ins. L.J. 1003 (1997).

[7] *See* 22 Holmes' Appleman on Insurance 2d § 139.3[A][3].

[8] *See* Scott J. Kaplan, *Is the Glass Half Full? Why an Insurance Company's Late Notice Defense to an Environmental Claim Should Fail,* 38 Tort Trial & Ins. Prac. L.J. 1049, 1050 (2003).

[9] *See* 22 Holmes' Appleman on Insurance 2d § 139.2.

[10] *See* note 3, above. *See also* 33 Holmes' Appleman on Insurance 2d § 193.01[F][1]; Country Mutual Ins. Co. v. Livorsi Marine, Inc., 856 N.E.2d 338, 346 (Ill. 2006); Alcazar v. Hayes, 982 S.W.2d 845, 850 (Tenn. 1998). One commentator has noted that, "[f]rom the early 1960s through the mid-1980s, courts in most states did not strictly enforce these notice provisions. Courts in these states required the insurer to prove prejudice from late notice before its performance would be excused." Marc S. Mayerson, *Perfecting and Pursuing Liability Insurance Coverage: A Primer for Policyholders on Complying With Notice Obligations*, 32 Tort & Ins. L.J. 1003 (1997).

ations.[11] First, the adhesive nature of insurance contracts justifies a more liberal interpretation of notice provisions, which are uniformly found in insurance policies and are not generally bargained for by insureds.[12] Second, a strict interpretation of the notice requirements may permit an insurer that has not suffered any prejudice as a result of the delayed notice to escape liability due to a technicality and thereby obtain a windfall in the form of the insured's forfeiture.[13] Finally, the public policy goal of compensating tort victims would be undermined by a narrow construction of notice terms that allowed an insurer to escape liability without suffering prejudice.[14]

A. Variations of the Notice-Prejudice Rule

There are three primary variations of the notice-prejudice rule.[15] In most jurisdictions applying the notice-prejudice rule, the insurer has the burden of establishing that it suffered prejudice as a result of the insured's failure to provide reasonable notice.[16] Courts adopting this position contend that the insurer is in a much better position to prove that it was prejudiced, as opposed to placing the burden on the insured to prove a negative.[17] As the Kentucky Supreme Court has stated:

> There are two reasons for imposing the burden on the insurance carrier to prove prejudice, rather than imposing on the claimant the burden to prove no prejudice resulted. The first is the obvious one: it is virtually impossible to prove a negative, so it would be difficult if not impossible for the claimant to prove the insurance carrier suffered no prejudice. Secondly, the insurance carrier is in a far superior position to be knowledgeable about the facts which establish whether prejudice exists. Indeed, it is difficult to imagine where the claimant would look for evidence that no prejudice exists.[18]

In addition, some courts have reasoned that placing the burden on the insurer encourages the insurer to conduct a preliminary investigation of any claim by the insured.[19]

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[11] *See Alcazar*, 982 S.W.2d at 850–51. Prior to *Alcazar*, Tennessee adhered to the no-prejudice rule. *Id.* at 849 (citing Hartford Accident & Indem. Co. v. Creasy, 530 S.W.2d 778, 779 (Tenn. 1975)).

[12] *Id.* at 850 (citing Brakeman v. Potomac Ins. Co., 371 A.2d 193 (Pa. 1977)).

[13] *Id.* at 851 (citing Miller v. Marcantel, 221 So. 2d 557, 559 (La. Ct. App. 1969)).

[14] *Id.* at 850–51 (citing *Brakeman*, 371 A.2d at 198 n. 8).

[15] *Id.* at 853.

[16] 22 Holmes' Appleman on Insurance 2d § 139.4[C][1]; *Alcazar*, 982 S.W.2d at 853–54 ("A clear plurality of states hold that once it is demonstrated that the insured breached the notice provision, the burden of proof is allocated to the insurer to prove that it has been prejudiced by the breach.").

[17] Jones v. Bituminous Cas. Corp., 821 S.W.2d 798, 803 (Ky. 1991).

[18] *Id.*

[19] *Alcazar*, 982 S.W.2d at 854 (citing Great Am. Ins. Co. v. C.G. Tate Constr., 279 S.E.2d 769, 775–76 (N.C. 1981)).

It should be noted that proving prejudice is not an easy burden for the insurer to satisfy. In evaluating whether an insurer has suffered prejudice, courts frequently consider factors such as the availability of witnesses, the existence of official reports concerning the occurrence, the availability of demonstrative and illustrative evidence, the ability of experts to reconstruct the occurrence, and the ability to discover other information.[20] An insurer asserting a late notice defense in a notice-prejudice jurisdiction should be prepared to demonstrate prejudice by showing that it lost access to material witnesses, significant evidence or a meritorious defense as a result of the delayed notice.[21] Unless significant, irreplaceable evidence has been lost or rendered unavailable by the passage of time, it may be difficult for the insurer to meet its burden.[22]

A second variation of the notice-prejudice rule specifically requires proof of "substantial" or "appreciable" prejudice as a result of the delayed notice.[23] In New Jersey, for example, courts assess two factors in determining whether an insurer has suffered appreciable prejudice: (1) whether substantial rights have been irretrievably lost by virtue of the insured's failure to give timely notice; and (2) whether the likelihood of success of the insurer in defending against the underlying claim has been adversely affected.[24] Likewise, a number of jurisdictions require an insurer to show "substantial prejudice," although this standard is imprecise and whether it actually increases the insurer's burden of proof is an open question.[25]

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[20] 22 Holmes' Appleman on Insurance 2d § 139.4[C][1].

[21] *Id.* Maryland, for example, has enacted a statute requiring the insurer to establish "actual prejudice," and one Maryland court has described this statutory requirement as follows:

> The requirement of actual prejudice means that an insurer may not disclaim coverage on the basis of prejudice that is only possible, theoretical, conjectural, or hypothetical. Nor is it enough to surmise harm that may have occurred by virtue of the passage of time; prejudice cannot be presumed from the length of the delay. . . . [C]ourts must be especially watchful against allowing insurers to avoid coverage on the basis of illusory harm.

Gen. Accident Ins. Co. v. Scott, 669 A.2d 773, 779 (Md. Ct. App. 1996) (internal citation omitted).

[22] *See* Scott J. Kaplan, *Is the Glass Half Full? Why an Insurance Company's Late Notice Defense to an Environmental Claim Should Fail*, 38 Tort Trial & Ins. Prac. L.J. 1049, 1050 (2003).

[23] 22 Holmes' Appleman on Insurance 2d § 139.4[C][1][a]; *see also*, Allen Levin, *No Harm, No Foul: Applying Insurance Policies' Notice Clauses*, 8 S.C. Law. 21, 23 (1997).

[24] *See* Morales v. Nat'l Grange Mut. Ins. Co., 423 A.2d 325, 355–56 (N.J. Super. Ct. Law Div. 1980).

[25] *See* Nat'l Publishing Co. v. Hartford Fire Ins. Co., 949 A.2d 1203, 1211 (Conn. 2008) (discussed at Section IV.B., below); Ferrando v. Auto-Owners Mut. Ins. Co., 781 N.E.2d 927, 944–45 (Ohio 2002); Coop. Fire Ins. Ass'n of Vt. v. White Caps, Inc., 694 A.2d 34, 38 (Vt. 1997); Vermont Mut. Ins. Co. v. Singleton, 446 S.E.2d 417, 421–22 (S.C. 1994); Jones v. Bituminous Cas. Corp., 821 S.W.2d 798, 803 (Ky. 1991); Bankers Ins. Co. v. Macias, 475 So. 2d 1216, 1218 (Fla. 1985); Rampy v. State Farm Mut. Auto. Ins. Co., 278 So. 2d 428, 434 (Miss. 1973). The application of the "substantial prejudice" standard varies by state. In Vermont, for example, substantial prejudice appears to be similar to actual prejudice. *See White Caps*, 694 A.2d at 364 (evidence offered by insurer was "insufficient as a matter of law to raise a genuine dispute as to whether it had

Courts adopting the third variation of the notice-prejudice rule have lessened the impact of the rule on insurers by creating a rebuttable presumption that the insurer suffered prejudice as a result of the delayed notice.[26] As one court explained, "[i]f the insured breaches the notice provision, prejudice to the insurer will be presumed, but may be rebutted by a showing that the insurer has not been prejudiced by the lack of notice."[27] This rebuttable presumption rule evolved "as a natural effort to properly balance the competing interests of insurer and insured, while recognizing the peculiar challenges of insurance law and maintaining the integrity of the contracts that create the underlying insurance obligation."[28] The competing interests of insurer and insured are readily apparent from the court decisions that have analyzed the rebuttable presumption rule. Courts rejecting this approach express a concern about requiring the insured to prove a negative—that the insurer was not prejudiced by the delayed notice.[29] In contrast, jurisdictions employing the rebuttable presumption version of the notice-prejudice rule are more concerned with principles of contract law and the insured's failure to comply with the notice provisions of the insurance contract. As the Supreme Court of Florida has explained:

> [The defendant] urges us to abandon the . . . presumption of prejudice rule as out of step with the modern trend requiring the insurer to show substantial prejudice resulting from the lack of notice. We decline to do so. A notice of accident in most insurance policies is a condition precedent to a claim. It was so designated in the policy in this case. Such a condition can be avoided by a party alleging and showing that the insurance carrier was not prejudiced by noncompliance with the condition. The burden should be on the party seeking an avoidance of a condition precedent.[30]

Thus, the rebuttable presumption version of the notice-prejudice rule may offer a significant advantage to the insurer asserting a late notice defense.

B. The No-Prejudice Rule

Some states still hold to the minority view of the late notice defense, which

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suffered actual prejudice"). In contrast, the "substantial prejudice" standard in Kentucky does not require a showing of actual prejudice. *Jones*, 821 S.W.2d at 803 ("[P]roof of actual prejudice is an unreasonable burden. We view the question of prejudice in terms of whether it is reasonably probable that the insurance carrier suffered substantial prejudice from the delay in notice.").

[26] 22 Holmes' Appleman on Insurance 2d § 139.4[C][1][b].

[27] *Bankers*, 475 So. 2d at 1218.

[28] 22 Holmes' Appleman on Insurance 2d § 139.4[C][1][b].

[29] *See* note 18 above and accompanying text. Courts have also reasoned that the insurer should bear the burden of proof because of the adhesive nature of the insurance contract and the harsh result that the insured would suffer as a result of a forfeiture of coverage. *See* Brakeman v. Potomac Ins. Co., 371 A.2d 193, 198 (Pa. 1977) ("In view of the facts that an insurance contract is not a truly consensual agreement, that what is involved is a forfeiture and it is the insurance company who chooses to disclaim its obligations under the policy, it is more equitable to place the burden of showing prejudice on the insurance company.").

[30] *Bankers*, 475 So. 2d at 1218.

allows an insurer to disclaim coverage where the insured has breached the policy's notice provision without regard to whether the insurer has suffered any prejudice as a result of the breach.[31] Courts that apply the no-prejudice rule generally find that an insurance policy's notice requirement is a condition precedent to coverage under the policy, and that the insured's failure to comply with the notice provision eliminates the insurer's coverage obligation even if the insurer was not prejudiced.[32] Application of the traditional no-prejudice rule does not necessarily defeat coverage as a matter of course where the insured has given delayed notice. Some courts in purporting to apply the no-prejudice rule still consider whether the insurer suffered prejudice as one of several factors when evaluating whether the insured's notice was reasonably prompt.[33]

C. Occurrence-Based Policies Versus Claims-Made Policies

While this article only addresses the notice-prejudice rule with respect to occurrence-based liability insurance policies, it is important to note that courts generally apply a no-prejudice approach with respect to claims-made policies.[34] Courts strictly construe notice requirements in claims-made policies because coverage is defined by the timing of the notice.[35] A recent New Hampshire decision explains this critical distinction between occurrence-based and claims-made policies:

> Claims-made policies provide liability coverage for claims that are made against the insured and reported to the insurer during the policy period. There is no requirement that an insurance company prove it was prejudiced due to lack of notice under a claims[-]made policy. This is because, unlike an occurrence policy in which coverage is triggered by the occurrence of a negligent act or omission during the coverage period, a claims[-]made policy provides coverage when the act or omission is discovered and brought to the attention of the insurer, regardless of when the act or omission occurred. Claims-made policies necessarily include a presumption that the insurer suffers prejudice when the insurer does not receive timely notice of the claim during the policy period, preventing the insured from seeking coverage under subsequent policies.[36]

Therefore, where late notice is an issue, the type of policy under which the insured

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[31] *See, e.g.*, Country Mutual Insurance Co. v. Livorsi Marine, Inc., 856 N.E.2d 338, 346 (Ill. 2006); Penn. Nat'l Mut. Cas. Ins. Co. v. Colyer-Lloyd, Inc., No. Civ.A. CV-93-AR-2627-E (N.D. Ala. Dec. 2, 1994) (applying Alabama law); Canadyne-Georgia Corp. v. Continental Ins. Co., 999 F.2d 1547 (11th Cir. 1993) (applying Georgia law); State Farm Fire & Cas. Co. v. Michael, 822 F. Supp. 575, 581 (W.D. Ark. 1993) (applying Arkansas law); State Farm Fire & Cas. Co. v. Scott, 372 S.E.2d 383, 385 (Va. 1988). *See also* Timothy S. Menter & Jeffrey W. Stempel, *The Status of the Notice/Prejudice Rule for Liability Insurance Claims in Nevada*, 15 Nev. Law. 10 (2007).

[32] 22 Holmes' Appleman on Insurance 2d § 139.4[A].

[33] *See Country Mutual*, 856 N.E.2d at 346 and discussion below at Section IV.D.

[34] 22 Holmes' Appleman on Insurance 2d § 139.8.

[35] *Id.*

[36] Bates v. Vermont Mut. Ins. Co., 950 A.2d 186, 190–91 (N.H. 2008) (quoting Bianco Prof. Ass'n v. Home Ins. Co., 740 A.2d 1051 (N.H. 1999)).

is seeking coverage may be outcome determinative.

III. NEW YORK'S ADOPTION OF THE NOTICE-PREJUDICE RULE

A. New York's Notice-Prejudice Statute

In July 2008, New York Governor David Paterson signed notice-prejudice legislation into law, "bringing New York into the mainstream with respect to establishing a 'prejudice' standard applicable to the late notice of claims."[37] The law, at least on a going-forward basis, reversed New York's no-prejudice rule, which had provided liability insurers a defense to coverage when the insured failed to strictly comply with policy provisions requiring prompt notice of a claim.[38] The new law requires that insurers be prejudiced by the late notice before denying a claim.[39] The statute's purpose is to avoid the "inequitable outcome [under the no-prejudice rule] with insurers collecting billions of dollars in premiums annually, and disclaiming coverage over an inconsequential technicality."[40]

An earlier version of the bill passed through both the New York House and Senate in 2007, but was vetoed by Governor Spitzer.[41] The 2008 legislation was supported by insurance agents' trade groups. One trade association, Professional Insurance Agents of New York State, contended that insurers' frequent denial of claims based on late notice "causes legal exposure for the agents and brokers who provided the policies under which claims are being denied" and "undue harm to New York insurance contract-holders."[42] Another group, Independent Insurance Agents and Brokers of New York, asserted that the new law would "correct a serious problem for insurance producers and their customers." The group explained that before the statute's enactment, insurance carriers would use their own guidelines for rejecting a claim due to late notice.[43] These procedures would vary from company to company and sometimes within one carrier, creating

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[37] Circular Letter No. 26 from Governor Paterson to All Authorized Property/Casualty Insurers; Rate Service Organizations; New York Medical Malpractice Insurance Plan; New York Automobile Insurance Plan; and Excess Line Association of New York (Nov. 18, 2008) (on file with author), available at http://www.ins.state.ny.us/circltr/2008/cl08_26.htm.

[38] *See* Argo v. Greater New York Mut. Ins., 827 N.E.2d 762 (N.Y. 2005).

[39] NY Ins. Law § 3420(a)(5).

[40] Helene E. Weinstein, New York State Assembly Memorandum in Support of Legislation, A.B. 11541, (June 13, 2008) (on file with author) available at http://public.leginfo.state.ny.us/bstfrmef.cgi.

[41] State of New York, Executive Chamber, Veto #98 (Aug. 1, 2007) (on file with author), available at http://ny.iiaa.org/Situation%20Room/veto_98.pdf.

[42] Letter from David Dickson, Professional Insurance Agents of New York State, President, to David Nocenti, Counsel to the Governor (July 25, 2007) (on file with author), available at www.piaonline.org/GIA/NY/NYGovsignbillS6306.pdf.

[43] Letter from Michael V. Barrett, Independent Insurance Agents & Brokers, Legislative Representative (July 16, 2008) (on file with author) available at http://ny.iiaa.org/Legislation/s8610ltr.pdf.

uncertainty for insurance producers and their clients when submitting claims.[44]

The new legislation took effect January 17, 2009, and applies to all occurrence-based liability policies, including renewals and excess policies, issued or delivered in New York on or after that date.[45] New York has long provided at least some protection to insureds with respect to notice by requiring every liability policy to provide that "failure to give any notice required by the policy within the time prescribed therein would not invalidate any claim if it could be shown not to have been reasonably possible to have given notice within the prescribed time, and that notice was given as soon as reasonably possible."[46] While this section remains, the new law also mandates insurers to include a policy provision stating that "failure to give any notice required to be given by such policy within the time prescribed therein shall not invalidate any claim made by the insured, injured person or any other claimant, unless the failure to provide timely notice has prejudiced the insurer."[47] According to the new statute, an insurer will not be deemed prejudiced "unless the failure to timely provide notice materially impairs the ability of the insurer to investigate or defend the claim."[48]

Whether the insured or the insurer has the burden of proof under this statute depends on when notice was given.[49] If the insured provides notice within two years of the time required under the policy, the insurer bears the burden of proving it was prejudiced by the untimely notice.[50] If the insured provides notice more than two years after the time required under the policy, the insured, injured person or other claimant bears the burden of proving that the insurer was not prejudiced.[51] Of significant note, if notice is not provided until after the insured's liability is established or the insured settles the case, there is an irrebuttable presumption of prejudice to the insurer.[52]

Not surprisingly, claims-made policies are exempt from the new provisions.[53] Insurers with claims-made policies may still require "that the claim shall be made during the policy period, any renewal thereof, or any extended reporting period."[54]

In addition to requiring proof of prejudice before an insurer disclaims coverage

[44] *Id.*

[45] Circular Letter No. 26.

[46] Circular Letter No. 26 (citing NY Ins. Law § 3420(a)(4)); *see also* U.S. Underwriter's Ins. Co. v. Ziering, No. 06-CV-1130 (JFB)(WDW), 2009 U.S. Dist. LEXIS 7077 (E.D.N.Y. Feb. 2, 2009).

[47] N.Y. Ins. Law § 3420(a)(5).

[48] N.Y. Ins. Law § 3420(c)(2)(C).

[49] N.Y. Ins. Law § 3420(c)(2)(A).

[50] *Id.*

[51] *Id.*

[52] N.Y. Ins. Law § 3420(c)(2)(B).

[53] N.Y. Ins. Law § 3420(a)(5).

[54] *Id.*

for late notice, the law allows plaintiffs suing for personal injury or wrongful death to bring a declaratory judgment action directly against the insurer to challenge denial of coverage based on late notice.[55] That section states:

> with respect to a claim arising out of death or personal injury of any person, if the insurer disclaims liability or denies coverage based upon the failure to provide timely notice, then the injured person or other claimant may maintain an action directly against such insurer, in which the sole question is the insurer's disclaimer or denial based on the failure to provide timely notice, unless within sixty days following such disclaimer or denial, the insured or the insurer: (A) initiates an action to declare the rights of the parties under the insurance policy; and (B) names the injured person or other claimant as a party to the action.[56]

Previously in New York, a plaintiff had a cause of action against an insurer only after a judgment against an insured remained unsatisfied for 30 days.[57]

Because the statute only applies to policies issued, renewed or modified on or after January 17, 2009, any claims based on policies issued prior to this date will continue to be governed by New York's common law rule that an insurer need not prove prejudice before denying coverage for late notice. For example, this means that the notice-prejudice provisions of the new law do not apply to long-tail liability claims that implicate historic insurance policies.

B. New York Notice Law Applicable to Pre-January 17, 2009 Insurance Policies

As noted above, before enacting the notice-prejudice statute, New York followed the no-prejudice rule. New York courts will presumably continue to generally apply this common law rule to claims under policies issued prior to January 17, 2009.[58] A 2005 New York Court of Appeals decision, *Argo v. Greater New York Mutual Insurance*, sets forth the policy reasons behind New York's historical no-prejudice rule.[59] In *Argo,* the court affirmed the long-standing rule in New York that commercial liability insurers need not show prejudice when denying coverage due to late notice of the occurrence, claim, or lawsuit.[60] The

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[55] N.Y. Ins. Law § 3420(a)(6).

[56] *Id.*

[57] Helene E. Weinstein, New York State Assembly Memorandum in Support of Legislation.

[58] The New York Court of Appeals has explained that although the no-prejudice rule is sometimes characterized as the "traditional rule," it is actually an exception to two contract principles:

> (1) that ordinarily one seeking to escape the obligation to perform under a contract must demonstrate a material breach or prejudice; and (2) that a contractual duty [requiring strict compliance] ordinarily will not be construed as a condition precedent absent clear language showing that the parties intended to make it a condition.

Rekemeyer v. State Farm Mut. Auto. Ins. Co., 828 N.E.2d 970, 974 (NY 2005) (quoting Unigard Sec. Ins. Co. v. North Riv. Ins. Co., 594 N.E.2d 571, 584 (N.Y. 1992)).

[59] *Argo*, 827 N.E.2d 762.

[60] *Id.* at 765.

case involved a pedestrian who filed suit after slipping on an icy sidewalk adjacent to a building managed, in part, by Argo.[61] Argo notified its insurer, Greater New York Mutual Insurance Company (GNY), 14 months after service of the lawsuit.[62] One month later, GNY disclaimed coverage, asserting that prompt notice was a "condition precedent" under the policy.[63] Argo's policy required notice "as soon as practicable."[64]

The trial court found that Argo had failed to comply with a condition precedent under the policy and the appellate court agreed.[65] Finding Argo's delay in giving notice to be unreasonable, the New York Court of Appeals assumed GNY was prejudiced, finding that "late notice of lawsuit in the liability insurance context is so likely to be prejudicial . . . as to justify the application of the no-prejudice rule."[66] The *Argo* court held that the insured had "the burden of establishing that the delay was not unreasonable."[67] The court stated that Argo's failure to notify GNY until 14 months after service of the lawsuit, was unreasonable as a matter of law and that "GNY was not required to show prejudice before declining notice."[68]

The court noted that New York strictly enforces insurance contracts requiring notice "as soon as practicable," for the following policy reasons: "strict compliance with the contract protects the carrier against fraud or collusion; gives the carrier an opportunity to investigate claims while evidence is fresh; allows the carrier to make an early estimate of potential exposure and establish adequate reserves and gives the carrier an opportunity to exercise early control of claims, which aids settlement."[69]

The *Argo* court further explained that it had recently applied the no-prejudice rule in the context of supplementary underinsured motorist insurance and excess insurance but declined to do so in the context of reinsurance.[70] Although Argo

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[61] *Id.* at 763.

[62] *Id.*

[63] *Id.* The court defined a "condition precedent" as "an act or event other than a lapse of time, which, unless the condition is excused, must occur before a duty to perform a promise in the agreement arises." *Id.* n.2.

[64] *Id.*

[65] *Id.* at 764.

[66] *Id.* at 765.

[67] *Id.*

[68] *Id.*

[69] *Id.* at 764 (citing *Unigard*, 594 N.E.2d 571; Sec. Mut. Ins. Co. of N.Y. v. Acker-Fitzsimons Corp., 293 N.E.2d 76 (N.Y. 1972)).

[70] *Id.* The *Argo* court noted that it had applied the no-prejudice rule in the context of supplementary underinsured motorist insurance (Matter of Metropolitan Prop. & Cas. Ins. Co. v. Mancuso, 715 N.E.2d 107, (N.Y. 1999); *cf.* Matter of Brandon (Nationwide Mut. Ins. Co.), 769 N.E.2d 810 (N.Y. 2002); *Rekemeyer*, 828 N.E.2d 970) and excess insurance (American Home Assurance Co. v. International Ins. Co., 684 N.E.2d 14 (N.Y. 1997)). *Id.* The court had declined to

contended that a 2002 case, *Matter of Brandon*, had abrogated New York's no-prejudice rule, the Court of Appeals disagreed, distinguishing the facts.[71] In *Brandon*, the insured timely notified the carrier of the claim but provided late notice of the lawsuit.[72] The *Brandon* court determined that prompt notice of the claim was more important than prompt notice of the lawsuit.[73] The court found that, while notice of the claim allowed the insurer an opportunity to timely investigate in order to curb fraud, "notices of legal action become due at a moment that cannot be fixed relative to any other key event, such as the injury, the discovery of the tortfeasor's insurance limits or the resolution of the underlying tort claim."[74]

Brandon represents a modest departure from a strict application of the no-prejudice rule. As the *Brandon* court explained:

> New York is one of a minority of states that still maintain a no-prejudice exception . . . . Formerly a majority of states took this approach, but, as the Supreme Court of Tennessee noted when it recently adopted a prejudice requirement in a case involving a late notice of claim for uninsured motorist coverage, "the number of jurisdictions that still follow the traditional view has dwindled dramatically". Indeed, that court noted that in the preceding 20 years, only two states-New York and Colorado-had "considered the issue" and "continued to strictly adhere to the traditional approach". Since then, Colorado adopted the majority rule, requiring insurers to demonstrate prejudice.
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> . . . . States often begin the shift to a prejudice requirement in the uninsured motorist context, where various policy considerations-the adhesive nature of insurance contracts, the public policy objective of compensating tort victims, and the inequity of the insurer receiving a windfall due to a technicality-are clearly implicated. The issue of whether New York should continue to maintain the no-prejudice exception when insurers assert late notice of claim as a defense is not before us.[75]

Rekemeyer v. State Farm Mutual Auto. Ins. Co.[76] is another New York case in which the court rejected a rigid application of the no-prejudice rule. In that case, the insured provided timely notice of the accident and the insurer undertook an investigation.[77] The court found that the notice was "sufficient to promote the valid policy objective of curbing fraud or collusion."[78] The court determined that "[u]nder these circumstances, application of a rule that contravenes general

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apply the no-prejudice rule in the context of reinsurance (*Unigard*, 594 N.E.2d 571).

[71] *Id.* at 765; Matter of Brandon, (Nationwide Mut. Ins. Co.), 769 N.E.2d 810 (N.Y. 2002).

[72] *Id.*

[73] *Id.*

[74] *Id.*

[75] *Brandon*, 769 N.E.2d at 813 n.3 (citations omitted).

[76] 828 N.E.2d 970 (N.Y. 2005).

[77] *Id.*

[78] *Id.*

contract principles is not justified" and required the insurer to establish prejudice "because it has the relevant information about its own claims-handling procedures and because the alternative approach would saddle the policyholder with the task of proving a negative."[79] The court specifically observed that "[t]here are important public policy issues that continue to arise both in federal and state courts which warrant a review of the no-prejudice exception, particularly when the insured has given timely notice of occurrence or claim."[80]

Notwithstanding *Brandon* and *Rekemeyer*, when the insured fails to notify the insurer of an accident or occurrence, or provides late notice of the same, *Argo's* no-prejudice reasoning appears to continue to control. In a case decided after New York's notice-prejudice statute was enacted, *Briggs Ave. LLC v. Ins. Corp. of Hannover*, the New York Court of Appeals applied the common law no-prejudice rule from *Argo* that "an insurer that does not receive timely notice in accordance with a policy provision may disclaim coverage, whether it is prejudiced by the delay or not."[81] In that case, the policyholder, Briggs, provided no notice to its insurer of an accident, occurrence or claim, and late notice of the lawsuit.[82] The insurance policy stated that the insured must notify the insurer of a claim or suit "as soon as practicable."[83] Briggs was unaware it was being sued until it received a motion of default judgment because the owner had failed to update its address with the Secretary of State.[84] The court stated "[w]hile this rule produces harsh results in some cases, it also, by encouraging prompt notice, enables insurers to investigate claims promptly and thus to deter or detect claims that are ill-founded and fraudulent."[85] The court noted that "[t]he legislature, weighing the competing interests at stake, has recently enacted legislation that strikes a different balance, more favorable to the insured, but that legislation has not yet become effective."[86]

It is worth noting that New York common law also applies prompt notice requirements for insurers disclaiming coverage. "An insurer must give written notice of disclaimer on the ground of late notice as soon as is reasonably possible

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[79] *Id.* at 974–75.

[80] *Rekemeyer*, 828 N.E.2d at 974. New York's lower courts have also applied the reasoning of *Brandon* and *Rekemeyer*, holding that "the late notice of legal action should not be given the same preclusive effect as late notice of claim without some showing of prejudice." City of New York v. Cont'l Cas. Co., 2005 N.Y. Slip Op. 9469, 4 (N.Y. App. Div. 1st Dep't 2005); *see also* American Transit Ins. Co. v. B.O. Astra Mgmt. Corp., 2007 N.Y. Slip Op. 3744, 1 (N.Y. App. Div. 1st Dep't 2007); American Transit Ins. Co. v. B.O. Astra Mgmt. Corp., 2006 N.Y. Slip Op. 26169, at 3 (N.Y. Sup. Ct. 2006).

[81] Briggs Ave. LLC v. Ins. Corp. of Hannover, 899 N.E.2d 947, 948 (N.Y. 2008).

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] *Id.* at 948–49.

[86] *Id.* at 949 (citations omitted).

after it learns of the accident or of grounds for disclaimer of liability[.]"[87] An insurer is deemed to have waived the late notice defense when it fails to disclaim coverage promptly and with specificity, when other defenses are asserted, and when "the insurer possesses sufficient knowledge (actual or constructive) of the circumstances" of late notice.[88] Waiver cannot be avoided "by a unilateral assertion in a disclaimer notice that it is reserving or not waiving a right to disclaim on other, unstated grounds."[89]

In short, while New York has enacted meaningful notice-prejudice legislation, it continues to follow the contours of its no-prejudice rule as set forth in *Argo*, *Brandon* and *Rekemeyer* with respect to policies issued prior to January 17, 2009.

IV. RECENT DEVELOPMENTS IN OTHER JURISDICTIONS

Courts in several states have recently rendered decisions addressing the issue of late notice. These decisions have generally followed the trend toward the notice-prejudice rule, with a few notable limitations.[90] For example, in 2008, the Supreme Court of Texas officially adopted the notice-prejudice rule, but also limited an insured's ability to prove as a matter of law that the insurer did not suffer prejudice.[91] The Supreme Court of Connecticut recently affirmed the notice-prejudice rule, but reiterated its minority position placing the burden on the insured to prove that the insurer was not prejudiced by the untimely delay.[92] The Supreme Court of Washington also affirmed that state's notice-prejudice rule, but declined to extend the rule to an insurer's claim for equitable contribution.[93] In contrast, Illinois has refused to follow the trend toward requiring prejudice for a late notice defense. A unanimous Supreme Court of Illinois recently embraced the no-prejudice rule, acknowledging that Illinois remained in the minority of states

[87] Estee Lauder Inc. v. OneBeacon Ins. Group, LLC, 2009 N.Y. Slip Op. 1313, 2 (N.Y. App. Div 1st Dep't Feb. 19, 2009) (quoting Matter of Firemen's Fund Ins. Co. of New York v. Hopkins, 666 N.E.2d 1354, 1355 (N.Y. 1996)).

[88] *Id.* (quoting State of New York v. Amro Realty Corp., 936 F.2d 1420, 1431 (2d Cir. 1991)).

[89] *Id.* (citing Hotel Des Artistes, Inc. v. General Accident Ins. Co. of Am., 9 A.D.3d 181, 185 (N.Y. App. Div. 1st Dep't), *leave to appeal dismissed*, 824 N.E.2d 52 (N.Y. 2004).

[90] Consistent with this trend, Colorado also joined the majority of jurisdictions and adopted the notice-prejudice rule in 2005, although this decision is several years old and is not discussed at length herein. *See* Friedland v. Travelers Indem. Co., 105 P.3d 639, 643 (Colo. 2005). For a further discussion of Colorado law on notice requirements and the *Friedland* decision, *see* David P. Hersh, *The Requirement for a Showing of Prejudice in Cases of Late Notice of Claim*, 30 Colo. Law. 83 (2001); Marilyn S. Chappell & Damian J. Arguello, *Liability Insurance: Notice-Prejudice After Friedland*, 35 Colo. Law. 71 (2006). Commentators have also recently opined that Nevada could be poised to join the majority and adopt the notice-prejudice rule. Timothy S. Menter & Jeffrey W. Stempel, *The Status of the Notice/Prejudice Rule for Liability Insurance Claims in Nevada*, 15 Nev. Law. 10 (2007).

[91] *See* Nat'l Union Fire Ins. Co. v. Crocker, 246 S.W.3d 603 (Tex. 2008); PAJ, Inc. v. The Hanover Ins. Co., 243 S.W.3d 630 (Tex. 2008).

[92] Nat'l Publishing Co. v. Hartford Fire Ins. Co., 949 A.2d 1203 (Conn. 2008).

[93] Mut. of Enumclaw Ins. Co. v. USF Ins. Co., 191 P.3d 866 (Wash. 2008).

that have refused to adopt a prejudice requirement for an insured's breach of a policy's notice provisions.[94] These decisions are discussed in further detail by jurisdiction below.

A. Texas

If there was any doubt regarding the applicability of the notice-prejudice rule in Texas, it was put to rest in 2008 with the decision in *PAJ, Inc. v. The Hanover Insurance Co.*[95] In *PAJ*, the Supreme Court of Texas expressly adopted the notice-prejudice rule, holding that "an insured's failure to timely notify its insurer of a claim or suit does not defeat coverage if the insurer was not prejudiced by the delay."[96]

PAJ recounts the history of the late notice defense in Texas.[97] In 1972, the Texas Supreme Court endorsed the minority no-prejudice rule, finding that an insured's failure to timely forward suit papers to his insurer precluded the insurer's liability irrespective of whether the insurer had suffered prejudice as a result of the delay.[98] The following year, the Texas State Board of Insurance responded to this decision by requiring a mandatory notice-prejudice endorsement to all Texas commercial general liability policies.[99] The endorsement prohibited forfeiture of coverage for an insured's untimely notice unless the insurer was prejudiced thereby.[100] The endorsement effectively overruled the no-prejudice rule in Texas, although no court had yet decided the issue.[101]

Two decades after implementation of this mandatory endorsement, Texas adopted a limited prejudice rule in *Hernandez v. Gulf Group Lloyds* with respect to settlements entered into by the insured without the insurer's consent.[102] In

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[94] Country Mut. Ins. Co. v. Livorsi Marine, Inc., 856 N.E.2d 338 (Ill. 2006).

[95] 243 S.W.3d 630 (Tex. 2008). Prior to *PAJ*, the Second and Fifth Circuits had applied the notice-prejudice rule under Texas law, and at least one treatise commented on Texas' apparent approval of the notice-prejudice rule. *See* Booking v. Gen. Star Mgmt. Co., 254 F.3d 414 (2d Cir. 2001); Hanson Prod. Co. v. Americas Ins. Co., 108 F.3d 627 (5th Cir. 1997); 22 Holmes' Appleman on Insurance 2d § 139.4[B].

[96] 243 S.W.3d at 636–37. For further discussion of *PAJ* and the notice-prejudice rule in Texas, *see* Randall L. Smith, Candace A. Ourso & Mollie Lambert, *Notice-Prejudice Under Texas Law*, 50 S. Tex. L. Rev. 207 (2008).

[97] *Id.* at 632–34.

[98] *Id.* at 632 (citing *Members Mut. Ins. Co. v. Cutaia*, 476 S.W.2d 278, 281 (Tex. 1972)); *see also* 22 Holmes' Appleman on Insurance 2d § 139.4[B].

[99] *PAJ*, 243 S.W.3d at 632.

[100] *Id.* Although the endorsement encompassed only bodily injury and property damage liability coverage, the court noted that, since October 2000, the Insurance Services Office version of Texas' mandatory endorsement has included a provision that requires a showing of prejudice for notice defects in personal and advertising injury claims. *Id.* at 633, n.1.

[101] *See* Booking v. Gen. Star Mgmt. Co., 254 F.3d 414, 420 (2d Cir. 2001) (after the mandatory endorsement was issued, "*Cutaia* was effectively overruled, and the prejudice rule was adopted.").

[102] 875 S.W.2d 691 (Tex. 1994).

Hernandez, the insurer denied liability because the insured violated the policy's "settlement-without-consent" exclusion by settling the underlying claim without obtaining the insurer's consent.[103] Noting the "fundamental principle of contract law" that a party is excused from performance when the other party commits a material breach of the contract, the court found that an insured's breach of a settlement-without-consent exclusion could not be material where the insurer suffered no prejudice as a result of the settlement.[104] Thus, the court concluded that "an insurer who is not prejudiced by an insured's settlement may not deny coverage under [a] . . . policy that contains a settlement-without-consent clause."[105] Following this decision, federal courts interpreting *Hernandez* suggested that Texas would adopt a notice-prejudice rule for insurers disclaiming coverage based on untimely notice.[106]

In *PAJ*, a divided Texas Supreme Court explicitly adopted a notice-prejudice rule. The policy at issue contained a prompt notice provision that required the policyholder (PAJ) to notify the insurer (Hanover) of a potential claim "as soon as practicable."[107] The parties disputed whether this prompt notice requirement created a covenant or a condition precedent.[108] PAJ argued that the notice requirement was a covenant, and that Hanover's performance would only be excused if PAJ's breach was material.[109] In turn, Hanover contended that its notice provision created a condition precedent, and PAJ's breach of the condition defeated coverage irrespective of whether Hanover suffered any prejudice as a result.[110] The court, however, found no need to determine whether the notice provision was a condition or a covenant because no such distinction was drawn in *Hernandez*.[111] Consistent with *Hernandez*, the court held that only a material breach of the notice provision could excuse Hanover's performance under the policy, and required a showing of prejudice for an insurer to defeat coverage on the basis of its insured's untimely notice.[112]

Four justices dissented, arguing in favor of the no-prejudice rule. Writing for the minority, Justice Willett contended that a policy's unambiguous notice provision was a condition precedent to coverage, the breach of which should

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[103] *PAJ*, 243 S.W.3d at 633.

[104] *Hernandez*, 875 S.W.2d at 691, 693.

[105] *Id.*

[106] *See* Booking v. Gen. Star Mgmt., 254 F.3d 414, 420–21; Hanson Prod. Co. v. Americas Ins. Co., 108 F.3d 627, 630–31 (5th Cir. 1997).

[107] 243 S.W.3d at 632.

[108] *Id.*

[109] *Id.*

[110] *Id.*

[111] *Id.* at 635.

[112] *Id.* at 632, 636–37.

provide the insurer a valid defense to coverage.[113] The dissent rejected the majority's characterization of *Hernandez*, claiming that the distinction between covenants and conditions was well established under Texas law and required a different outcome in this case.[114] Without deciding the issue, the majority doubted whether the notice provision was properly characterized as a condition precedent, noting that "where another reasonable reading that would avoid a forfeiture is available, we must construe contract language as a covenant rather than a condition."[115]

The dissent also acknowledged that Texas' 1973 mandatory endorsement effectively overturned the no-prejudice rule for bodily injury and property damage liability, and conceded it was unclear whether Texas now required the endorsement for personal or advertising injury coverage.[116] Yet the dissent's analysis declined to impose such an endorsement where none was present in the policy at issue.[117] In response, the majority argued that the dissent's construction of the policy created an absurd consequence whereby "identical policy language creates a condition precedent as to one type of coverage (advertising injury) but a covenant as to the other (bodily injury and property damage)."[118]

Despite the *PAJ* dissenters' concerns, the notice-prejudice rule won the day in Texas. A month after *PAJ* was decided, Justice Willett wrote for a unanimous court in *National Union Fire Ins. Co. v. Crocker*, again addressing the application of the notice-prejudice rule.[119] *Crocker* came to the Texas Supreme Court on certified questions from the Fifth Circuit.[120] Crocker, the plaintiff in the underlying tort claim, sued a nursing home and its employee, Richard Morris, for injuries she sustained when she was hit by a door swung open by the employee.[121] The nursing home was defended by its insurer, National Union.[122] Morris was an additional insured under the policy and National Union knew that he was a named defendant in the case, but National Union did not inform the Morris of the coverage or offer to defend him.[123] Morris did not separately inform National

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[113] *Id.* at 637.

[114] *Id.* at 642–43.

[115] *Id.* at 635–36.

[116] *Id.* at 641–42. The dissent notes that this determination would not bear on the outcome, since the policy was in effect no later than 1999, and the earliest Texas would have required the notice-prejudice rule endorsement for personal and advertising injury was October 2000.

[117] *Id.* at 641.

[118] *Id.* at 635.

[119] 246 S.W.3d 603 (Tex. 2008).

[120] *Id.* at 604.

[121] *Id.*

[122] *Id.*

[123] *Id.* at 604–05. National Union did attempt to contact Morris about the claims, but its mail was returned and its phone calls were ignored. *Id.* at 605. Morris spoke to Crocker's attorney at a

Union of the suit or request a defense.[124] The district court severed the claims against Morris, and he never answered the suit and failed to appear at trial.[125] The jury awarded a complete defense verdict for the nursing home, but the court entered a default judgment for $1 million against Morris.[126]

Crocker then sued National Union to collect the judgment against Morris. National Union argued that it had no duty to defend or indemnify Morris because he failed to comply with the policy's notice provision.[127] Crocker contended that National Union could not deny coverage based on the notice provisions because it had actual notice of the suit and thus could not have suffered prejudice as a matter of law.[128] The district court agreed with Crocker and awarded her $1 million, finding that National Union breached a duty to defend Morris by failing to notify him that it would accept a defense.[129] The district court also held that National Union had to show prejudice to succeed on its late notice defense.[130] National Union appealed, and the Fifth Circuit certified the following issues to the Texas Supreme Court: (1) does an insurer that has knowledge of a suit implicating coverage have a duty to inform its additional insured of coverage, and (2) does an insurer's actual knowledge of suit establish as a matter of law that the insurer did not suffer prejudice from an additional insured's failure to comply with the policy's notice provisions?[131]

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deposition but refused to speak with the nursing home's counsel. *Id.*

[124] *Id.* at 605.

[125] *Id.*

[126] *Id.* Interestingly, the court noted that the jury rejected Crocker's claim based on its finding that Morris did not act negligently. Thus, the default judgment was "directly contrary" to the jury verdict. *Id.* at 607 n.22.

[127] *Id.* at 605.

[128] *Id.* at 605–06.

[129] *Id.* at 606.

[130] *Id.*

[131] *Id.* at 606, 609. The Fifth Circuit specifically certified the following three questions to the Texas Supreme Court:

> (1) Where an additional insured does not and cannot be presumed to know of coverage under an insured's liability policy, does an insurer that has knowledge that a suit implicating policy coverage has been filed against its additional insured have a duty to inform the additional insured of the available coverage?
>
> (2) If the above question is answered in the affirmative, what is the extent or proper measure of the insurer's duty to inform the additional insured, and what is the extent or measure of any duty on the part of the additional insured to cooperate with the insurer up to the point he is informed of the policy provisions?
>
> (3) Does proof of an insurer's actual knowledge of service of process in a suit against its additional insured, when such knowledge is obtained in sufficient time to provide a defense for the insured, establish as a matter of law the absence of prejudice to the insurer from the additional insured's failure to comply with the notice-of-suit provisions of the policy?

Id. at 606, 608 n.30, 609. The Texas Supreme Court did not answer the second question because the

The court answered the first question in the negative, holding that "an insurer that has not been notified that a defense is expected bears no extra-contractual duty to provide notice that a defense is available to an additional insured."[132] Despite ruling in National Union's favor on this point, the court noted that an insurer may have a number of practical reasons to inform an additional insured of an available defense, such as avoiding an unnecessary judgment and subsequent litigation.[133]

The court then turned to National Union's notice defense, finding that National Union's actual knowledge of the suit against Morris did not estop the insurer from denying coverage based on Morris' failure to satisfy the policy's notice provision.[134] The court reasoned that this conclusion was compelled by its answer to the first question—since National Union had no duty to notify Morris of coverage or defend him until Morris notified National Union of the suit, National Union could not be liable to Crocker for the $1 million judgment.[135] As Justice Willett wrote, "[a]bsent a threshold duty to defend, there can be no liability to Morris, or to Crocker derivatively."

Justice Willett went on to distinguish *Crocker* from the court's month-old decision in *PAJ*.[136] *PAJ* required an insurer to show prejudice when denying coverage based on an insured's untimely notice.[137] Unlike the insured in *PAJ*, however, Morris did not give late notice; he never gave National Union any notice at all.[138] Finding that National Union's duty to defend was never triggered due to Morris' failure to notify, the court reasoned that an additional insured may have a variety of legitimate reasons for choosing not to notify or seek a defense from an insurer, including the possibility that the additional insured may wish to hire its own counsel to control its defense.[139]

B. Connecticut

Like most jurisdictions, Connecticut applies the notice-prejudice rule, requiring an insurer to suffer prejudice when denying coverage based on late notice.[140] Unlike most jurisdictions adopting the notice-prejudice rule, however, Connecticut places the burden on the insured to show that the insurer was not prejudiced

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first question was answered in the negative. *Id.* at 608 n.30.

[132] *Id.* at 608.

[133] *Id.*

[134] *Id.* at 609.

[135] *Id.*

[136] *Id.*

[137] 243 S.W.3d 630, 636–37.

[138] 246 S.W.3d at 609.

[139] *Id.* at 609–10.

[140] Aetna Cas. & Sur. Co. v. Murphy, 532 A.2d 219, 223 (Conn. 1988).

by the late notice.[141] The Supreme Court of Connecticut recently affirmed its notice-prejudice rule and this "uncommon system of burden allocation" in *National Publishing Co. v. Hartford Fire Ins. Co.*[142]

National Publishing, the insured, suffered a loss in early January 1995, when two employees stole company property and sabotaged the software that allowed it to fill large customer orders.[143] National Publishing was unable to operate without the software and the stolen property.[144] Shortly thereafter, National Publishing's president discovered that the company had insurance coverage through Hartford, so he called the company's broker and informed him of the loss.[145] The broker did not notify Hartford of the loss until March 1995, when he submitted the employee dishonesty claim.[146] Moreover, National Publishing did not inform Hartford of its claims for business interruption coverage until August 1995, months after several unsuccessful requests for information by Hartford.[147]

At trial, Hartford asserted a late notice defense.[148] Hartford asked the court to instruct the jury that, in order for National Publishing to recover, it must prove by a preponderance of the evidence that Hartford suffered no material prejudice due to the late notice.[149] The trial court declined to give Hartford's requested jury instruction on late notice defense, and the jury returned a verdict in favor of National Publishing.[150] On appeal, the Supreme Court of Connecticut remanded the case for a new trial, holding that Hartford's late notice instruction was warranted under Connecticut law and it was harmful error for the trial court to refuse the instruction.[151]

The court recognized that, under Connecticut law, an insured is presumed to

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[141] *Id.* at 224; Nat'l Publishing Co. v. Hartford Fire Ins. Co., 949 A.2d 1203, 1211 (Conn. 2008).

[142] Nat'l Publishing Co. v. Hartford Fire Ins. Co., 949 A.2d 1203 (Conn. 2008).

[143] *Id.* at 1206.

[144] *Id.* at 1206–07.

[145] *Id.* at 1207.

[146] *Id.*

[147] *Id.* 1208.

[148] *Id.* at 1208.

[149] *Id.* at 1209. Hartford's requested instruction provided, in part:

> The insured bears the burden of establishing compliance with notice provisions in an insurance policy, and proving the reasonableness of any time period elapsing between the trigger event and the giving of notice.
>
> If you determine that late notice was provided by [National] to . . . Hartford, then you must find that [National] breached the notice condition of [its] policy, and further, you must find that there is no coverage, unless you conclude that [National] has proven that there was no material prejudice to . . . Hartford as a result of the late notice. However, the burden of establishing lack of prejudice must be borne by the insured, who, in this case, is [National].

Id. at 1209 n. 5.

[150] *Id.* at 1208.

[151] *Id.* at 1215, 1218–19.

have complied with the terms of the policy unless the insurer places such compliance at issue.[152] Once the insurer has pled such a defense, the presumption is extinguished and the insured bears the burden of proving that it complied with the terms of the policy, including any notice provisions.[153] Connecticut first adopted this unusual burden-shifting mechanism in *Aetna Casualty & Surety Co. v. Murphy*.[154] *Murphy* followed a minority of notice-prejudice jurisdictions that have adopted a similar system of burden allocation by creating a rebuttable presumption that the insurer has suffered prejudice as a result of delayed notice.[155] The court explained its rationale for affirming the rule:

> In *Murphy*, we recognized that rigid application of the general rule discharging an insurer's liability when an insured has failed to comply with the notice provisions of the policy, without any initial inquiry into whether the insurer was prejudiced by the timing of the notice, would likely yield a " 'disproportionate forfeiture.' " Although we noted that most jurisdictions placed the burden upon an insurer to show prejudice before being discharged from liability due to an insured's late notice, we opted instead to place the burden on the insured to show that the insurer had not been prejudiced by the timing of the notice. In arriving at this rule, we balanced the competing principles of protecting an insured from disproportionate forfeiture and safeguarding an insurer's "legitimate interest in protection from stale claims." In this regard, we noted that "[t]he purpose of a policy provision requiring the insured to give the company prompt notice of an accident or claim is to give the insurer an opportunity to make a timely and adequate investigation of all the circumstances." In explaining why the insured should bear the difficult burden of proving lack of prejudice to the insurer, we noted that an insured who bears this burden has not provided timely notice, and, therefore, is "seeking to be excused from the consequences of a contract provision with which he has concededly failed to comply." Under the system of burden allocation we adopted in Murphy, then, a fact finder must engage in a factual inquiry into whether an insured was prejudiced by any delay in notice, and the "burden of establishing lack of prejudice must be borne by the insured."[156]

As this rationale suggests, jurisdictions that have adopted this "rebuttable presumption" form of the notice-prejudice rule have tried to find a "middle-ground" to lessen the impact of the notice-prejudice rule on insurers.[157]

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[152] *Id.* at 1210.

[153] *Id.* ("When a defendant pleads failure to comply with the terms of an insurance policy as a special defense, the usual presumption of compliance is extinguished, and the insured carries the burden of proving compliance with the insurance contract, including the conditions precedent to coverage.").

[154] 532 A.2d 219 (Conn. 1988).

[155] *Id.* at 224; *see also* 22 Holmes' Appleman on Insurance 2d § 139.4[C][1][b].

[156] *Nat'l Publishing*, 949 A.2d at 1211 (internal citations omitted).

[157] 22 Holmes' Appleman on Insurance 2d § 139.4[C][1][b] ("The shift from the *no-prejudice* rule to the *prejudice rule* placed a great and previously non-existent burden upon insurers when seeking to disclaim coverage obligations in response to breaches of contracts by their insureds. A

After affirming this version of the notice-prejudice rule, the court determined that Hartford suffered harmful error due to the trial court's failure to provide the requested instruction on late notice.[158] The court noted that questions of late notice involve particularly fact intensive inquiries, and that National Publishing would have to make a "difficult showing . . . to establish lack of prejudice to Hartford."[159] In fact, the only evidence National Publishing had offered to show Hartford's lack of prejudice was related to Hartford's delay in responding to the broker's March 1995 notice.[160] As a result, the court reversed the trial court's judgment and remanded the case for a new trial.[161]

Although *National Publishing* did not change the landscape of Connecticut law on late notice, the decision is significant because it cemented Connecticut's minority position that favors a weaker form of the notice-prejudice rule. Moreover, *National Publishing* underscores the importance of a proper jury instruction on late notice and the related burden of proof issue.

C. Washington

Washington's "late tender" rule is the equivalent of the notice-prejudice rule. The late tender rule provides that "an insurer must perform under the insurance contract even where an insured breaches the timely notice provision of the contract unless the insurer can show actual and substantial prejudice due to the late notice."[162] Washington has also adopted a "selective tender" rule, which provides that "where an insured has not tendered a claim to an insurer, that insurer is excused from its duty to perform under the policy or to contribute to a settlement of the claim."[163] The Supreme Court of Washington recently addressed the compatibility of these two rules in *Mutual of Enumclaw Ins. Co. v. USF Ins. Co.*[164]

In *Enumclaw*, two insurers that settled their insured's construction defect litigation brought equitable contribution and subrogation claims against USF, a

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number of jurisdictions have attempted to lessen that significant burden by creating a rebuttable presumption of prejudice in favor of the insurer, which presumption of prejudice is generally applicable when the insured unreasonably delays in providing the insurer with notice of occurrence. accident, claim or suit.").

[158] *Nat'l Publishing*, 949 A.2d at 1218–19.

[159] *Id.* at 1218.

[160] *Id.* Hartford did not inspect National's premises until September 1995. *Id.*

[161] *Id.* at 1219. Two justices dissented, arguing that the trial court's failure to give the late notice instruction was not harmful error because Hartford failed to establish that the outcome of the trial likely would have been different if the instruction had been given. *Id.* at 1222. The majority and dissent agreed, however, that the instruction was a proper statement of Connecticut law and should have been given. *Id.* at 1222 n. 10.

[162] Mut. of Enumclaw Ins. Co. v. USF Ins. Co., 191 P.3d 866, 871 (Wash. 2008) (citing Uniguard Ins. Co. v. Leven, 983 P.2d 1155 (Wash. Ct. App. 1999)).

[163] *Id.*

[164] 191 P.3d 866 (Wash. 2008).

third insurer that did not participate in the settlement.[165] The insured never tendered a claim to USF.[166] Instead, as part of the settlement, the insured assigned its rights against USF and other non-participating insurers to the settling insurers.[167] The settling insurers then sent a letter to USF demanding partial reimbursement for defense and indemnity costs.[168] This letter was the first time USF received notice of the claim.[169] USF moved for summary judgment based on the selective tender rule, arguing that it never had a duty to defend, indemnify, or contribute to a settlement because the insured never tendered a claim.[170] After the trial court and the appellate court reached differing conclusions,[171] the Supreme Court of Washington held that the selective tender rule barred the settling insurers' contribution claim, while the late tender rule applied to (and saved) their subrogation claim.[172]

With regard to the insurers' equitable contribution claim, the court noted that the relevant inquiry is whether the non-participating coinsurer had a legal obligation to provide a defense or indemnify the insured prior to the settlement.[173] Under Washington's selective tender rule, an insurer has no duty to perform under the policy where its insured has not tendered a claim.[174] Moreover, an insurer seeking contribution cannot tender a claim to another insurer on behalf of the insured.[175] Accordingly, the court concluded that "if the insured has not tendered a claim to an insurer prior to settlement or the end of the trial, other insurers cannot recover in equitable contribution against that insurer."[176]

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165 *Id.* at 870–71.

166 *Id.* at 870.

167 *Id.* at 871. Although the parties' did not dispute the assignment of rights, the court discussed the effectiveness of the assignment and indicated that the trial court should rule on the issue after determining whether the parties wished to present extrinsic evidence. *Id.* at 875 n.9.

168 *Id.* at 871.

169 *Id.*

170 *Id.*

171 The trial court granted USF's motion for summary judgment and denied the settling insurer's subrogation and equitable contribution claims. *Id.* The court of appeals reversed, concluding that the selective tender rule could not apply where there had been an assignment of rights. *Id.* Neither the trial court nor the court of appeals distinguished the subrogation and equitable contribution claims. *Id.*

172 *Id.* at 870.

173 *Id.* at 872 (citing Safeco Ins. Co. of Am. v. Superior Court, 140 Cal. App. 4th 874, 879 (2006)).

174 *Id.* at 871.

175 *Id.* at 873 ("[T]he insurer who seeks contribution does not sit in the place of the insured and cannot tender a claim to the other insurer.").

176 *Id.* The court also discussed why the late tender rule was not applicable to claims of equitable contribution. The rationale for the late tender rule provided that insurance "policies should operate to afford to affected members of the public . . . the maximum protection possible consonant with fairness to the insurer." *Id.* at 874. The court reasoned that the public policy concerns about

The court then turned to the subrogation claim. In contrast to contribution, an insurer asserting a subrogation claim "stands in the shoes of the insured."[177] When the settling insurers were assigned the insured's rights in the settlement agreement, they acquired the insured's right to make a late tender of the claim to other insurers.[178] Thus, the late tender rule applied to the insurers' subrogation claim, and USF was required to show actual and substantial prejudice in order to avoid liability for a portion of the settlement on a notice-based defense.[179] The court recognized that the rationale of the selective tender rule was inapplicable to a subrogation claim where the insured had given up its right to control tender by assigning its rights.[180] In fact, the court reasoned that the application of the selective tender rule would effectively devalue an assignment of rights.[181] If the selective tender rule barred a subrogation claim where the insured had failed to tender a claim to non-participating insurers, the assignment of rights would lose its value as a bargaining tool in the settlement process because it would not provide the settling insurers with any recourse against the non-participating insurers.[182] As a result, the court held that the settling insurers could pursue their subrogation claim against USF.[183]

At first blush, the *Enumclaw* decision appears to be internally inconsistent. With regard to the contribution claim, the court declared that the insurer has no right to tender the claim on behalf of the insured.[184] In contrast, with respect to the subrogation claim, the court held that an insurer seeking subrogation acquires the "right to late tender" when it is assigned the rights of the insured.[185] This apparent inconsistency is explained by the difference between the causes of action for contribution and subrogation. As discussed above, the claim of contribution is a right of the insurer, while the claim of subrogation is a right of the insured that is passed to the insurer by law or by contract. Thus, an insurer cannot tender a claim on behalf of an insured when seeking contribution, but an insurer can tender the insured's claim to a coinsurer when pursuing a subrogation claim. The

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protecting recovery for tort victims' are not present with respect to contribution claims because one or more insurers has already covered the loss. *Id.* Further, because each insurer agreed to cover the entire loss by issuing its policy, no insurer is harmed by the lack of contribution. *Id.*

[177] *Id.* at 874 (internal quotation omitted). The court distinguished between conventional subrogation, which arises by contract, and equitable subrogation, which arises by law. *Id.* In this case, the settling insurers had asserted a claim for conventional subrogation because they had received an assignment of rights from the insured. *Id.*

[178] *Id.* at 875.

[179] *Id.* at 875–76.

[180] *Id.* at 875.

[181] *Id.*

[182] *Id.*

[183] *Id.* at 876.

[184] *Id.* at 874.

[185] *Id.* at 875.

Enumclaw decision provides that, under Washington law, the insurer that acquires a subrogation claim obtains the benefit of the late tender rule. Accordingly, an insurer that wishes to pursue reimbursement from a coinsurer that never received tender of a claim should consider obtaining an assignment of the insured's rights against that coinsurer.

D. Illinois

In contrast to the decisions discussed above, Illinois is aligned with a minority of states that have not adopted a notice-prejudice rule. The Supreme Court of Illinois recently affirmed this minority position in *Country Mutual Ins. Co. v. Livorsi Marine, Inc.*[186]

Country Mutual involved two defendants, both of whom had obtained general liability policies from Country Mutual Insurance Company.[187] The insurance policies provided that the insured was required to notify Country Mutual of a claim or suit "as soon as practicable."[188] The two defendants had previously sued each other for trademark violations in December 1999, but neither defendant informed Country Mutual of the lawsuit until August 2001.[189] Thereafter, Country Mutual filed a declaratory judgment action against the two defendants, arguing that it had no obligation to defend or indemnify either defendant with respect to the trademark claims due to their breach of the notice provision.[190]

The defendants claimed that Country Mutual should not be relieved of its duty to defend because it was not prejudiced by the delayed notice.[191] In support of this argument, the defendants cited *Rice v. AAA Aerostar, Inc.*,[192] an Illinois Court of Appeals decision which held that "[w]hen notice of the lawsuit is the issue, the rule is that the insurer is required to show that it was prejudiced by the insured's omission or delay in order to escape liability on its policy."[193] Despite identifying a number of Illinois decisions that did not require an insurer to show prejudice in order to deny coverage based on an insured's breach of a notice of occurrence provision, the *Rice* court felt there was some uncertainty under Illinois law as to whether prejudice to the insurer must be shown before it is relieved of its duty to indemnify.[194] In *Rice*, the insurer disclaimed coverage because it had not received notice of the lawsuit, even though the insured provided notice of the occurrence

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[186] 856 N.E.2d 338 (Ill. 2006). For a further discussion of Illinois law on notice, *see* Helen Gunnarson, *Insureds Must Give Reasonable Notice of Claims or Suits to Insurers*, 94 Ill. B.J. 343 (July 2006).

[187] 856 N.E.2d at 339.

[188] *Id.* at 340.

[189] *Id.*

[190] *Id.*

[191] *Id.*

[192] 690 N.E.2d 1067 (Ill. App. Ct. 1998).

[193] *Id.* at 1072.

[194] *Id.* at 1071–72.

prior to the filing of the lawsuit.[195] The court distinguished between notice of an occurrence and notice of a lawsuit, reasoning that "[t]he purpose of notice of the occurrence is to enable the insurer to conduct a timely and thorough investigation of the insured's claim, while the purpose of notice of the lawsuit is to enable the insurer to locate and defend the suit."[196] Based on this analysis, the court applied a notice-prejudice rule to the insured's late notice of the lawsuit.[197] After *Rice*, courts interpreting Illinois law continued to differentiate between notice of an occurrence and notice of a lawsuit, recognizing that the notice-prejudice rule applied only to cases where the insured failed to timely notify the insured of a lawsuit.[198]

The *Country Mutual* decision expressly overturned *Rice* and rejected the notice-prejudice rule without regard to whether the case involved notice of an occurrence or notice of a lawsuit.[199] The Supreme Court of Illinois noted that, despite some inconsistencies, the majority of Illinois appellate decisions adhered to the analysis in *Simmon v. Iowa Mutual Casualty Co.*,[200] which provided that "lack of prejudice may be a factor in determining the question of whether a reasonable notice was given in a particular case yet it is not a condition which will dispense with the [notice] requirement."[201] *Simmon* further held that "[b]reaching a policy's notice clause by failing to give reasonable notice will defeat the right of the insured party to recover under the policy," without regard to the type of notice in dispute.[202] The *Country Mutual* court agreed and found no basis to distinguish between notice of an occurrence and notice of a lawsuit. Accordingly, the court rejected *Rice*, holding:

> [T]he presence or absence of prejudice to the insurer is one factor to consider when determining whether a policyholder has fulfilled any policy condition requiring reasonable notice. We also hold that once it is determined that the insurer did not receive reasonable notice of an occurrence or a lawsuit, the policyholder may not recover under the policy, regardless of whether the lack of reasonable notice prejudiced the insurer. To the extent that *Rice* and its progeny

[195] *Id.* at 1068.

[196] *Id.* at 1071.

[197] *Id.* at 1072.

[198] *See, e.g.*, *Country Mutual*, 856 N.E.2d at 345 (collecting cases); Zurich Ins. Co. v. Walsh Constr. Co. of Ill., 816 N.E.2d 801, 807–08 (Ill. App. Ct. 2004); Great W. Cas. Co. v. Rogers Cartage Co., No. 00 C 6221, 2001 U.S. Dist. LEXIS 20486, at *16 (N.D. Ill. Dec. 12, 2001)); *see also* Stanley C. Nardoni, *Illinois Adopts the "Modern" Prejudice Rule for Insurers' Late Notice Defense*, 87 Ill. B.J. 86 (Feb. 1999).

[199] *Country Mutual*, 856 N.E.2d at 346.

[200] 121 N.E.2d 509 (Ill. 1954).

[201] *Id.* at 511.

[202] *Id.* at 509. Under Illinois law, a policy condition requiring notice "as soon as practicable" means notice must be provided "within a reasonable time." *Country Mutual*, 856 N.E.2d at 343 (citing Barrington Consol. High Sch. v. Am. Ins. Co., 319 N.E.2d 25 (Ill. 1974)).

contradict our holdings, these cases are overruled.[203]

The court in *Country Mutual* therefore soundly repudiated *Rice* and the distinction between late notice of occurrence and late notice of a lawsuit, but declined the opportunity to explain why it departed from the majority of jurisdictions in retaining the no-prejudice rule. Although the defendants apparently relied entirely on *Rice* to argue for a notice-prejudice rule with respect to notice of a lawsuit, the defendants' amici asked the court to join the majority of jurisdictions and adopt the notice-prejudice rule with respect to all types of notice.[204] Without addressing the amicus briefs, the court responded that it was "not inclined to adopt a rule that the parties themselves have not requested."[205] It is unclear whether the court's reticence in this regard has any significance, but *Country Mutual* could be interpreted to invite other policyholders to argue in favor of the wholesale adoption of the notice-prejudice rule in Illinois. In the meantime, *Country Mutual* serves to clarify the late notice defense in Illinois by affirming the broad application of the no-prejudice rule.

V. CONCLUSION

The 2008 New York legislation and recent decisions in Texas, Connecticut, and Washington suggest that the modern trend toward a prejudice requirement continues unabated. However, states that have adopted the notice-prejudice rule have not done so with complete uniformity, and a few states, such as Illinois, have resisted the trend and maintained the minority no-prejudice approach.

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[203] *Country Mutual*, 856 N.E.2d at 346. *Country Mutual* has been described as an "unusual hybrid approach between the no-prejudice and notice-prejudice rules because it allows for consideration of prejudice as a factor when determining whether notice was reasonable. Timothy S. Menter & Jeffrey W. Stempel, *The Status of the Notice/Prejudice Rule for Liability Insurance Claims in Nevada*, 15 Nev. Law. 10, 11 n. 3 (2007).

[204] *Id.* at 347.

[205] *Id.* at 347.