BY NORMAN H. DACHS AND JONATHAN A. DACHS

Legislative Initiatives Regarding the 'No-Prejudice Rule'

Norman H. Dachs

Jonathan A. Dachs

One of the most significant recent developments in New York Insurance Law has been the gradual erosion of the "no-prejudice" rule—the well-established doctrine, unique to the state of New York,[1]—that an insured's failure to provide timely notice to an insurer relieves the insurer of its obligation to perform under its policy, regardless of whether the insurer can demonstrate prejudice.[2]

Although the "no-prejudice" rule had appeared to be sacrosanct for many years, beginning in 2002 the New York courts began a shift away from that doctrine, a position that has gained momentum in recent decisions.

As will be shown below, it appears that the courts have gone as far as they will go, and have stopped short of completely eviscerating the "no-prejudice" rule. Thus, as will also be shown, the plaintiffs'/insureds' bar has turned its attention and marshaled its forces towards the Legislature, seeking a legislative cudgel to complete the job.

Judicial Trend

The judicial erosion of the "no-prejudice" rule began in earnest in 1992, when the Court of Appeals, in *Unigard Security Ins. Co. v. North River Ins. Co.*,[3] held that the rule was inapplicable to the failure to comply with the prompt written notice requirement in a reinsurance contract. Under reinsurance policies, the insurer must demonstrate how it was prejudiced by the late notice it received, and may not rely upon a presumption of prejudice.

'Brandon'

Ten years later, in *Brandon v. Nationwide Mutual Ins. Co.*,[4] the Court of Appeals held, in the context of a claim for Supplementary Uninsured Motorists (SUM) benefits, where various policy considerations, such as "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 or may be implicated, and, more specifically, in the context of a claim of late notice of legal action (as opposed to late notice of the SUM claim or of the accident, where it had previously applied the "no-prejudice" rule) (see *Metropolitan Prop. & Cas. Ins. Co. v. Mancuso*[5]), the insurer must prove that it was prejudiced by the breach of the Notice of Legal Action condition.

'Argo/Rekemeyer'

It was not until three years after *Brandon* that the Court of Appeals again definitively addressed the "no-prejudice" rule, which it did in two cases decided on the very same day in April 2005.

In *Rekemeyer v. State Farm Mutual Auto. Ins. Co.*,[6] the Court held that the "no-prejudice" rule should be relaxed in SUM cases and, thus, "where an insured previously gives timely notice of the accident, the [SUM] carrier must establish that it is prejudiced by a late notice of SUM claim before it may properly disclaim coverage." As explained by the Court, although the idea behind strict compliance with the notice provisions in an insurance contract was to protect the carrier against fraud or collusion, under circumstances where the plaintiff gave timely notice of the accident and made a claim for no-fault benefits soon thereafter, the Court found that such notice was sufficient to promote the valid policy objective of curbing fraud or collusion. Under those circumstances, "application of a rule that contravenes general contract principles is not justified," and absent a showing of prejudice, the insurer "should not be entitled to a windfall." In addition, the Court further concluded, as it previously had done in *Brandon*, that the insurer should bear the burden of establishing 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."

However, in *Argo Corp. v. Greater New York Mutual Insurance Co.*,[7] a case involving a general liability insurance policy, the Court held that the general "no-prejudice" rule applicable to liability policies (as opposed to SUM policies) was not abrogated by *Brandon* and that *Brandon* should not be extended to cases where the liability carrier received unreasonably late notice of the claim. Insofar as the "rationale of the no-prejudice rule is clearly applicable to a late notice of lawsuit under a liability insurance policy," the Court held that a primary (liability) insurer need not demonstrate prejudice to disclaim coverage based upon a late notice of lawsuit.

More Recent Decisions

In several recent decisions, the courts have expanded the holdings in *Brandon* and *Rekemeyer* and applied them to other types of claims and defenses.

In *American Transit Ins. Co. v. B.O. Astra Management Corp.*,[8] the Supreme Court held that the rationale of *Brandon* applied in a non-SUM case. Thus, where the insurer was not only given timely notice of claim (as in *Brandon*), but it was also informed that counsel had been retained, and in response, the insurer stated that it would investigate the claim and provided counsel with the name of a claims adjuster; where the insurer was also the no-fault carrier and requested claimant to appear for an IME five weeks after the accident and followed up that request with three additional requests; and where the insurer received notice of the lawsuit before a default judgment had been entered (unlike *Argo*) and, indeed, could have prevented the default "but chose instead to allow the default judgment to be entered unopposed so that it could later avail itself of the 'no-prejudice' rule," the court held that the "no-prejudice" rule did not apply.

In a decision rendered on April 27, 2007, the First Department essentially affirmed the decision of the Supreme Court, modifying only to declare in the insured's favor, holding that "Having received timely notice of claim, plaintiff's

Norman H. Dachs *and* **Jonathan A. Dachs** *are with the firm of Shayne, Dachs, Stanisci, Corker & Sauer, in Mineola.*

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insurer was not entitled to disclaim coverage based on untimely notice of the claimant's commencement of litigation unless it was prejudiced by the late notice [citing *Rekemeyer* and *Brandon*], and such prejudice was not shown."[9]

In *New York Central Mutual Ins. Co. v. Davalos*,[10] the Second Department held that the rationale of the Court of Appeals in *Rekemeyer* was equally applicable to claims for uninsured motorist benefits made pursuant to a SUM endorsement as to underinsured motorist claims. Thus, where the insurer had been given timely notice of the accident and of the claim for no-fault benefits, but not timely notice of the uninsured motorist claim, the Court held that "since the petitioner has not claimed any prejudice arising from the late notice of the SUM claim, the court correctly determined that it is not entitled to a stay of arbitration on this ground" (citing and relying upon *Rekemeyer*).

By contrast, in *Assurance Company of America v. Delgrosso*,[11] where the insured failed to submit any notice of claim for over two years after the accident, one year and three months after he commenced a personal injury action, and 11 months after he learned of the tort feasor's policy limits, the court held that the insured's notice of claim was untimely, and that "since the insurer did not rely on the late notice of legal action defense [citing *Brandon*, supra] but, rather, it relied on a late notice under a SUM endorsement where the insured did not previously give any notice of the accident (cf. *Rekemeyer*...), there was no requirement for the insurer to demonstrate prejudice."

Proof of Claim

In *Nationwide Mutual Ins. Co. v. Mackey*,[12] the Third Department applied the rationale of *Rekemeyer* to a case involving a failure by the insured to complete and return a "Proof of Claim" form supplied by the insurer. As stated by that court, "The rationale in *Rekemeyer* applies here; as respondents' attorney supplied prompt written notice of the accident, made a claim for no-fault benefits and indicated that SUM coverage was implicated. Written notice regarding a SUM claim was repeated at least twice over the ensuing six months. Respondents forwarded to petitioner the police accident report of the accident, as well as the pertinent medical records. Petitioner does not deny receiving any of these various letters and documents from respondents. Petitioner failed to show any prejudice and, under the circumstances of this case, should not be permitted to disclaim SUM coverage."

More recently, in *New York Central Mutual Fire Ins. Co. v. Ward*,[13] another case involving the insured's failure to complete and return proof of claim forms supplied by the insurer, the Second Department followed *Nationwide v. Mackey*, supra, and held that "the notice of claim exception to the no-prejudice rule set forth by the court in *Rekemeyer* should now be extended to apply to proof of claim." Thus, because the record established that the insurer "substantially complied with the policy's notice and proof of claim conditions insofar as he supplied the petitioner with prompt written notice of the accident, an application for no-fault benefits, a sworn police accident report, and authorizations to obtain medical records," the court held that "the Facts, as in *Rekemeyer*, warrant a showing of prejudice by the insurance carrier."[14]

Legislative Initiatives

It was against this backdrop that legislation was proposed in June 2007 to, inter alia, amend the Insurance Law in relation to the timing for giving notice of a claim under insurance contracts, and, specifically, the elimination of the "no-prejudice" rule. While this particular piece of legislation, S. 6306 (and a companion Assembly bill) also included a proposed amendment to the CPLR in relation to declaratory judgment actions against insurers—allowing the injured party to commence a "DJ" action against the insurer before a judgment is obtained against the insured (effectively overruling *Lang v. Hanover Ins. Co.*[15]—for present purposes, discussion will be limited to the notice/prejudice aspects of the legislation).

Proposed Statutory Changes

As pertinent hereto, the bill proposed the addition of a new §3451, entitled "Notice of a claim for insurance coverage" and applicable "to all insurance coverage in the state issued pursuant to this article," (as distinct from claims arising under Article 51 of the Insurance Law ["No-Fault"]). Pursuant to that section, "an insurer subject to the provisions of this article shall not deny coverage for a claim based on the failure of an insured to give timely notice of a claim unless the [insurer] is able to demonstrate that it has suffered material prejudice as a result of the delayed notice." In

furtherance of its stated intention to confer a "benefit to an insured" and "to mitigate against the potential for procedural denial of insurance coverage resulting in unreasonable loss of insurance protection for claimants," the bill additionally provided that "Evidence that such insurer had knowledge of the accident, loss, injury or death that is the subject of the claim, including any communication from the claimant or the claimant's representative or health care provider, or from any other injured person or injured person's representative or health care provider, or from such insurer to the insured regarding the accident, loss, injury or death, shall create a rebuttable presumption that such insurer has not been prejudiced by delayed notice."

Governor's Veto

Although this bill was passed by the state Senate on June 20, 2007 and its companion bill was passed by the Assembly on June 21, 2007, the legislation was vetoed by Governor Eliot Spitzer on Aug. 1, 2007. Significantly, in his veto message, the governor made known that the only real problem he had with the proposed legislation was with the declaratory judgment provisions, about which he required more information. Governor Spitzer, however, referred to the notice/prejudice provisions as "important reforms" and stated that other than a question about the burden of proof, "if this bill merely permitted late notice of claim where there is no prejudice to the insurer, I would sign it."

Insurance Department

As has been written in another recent article in these pages,[16] "The governor appears to invite resubmission of a similar bill, at least with respect to a notice-prejudice standard." It is presumably with that in mind that the Insurance Department of the State of New York proposed, on Aug. 3, 2007, its own suggested statutory amendments for consideration by the Legislature.

The first of these adds a new provision to Ins. L. §3420 (a), which provides that, except with respect to a claims-made policy, the failure to give any notice required to be given by a liability policy issued or delivered in this state shall not invalidate any claim made by the insured, the injured person or any other claimant "unless the insurer demonstrates that the failure to provide timely notice has prejudiced the insurer's rights," which "shall not be deemed prejudiced unless the insurer demonstrates that such failure hampers or hinders the insurer's ability to effectively investigate, negotiate, settle or defend the claim." It appears that this provision is intended to apply to any notice under the policy, i.e., notice of the accident or occurrence and/or notice of the claim or suit.

In addition, the Insurance Department has proposed a new subdivision 5 to Ins. L. §3420 (a), which provides that "if the insurer disclaims liability or denies coverage based upon the failure to provide timely notice and if, within 180 days following such disclaimer or denial, the insured does not initiate an action against the insurer appealing such determination, an injured person or other claimant may maintain an action directly against the insurer on the sole question of whether the insurer's rights have been prejudiced...." This is an obvious attempt to more narrowly, and perhaps less objectionably, reverse the *Lang v. Hanover* holding and allow only limited prejudgment declaratory judgment actions by injured parties.

In a proposed amendment to Ins. L. §3420 (c), the burden of proof is assigned to the insurer to demonstrate prejudice from the late notice. In addition, this new provision states that if prejudice is not established by the insurer in the declaratory judgment action commenced by the injured party or other claimant on the issue of prejudice, that finding will be binding on all parties in a subsequent "DJ" action that might be brought by other parties on other coverage issues.

Other Aspects

There are other significant and potentially controversial aspects to the Insurance Department's proposal, which cannot be discussed in the limited space of this article. These include: (1) an amendment requiring an insurer to disclose, within 45 days of a request from an injured party or insured, whether or not the insurer issued a liability insurance policy and, if so, the limits of coverage for such party; and (2) an amendment to Ins. L. §3420 (d), the disclaimer statute, which eliminates the limitation to the applicability of that statute to actions involving "death or bodily injury arising out of a motor vehicle accident or any other type of accident occurring within this state," and thus appears to broaden the scope of the disclaimer rules to include property damage cases and out-of-state accidents.

It remains to be seen whether these proposed amendments "have legs" and whether they will make their way into legislation that is acceptable to both Houses of the state Legislature and to the governor. Clearly, though, "the game's afoot," and the winds of change are blowing.

1. As noted by Chief Judge Judith Kaye in footnote 3 of her decision in *Brandon v. Nationwide Mutual Ins. Co.*, 97 NY2d 491, 496 (2002): "New York is one of a minority of states that still maintain a no-prejudice exception (see Ostrager and Neuman, "Insurance Coverage Disputes §4.04" [11th ed])." 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." *Alcazar v. Hayes*, 982 SW2d 845, 850 [Tenn. 1998]. Indeed, that court noted that in the preceding 20 years, only two states—New York and Colorado—"continued to strictly adhere to the traditional approach" (id. at 853). Since then, Colorado adopted the majority rule, requiring insurers to demonstrate prejudice (see *Clementi v. Nationwide Mut. Fire Ins. Co.*, 16P3d 223, 230 [Colo 2002]).

2. See *Security Mut. Ins. Co. v. Acker-Fitzsimons Corp.*, 31 NY2d 436, 440 (1972). The "no-prejudice rule," which is based upon the notions that "the insurer [must have] an opportunity to protect itself" (id., 31 NY2d at 440), without timely notice "an insurer may be deprived of the opportunity to investigate a claim and is rendered vulnerable to fraud" (see *Power Authority v. Westinghouse Electric Corp.*, 117 AD2d 336, 339 [1st Dept. 1988]); and late notification may "prevent the insurer from providing a sufficient reserve fund" (id. at 339), constitutes a limited exception to two well-established rules of contract law:

> (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 ordinarily will not be construed as a condition precedent absent clear language showing that the parties intended to make it such.

See *Unigard Security Ins. Co. v. North River Ins. Co.*, 79 NY2d 576, 581 (1992); *Restoration Realty Corp. v. Roberto*, 58 NY2d 1089, 1091 (1983); 11 Williston, "Contracts, §1292," at 8 [3d ed.]; Restatement (Second) of Contracts, §237 (1979); *Manning v. Michaels*, 149 AD2d 897, 898 (3d Dept. 1989); *F.H.R. Auto Sales v. Scuitti*, 144 AD2d 956 (4th Dept. 1988); 22 NY Jur.2d, Contracts, §§234, 237.

3. 79 NY2d 576 (1992).
4. 97 NY2d 492 (2002).
5. 93 NY2d 487 (1999).
6. 4 NY3d 468 (2005).
7. 4 NY3d 332 (2005).
8. 12 Misc.3d 740 (Sup. Ct., N.Y. Co. 2006).
9. 39 AD3d 432 (1st Dept. 2007).
10. 39 AD3d 654 (2d Dept. 2007).
11. 38 AD3d 649 (2d Dept. 2007).
12. 25 AD3d 905 (3d Dept. 2006).
13. 38 AD3d 898 (2d Dept. 2007).
14. The court in *New York Central Ins. Co. v. Ward*, supra, also based its decision to deny the Petition to Stay Arbitration on the ground that the policy at issue contained a provision that imposed upon the insurer a requirement that it demonstrate prejudice as a result of an alleged breach of the notice and proof of claim conditions—"We have no duty to provide coverage under this policy if the failure to comply with the following duties is prejudicial to us...." This self-imposed duty was held to be binding upon the insurer.
15. 3 NY3d 350 (2004).
16. Bassis, Barry T., "Insurers Dodge Bullet in New York," NYLJ, Aug. 20, 2007, p. 2, col. 3.