BY NORMAN H. DACHS AND JONATHAN A. DACHS

Status of 'No Prejudice' and Direct Action Legislation

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In our column of Sept. 11, 2007 ("Legislative Initiatives Regarding the 'No Prejudice' Rule"), we discussed legislation that had been proposed in June 2007 to, inter alia, amend the Insurance Law in relation to the timing for giving notice of claim under insurance contracts, and, specifically, the elimination of the "no prejudice" rule—and to amend the CPLR in relation to declaratory judgment actions against insurers, specifically, allowing injured parties to commence such actions before they obtain a judgment against the insured.

As we noted therein, it was the stated intention of the Legislature, at least with respect to the "no prejudice" piece, 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."

Although this bill was passed by both houses of the state Legislature, it was vetoed by then-Governor Eliot Spitzer on Aug. 1, 2007. Notably, however, in his veto message, Mr. Spitzer indicated that his only problem with the legislation was with the declaratory judgment provisions, but that he considered the notice/prejudice provisions to be "important reforms," of which he was in favor.

Indeed, it was readily apparent that despite his veto, Mr. Spitzer actually invited resubmission of a similar bill, at least with respect to the notice/prejudice standard. Although on Aug. 3, 2007, the Insurance Department did exactly that, proposing its own suggested statutory amendments for consideration by the Legislature, which included:

(1) a requirement that, with respect to all liability policies, other than "claims made" policies, issued or delivered in this state, the insurer must demonstrate that the failure to provide timely notice has prejudiced the insurer's rights, i.e., that such failure hampered or hindered the insurer's ability effectively to investigate, negotiate, settle or defend the claim;

(2) the imposition of the burden of proof to establish prejudice on the insurer;

(3) the allowance of an injured party to commence an action directly against an insurer on the sole question of whether the insured's rights have been prejudiced if the insurer has disclaimed liability or denied coverage for late notice and the insured has not within 180 days thereafter commenced an action against the insurer;

(4) the requirement that 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, its coverage limits; and

(5) the elimination of the limitation of the applicability of the disclaimer statute, Ins. L. §3420(d), to actions "involving death or bodily injury."

That proposal did not make much progress towards becoming law.

In the interim, as we all know, there was a historic change in the leadership of the state, as Governor Spitzer resigned and was replaced by Governor David Paterson. Shortly after taking office, the new governor picked up the ball and carried it further, actually preparing and proposing his own legislative initiative for introduction to the Legislature.

The chief components of the Governor's Bill, which is intended to "protect[] individuals who suffer personal injuries, and families whose loved ones die as a result of tortious conduct," by prohibiting certain liability insurers from denying coverage for a claim for late notice unless the insurer suffers prejudice as a result of the delayed notice, and by permitting tort plaintiffs to bring declaratory judgment actions against insurers in certain circumstances to challenge the insurer's denial of coverage based on a late notice of claim (see Statement in Support of Governor's Program Bill #65), are summarized below:

Prejudice Requirement

The new legislation, in order to prevent insurers from denying coverage based upon an "inconsequential technicality" (see Statement in Support), and to eliminate the "extreme hardship placed on those who pay their premiums timely only to find at a time of need that their policy is not available" (id.), adds a new subdivision, §3420(a)(5), which is similar to previous drafts in that it provides 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, the injured party or any other claimant, unless the failure to provide timely notice has prejudiced the insurer" (with exceptions for "claims made" policies.)

'Prejudice' Defined

In a new §3420(c)(2)(C), the governor's draft includes the most limited definition of "prejudice" yet. While previous drafts provided, for example, that the insurer's rights would not be deemed prejudiced unless the failure to timely provide notice "materially impaired a significant interest of the insurer, including its ability to investigate the claim, negotiate a settlement, defend the claim or maintain adequate reserves," or "impair[ed] a significant interest of the insurer, including but not limited to, its ability to investigate the claim, negotiate a settlement; or defend a claim," the provision in the latest draft is narrower. It provides that "the insurer's rights shall not be deemed prejudiced unless the failure to timely provide notice materially impairs the ability of the insurer to investigate or timely defend the claim." The prior references to negotiation of settlements and maintenance of reserves have been omitted.

Burden of Proof

The new proposed legislation creates, in new §3420(c)(2)(A), a shifting burden of proof on the issue of prejudice. Pursuant thereto, in any action in which the insurer alleges that it was prejudiced as a result of late notice,

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the burden of proof to demonstrate prejudice shall be on the insurer "if the notice was provided within two years of the time required under the policy." The burden of proof is on the insured, the injured person or other claimant, however, "if the notice was provided more than two years after the time required under the policy." Moreover, pursuant to §3420(c)(2)(B), there will be an irrebuttable presumption of prejudice if, prior to notice, the insured's liability has already been determined by a court or arbitrator, or if the insured has resolved the claim or suit by settlement or other compromise.

Direct Actions

With respect to the direct action against an insurance company, the new proposed §3420(a)(6) allows, in wrongful death and personal injury actions only, that if the insurer disclaims liability on the ground of late notice, and the insurer or the insured has not commenced a declaratory judgment action within 60 days after denial, the injured person or other claimant may maintain an action directly against the insurer in which the sole question will be the validity of the insurer's late notice disclaimer or denial.

Confirm Coverage

Pursuant to a new §3420(d)(1), with respect to liability policies that afford coverage for bodily injury or wrongful death claims where the policy is a personal lines policy other than an excess or umbrella policy, within 60 days of receipt of a written request by an injured party or other claimant who has filed a claim or by another claim, an insurer must confirm in writing whether the insured had a liability insurance policy in effect with that insurer on the date of the occurrence, and the limits of coverage provided under that policy.

The bill further provides that if the insurer does not have sufficient information to identify such a policy, the insurer has 45 days from the initial request to ask for more information and then another 45 days after such information is provided to furnish the requested information. Pursuant to an amendment to Ins. L. §2601(a) ("Unfair Claim Settlement Practices"), the failure to comply with these disclaimer requirements may result in departmental sanctions, including financial penalties.

Absent From the Draft

One thing conspicuously absent from the proposed legislation, as noted by insurers, is any requirement that an insured, injured party or other claimant also demonstrate prejudice before relying upon a late notice of denial or disclaimer pursuant to Ins. L. §3420(d).

An insurer's denial or disclaimer will still be invalidated, even without any prejudice to the insured or injured party, if such denial or disclaimer is based upon policy exclusions and/or breaches of policy conditions.

This absence of a "quid pro quo" is deemed by some as a major flaw in the proposed law. Of course, by others, it is seen as a very positive feature of the bill.

Effective Date

According to its terms, the proposed bill would take effect 180 days after it is enacted into law, and shall then apply prospectively only, to policies issued or delivered in this state on or after such date and to any action maintained under such a policy. The proposed bill further provides that the Insurance Department is permitted to develop appropriate rules or regulations for the implementation of the new law, effective immediately.

As we were writing this article, we were advised that the Governor's Program Bill was approved by both houses of the Legislature, without amendment, on June 23, 2008. In view of the source of this new legislation, it is reasonable to assume that no veto will be forthcoming. Once this bill is signed into law, the rules of the game will have dramatically changed, as will the scope of future litigation in this particular area of insurance law.