

## NEW YORK STATE ENDS ADHERENCE TO NOTICE-PREJUDICE RULE

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New York has long maintained a reputation as a state with laws favorable to insurance companies. That distinction suffered a serious blow on July 21, 2008, when Gov. David A. Paterson signed a bill amending New York's Insurance Law to restrict the situations in which liability insurers can deny coverage based on policyholders' failure to provide timely notice of claims.

The new law also expands the ability of third parties to directly sue insurers to contest late-notice disclaimers and imposes new requirements on insurers to communicate information to these third parties. The new law takes effect on January 17, 2009 and applies to policies issued on and after that date.

### EXISTING LAW

Liability insurance policies typically require an insured to notify the insurer of a claim "as soon as practicable." "As soon as practicable" is interpreted to mean within a reasonable

time. *See, e.g., Security Mut. Ins. Co. v. Acker-Fitzsimons Corp.*, 31 N.Y.2d 436 (1972).

Traditionally, this requirement was considered a condition precedent to coverage and was strictly enforced. This meant that an insured's failure to provide notice within a reasonable period of time would not obligate its insurer to provide coverage, regardless of whether that untimely notice had any practical effect on the insurer's ability to investigate or defend the claim. Until the approval of the new legislation, New York subscribed to this approach. Under existing law, where a policyholder fails to provide timely notice, an insurer may deny coverage without proving that it was prejudiced as a result. *Argo Corp. v. Greater N.Y. Ins. Co.*, 4 N.Y.3d 332 (2005).

The majority view is that an insured's failure to provide requisite notice generally does not relieve an insurer of its duties unless the insurer can show that it suffered actual prejudice as a result. *See, e.g., Clemmer v. Hartford Ins. Co.*, 22 Cal.3d 865 (Cal. 1978); *Cooper v. Gov't Employees Ins. Co.*, 237 A.2d 870 (N.J. 1968); *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193 (Pa. 1977); *PAJ, Inc. v. Hanover Ins. Co.*, 243 S.W.3d 630 (Tex. 2008).

### CHANGES TO NOTICE REQUIREMENTS

Under the amended statute, failure to give notice within the time prescribed in the policy does 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. Ins. Law §3420(a)(5). Going forward, an insurer is prejudiced where the failure to provide timely notice

"materially impairs the ability of the insurer to defend or investigate the claim." Ins. Law §3420(c)(2)(C).

Exceptions exist where an insured fails to provide notice until after it has been found liable by a court or arbitrator or where the insured has settled a claim without first notifying the insurer. In those circumstances, an insurer will still be able to deny coverage without proving prejudice. Instead, the new law provides for an irrebuttable presumption that prejudice has occurred. Ins. Law §3420(c)(2)(B).

Where prejudice must be proven, the new law assigns the burden of proof. If notice is provided within two years of the time required under the policy, the insurer has the burden of proving it was prejudiced; if notice is provided more than two years after the time required under the policy, the burden is on the insured. Ins. Law §3420(c)(2)(A).

It appears that the prejudice requirement may also apply to claims-made policies, which comprise the majority of professional liability coverages. The new law states that a claims-made policy may require that the claim be made during the policy period, but it does not expressly state that an insurer may deny coverage for late notice under a claims-made policy without showing prejudice. Ins. Law §3420(a)(5). Some claims-made policies limit coverage to claims that are both made against the insured during the policy period and communicated to the insurer during the policy period ("claims-made and reported policies"). Many states hold that "claims-made and reported" policies are not subject to the notice-prejudice rule. *See, e.g., Burns v. Int'l Ins. Co.*, 929 F.2d 1422 (9<sup>th</sup> Cir. 1991); *Maynard v. Westport Ins. Corp.*, 208 F.

Supp.2d 568 (D.Md. 2002); *Pizzini v. American Int'l Specialty Lines Ins. Co.*, 210 F. Supp.2d 658 (E.D.Pa. 2002); *Zuckerman v. National Union Fire Ins. Co.*, 495 A.2d 395 (N.J. 1985). The new law's silence on this issue implies that even "claims-made and reported" policies are no longer immune from the prejudice requirement under New York law.

### NO QUID PRO QUO FOR INSURERS

Despite the institution of a prejudice requirement in favor of insureds, the new law imposes no similar requirement in favor of insurers.

Under existing law, an insurer must disclaim coverage "as soon as is reasonably possible." Ins. Law §3420(d)(2). Where an insurer fails to do so, it may be estopped from disclaiming coverage. *First Financial Ins. Co. v. Jetco Contracting Corp.*, 1 N.Y.3d 64 (2003). There is no requirement that the insured show that it was prejudiced by the timing of the insurer's disclaimer.

The new law does nothing to change this situation. Accordingly, while an insurer that receives untimely notice must now prove that it was prejudiced as a result, an insured that receives a late disclaimer will be covered regardless of whether the timing of the disclaimer had any effect on the insured's ability to investigate the claim or defend itself.

### THIRD PARTIES' DECLARATORY JUDGMENT ACTIONS

The new law has expanded the right of a third-party claimant to sue an insurer before obtaining a judgment against the insured. If an insurer disclaims based upon the failure to provide timely notice in a wrongful death or personal injury claim, the party who brought the claim against the insured may now maintain a declaratory judgment action directly against the insurer even without having obtained a judgment against the insured. CPLR §3001; Ins. Law §3420(a)(6). That action may address only the validity of the insurer's late-notice denial and cannot be brought if, within 60 days following the disclaimer, the policyholder or the insurer

files its own action naming the injured person as a party.

### REQUESTS TO CONFIRM COVERAGE

Insurers will now be required to provide information concerning coverage for injured claimants upon written request. For wrongful death or bodily injury claims under primary personal lines (e.g., homeowners) policies, the insurer must confirm to the injured person or other claimant in writing: (1) whether the insured had a liability insurance policy in effect with the insurer on the date of the alleged occurrence and; (2) the policy limits provided under the policy within 60 days of receiving a written request. Ins. Law §3420(d)(1)(B). An insurer's failure to comply with a request for this information will be deemed an unfair claims practice. Ins. Law §2601(a)(6).

### LIKELY AREAS OF LITIGATION

The amended Insurance Law leaves some gray areas that are likely to generate litigation. One question relates to application of the burden of proof. The burden will be assigned based on whether notice was provided more than or less than two years after the time required under the policy. Most policies do not require notice within a specified period of time but instead require notice "as soon as practicable," which is interpreted as a reasonable time under the circumstances. Expect disputes over when "the clock starts ticking" for purposes of determining the timeliness of notice.

The prejudice requirement itself will also be a focus of litigation. The amended law defines prejudice as "material impairment," but that term is not itself defined. Since the meaning of "material impairment" has not yet been litigated in New York, courts in the Empire State are likely to look to cases from other jurisdictions for guidance. As the intent of the notice requirement is to allow the insurer to investigate claims, a carrier may be prejudiced, for example, by its inability to interview witnesses, preserve evidence, reconstruct the accident, make an early settlement of the claim, or assert affirmative

defenses. See, e.g., *Northwestern Title Security Co. v. Flack*, 6 Cal. App. 3d 134, 142-143 (1<sup>st</sup> Dist. 1970); *Kermans v. Pendleton*, 62 Mich. App. 576 (1975); *Great Am. Ins. Co. v. C. G. Tate Constr. Co.*, 303 N.C. 387 (1981). Prejudice will be found where the delay "materially" impairs an insurer's ability to contest its liability to an insured or the liability of the insured to a third party. *West Bay Exploration Co. v. AIG Specialty Agencies*, 915 F.2d 1030, 1036-37 (6<sup>th</sup> Cir. 1990). In short, an insurer may establish prejudice by demonstrating that it was made worse off by a delay in receiving notice. See, e.g., *MacLean Townhomes, LLC v. Charter Oak Fire Ins. Co.*, 138 Wash. App. 186 (Wash. App. Div. 2007).

Finally, while an irrebuttable presumption of prejudice applies where an insured's liability has been judicially determined before notice is provided to the insurer, the statute does not explain what this means. For example, where a default has been entered against an insured but judgment has not yet been entered, has the insured's liability been determined? Insurers will contend that the default itself is a determination of liability and that any further proceedings in the case are for the assessment of damages, whereas policyholders will argue that liability has not been determined until judgment is entered.

### CONCLUSION

The purpose of the amendments is to make New York more consumer-friendly, bringing the state into line with the majority of jurisdictions that apply a notice-prejudice rule. While the revisions to the Insurance Law will reduce the number of late-notice disclaimers, the changes are apt to increase litigation over new issues. Should insurers be faced with a rise in legal costs associated with additional lawsuits, they likely will be forced to increase premiums, thereby blunting the pro-policyholder impact of the new law.

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