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Just How Late Is Too Late?

COURTS GIVE POLICYHOLDERS GREATER LEEWAY IN FILING 'TIMELY' CLAIMS

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"Late notice" is an uncomplicated phrase that, when applied in the context of insurance coverage, often elicits confusion and doubt. Indeed, the timely notice of claims is generally an express requirement of an insurance policy and fundamental to the efficient and predictable administration of claims. However, the modern trend by U.S. courts and legislatures has been to diminish "late notice" as a defense to coverage.

Specifically, numerous U.S. jurisdictions have moved away from strict enforcement of the requirement of timely notice (*i.e.,* failure to notify timely constitutes a forfeiture of coverage) to one that requires a showing of harm to the insurer before coverage is lost. Dubbed the "notice-prejudice" rule, the basic premise is that unless the insurer has been prejudiced by an insured's late notice, coverage will not be forfeited. As explained in more detail below, recent litigation and legislation from around the country has bolstered this trend and further obscured the viability of a late notice defense.

New York Amendment

For decades, New York law instructed that where an insurance policy required the insured to notify the insurer of an occurrence "as soon as practicable." The absence of timely notice constituted a failure to comply with a condition precedent which, as a matter of law, vitiates the contract. The burden was placed on the insured to show that the delay was not unreasonable (*i.e.,* that there was a reasonable excuse for the delay) and delays of less than 10 months and even as short as 29 days were routinely found to be unreasonable as a matter of law.

Recently, however, this longstanding common law tradition was obviated by legislation prohibiting liability insurers from denying coverage based on the policyholder's failure to provide timely notice unless the insurer was prejudiced by the late notice. Effective Jan. 17, 2009, Insurance Law 3420 now requires insurance companies to show prejudice as a condition to denying coverage based on late notice of claim if notice is provided within two years of the time it was due. If notice is provided more than two years after it was due, the insured must show a lack of prejudice.

Proponents of the bill argued that New York was in the minority of states requiring no showing of prejudice to deny coverage based on late notice and allowing insurers to deny coverage based on what they deemed "an inconsequential technicality." As amended, the statue only applies to policies issued on or after Jan. 17, 2009. Thus, over time, how the New York courts apply the statute and what constitutes "prejudice" to an insurer will dictate the ultimate impact of the statute on the viability of late notice claims in New York.

Claims-Made Policies

Equally unsettling for insurers is the Texas Supreme Court's recent decision in *Prodigy Communications Corp. v. Agriculture Excess & Surplus Insurance Co.* This 6-3 decision, written over a forceful dissent, instructs that under Texas law a claims-made policy provision requiring notice be given "soon as practicable" does not, in the absence of prejudice to the insurer, defeat coverage.

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Writing for the majority, Chief Justice Wallace B. Jefferson framed the question before the court as "whether, under a claims made policy, an insurer can deny coverage based on its insured's alleged failure to comply with a policy provision requiring that notice of claim be given 'as soon as practicable' when (1) notice of claim was provided before the reporting deadline specified in the policy; and (2) the insurer was not prejudiced by the delay."

After reviewing the role of the notice provisions within claims made policies generally, the court concluded that the insured's obligation to provide notice "as soon as practicable" was not a material part of the bargained-for exchange. Therefore, when an insured gives notice of a claim within the policy period or other specified reporting period, the insurer must show that the insured's noncompliance with the policy's "as soon as practicable" notice provision preju-

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diced the insurer before it may deny coverage. Notably, the majority did not consider it determinative that notice as "as soon as practicable" was identified in the policy as a "condition precedent" to coverage.

The majority opinion in *Prodigy* is further confirmation that the trend amongst U.S. courts is to apply the "no harm – no foul" principle to late notice coverage denials, regardless of the clarity of policy terms and the circumstances of the late notice.

'Notice-Prejudice' Rule

Early this year, the Sixth Circuit Court of Appeals predicted that the Kentucky Supreme Court would extend the "notice-prejudice" rule to the excess-liability context and instructed the District Court to reconsider whether a reasonable trier of fact could conclude that, with timely notice, there is a reasonable probability that the excess carrier would have achieved more favorable resolution of the underlying claim.

In so holding, the court considered the various factors identified by the Kentucky Supreme Court in *Jones v. Bituminous Casualty Corp.* – the fact that modern insurance policies are contracts of adhesion; the doctrine of reasonable expectations; the public policy underlying statutorily mandated insurance coverage; and the possibility of creating a windfall for insurers – and concluded that they weighed in favor of extending the "notice-prejudice" rule to excess liability insurance. Accordingly, the court found that to avoid coverage an excess insurer must show a reasonable probability that it was substantially prejudiced by the late notice. The court explicitly rejected the insurer's contention that prejudice should be presumed where notice is extremely late (between six and 16 years). Concurring in part and dissenting in part, Judge Martha Craig Daughtrey concluded that given the extreme lateness of notice, the court should impose a rebuttable presumption that the delay caused prejudice.

This policyholder-friendly decision is interesting in that it leaves unanswered more questions than it resolves. As an initial matter, the decision merely predicts the development of Kentucky law, thus whether the Kentucky Supreme Court will follow suit is yet to be seen. Further, Judge Daughtrey's dissent raises the possibility that in extreme late notice cases Kentucky courts will shift the burden of proving prejudice to the insured.

Looking Forward

The decisions and legislation discussed above illustrate the uncertainty and disorder of U.S. law regarding the viability of a late notice defense to coverage. Consequently, insureds and insurers alike must continue to be vigilant. Insureds must be careful to comply fully with all policy conditions or they may be found to have waived their rights to insurance coverage. Likewise, insurers must be aware of the law in each of the jurisdictions in which they issue policies to ensure a denial of coverage based upon an insured's noncompliance with a notice provision remains supported by the ever changing controlling law. ■