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The Continuing Shift Away from the "No-Prejudice" Rule

By Jonathan A. Dachs

One of the more interesting, and 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. (*See Security Mut. Ins. Co. v. Acker-Fitzsimons Corp.*[2]). Although the no-prejudice rule had appeared to be sacrosanct for many years, beginning in 2002 the courts of this state began a shift away from that doctrine, which has gained momentum in recent decisions.

Brandon

In *Brandon v. Nationwide Mutual Ins. Co.*,[3] 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 clearly implicated, and, specifically, in the context of a claim of late notice of legal action[4] (as opposed to late notice of the claim or of the accident), that the insurer must prove that it was prejudiced by the breach of the Notice of Legal Action condition. Although the court noted that it had previously applied the no-prejudice rule in cases where the insurer received late notice of the SUM claim itself (*see Metropolitan Prop. & Cas. Ins. Co. v. Mancuso*,)[5] the question presented in *Brandon* was different—"whether late notice of legal action should be given the same preclusive effect as late notice of claim." In discussing the rationale for its decision to create a limited exception to the no-prejudice rule, the *Brandon* court explained that "Generally, 'one seeking to escape the obligation to perform under a contract must demonstrate a material breach or prejudice'" (*Unigard Sec. Ins. Co. v. North River Ins. Co.*[6]). By allowing insurers to avoid their obligations to premium-paying clients without showing prejudice, *Security Mutual* created a limited exception to this general rule. The rationales for this limited exception include the insurer's need to protect itself from fraud by investigating claims soon after the underlying events; to set reserves; and to take an active, early role in settlement discussions (*see American Home Assur. Co. v. International Ins. Co.*[7]). In the SUM context, however, the court observed:

> While immediate notice of legal action may help SUM insurers to protect themselves against fraud, set reserves, and monitor and perhaps settle the tort actions, the notice of claim requirement serves this purpose.

Thus, the court concluded:

> Under these circumstances, and given the protection SUM insurers already enjoy by virtue of the notice of claim requirement and the clauses governing settlement, insurers relying on the late notice of legal action defense should be required to demonstrate prejudice. We place the burden of proving prejudice on

> the insurer 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.

Interestingly, although Chief Judge Judith Kaye specifically noted in her famous footnote in *Brandon* that "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," speculation began to build as to whether, in fact, the time had come for New York to join the rest of the country on that issue.

In *Mark A. Varrichio & Associates v. Chicago Ins. Co.*,[8] the Second Circuit Court of Appeals examined the scope and effect of *Brandon*—specifically, whether it was limited in its application to notice of suit provisions in SUM policies, or whether it applied to all notice of suit provisions and "marks the death of New York's traditional no-prejudice rule for notice of suit provisions where there has been a timely notice of claim." While the Second Circuit stated that if it were to decide the issue, it would likely conclude "that the general principles that the New York Court of Appeals adopted in *Brandon* suggest that the court would not apply the no-prejudice rule" in the situation where, in a non-SUM context, the insured complied with the notice of claim provision, but not the notice of legal action provision, insofar as that court could not be sure whether a shift to a general prejudice requirement was under way in New York, it certified the following question to the New York Court of Appeals:

> Where an insured has already complied with a policy's notice of claim requirement, does New York require the insurer to demonstrate prejudice in order to disclaim coverage based on the insured's failure to comply with the policy's notice of suit requirement?

While the Court of Appeals accepted that certified question,[9] the question, and, thus, the opportunity for Court of Appeals response, was subsequently withdrawn[10] because the case was settled by the parties.

Argo/Rekemeyer

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

In *Argo Corporation v. Greater New York Mutual Insurance Company*,[11] a case involving a general liability insurance policy, the court held that the general "no-prejudice" rule applicable to liability policies was not abrogated by *Brandon v. Nationwide Mutual Ins. Co.* 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.

However, in *Rekemeyer v. State Farm Mutual Auto. Ins. Co.*,[12] the court reexamined the applicability of the no-prejudice rule in the SUM context and held that the 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 the court explained in *Rekemeyer*, *supra*, although the idea behind strict compliance with the notice provisions in an insurance contract was to protect the carrier against fraud or collusion, under the circumstances of the *Rekemeyer* case, 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 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."

Recent Decisions Continue the Trend

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

As to notice of suit, in *New York Central Mutual Fire Ins. Co. v. Reinhardt*,[13] the court held that although the insured/claimant did not comply with the SUM endorsement requirement that she "immediately" forward the summons and complaint in her lawsuit against the tortfeasor to the SUM carrier—i.e., she breached the "Notice of Legal Action" condition—the carrier was required to show prejudice before relying upon that breach, pursuant to *Brandon*, but failed to do so.

In *American Transit Ins. Co. v. B.O. Astra Management Corp.*,[14] 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. Furthermore, the court held that even if the no-prejudice rule were to apply under the facts of this case, the claimant's counsel's letter to the insurer informing it that counsel had been retained and of potential claims against it satisfied the notice of lawsuit requirement because it served the notice requirement's function, as identified in *Argo*, *supra*, of allowing the insurer "to be able to take an active, early role in the litigation process and in any settlement discussions and to set adequate reserves."

In a decision rendered on April 26, 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 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."[15]

As to proof of claim, in *New York Central Mutual Ins. Co. v. Davalos*,[16] 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, in that case, where the insured had been given timely notice of the accident and of the claimant's 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*,[17] 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 tortfeasor'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 Forms

In *Nationwide Mutual Ins. Co. v. Mackey*,[18] the court 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.

In *State Farm Mut. Auto. Ins. Co. v. Rinaldi*,[19] the court reiterated the *Rekemeyer* rule, and held that although no prejudice had been demonstrated by the insurer, because *Rekemeyer* was decided after the Supreme Court's decision, the matter should be remanded "for the carrier to have an opportunity to demonstrate prejudice," if any. *See also Nationwide Mut. Ins. Co. v. Perlmutter*.[20]

More recently, in *New York Central Mutual Fire Ins. Co. v. Ward*,[21] 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 insured "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." The court determined that the insurer "demonstrated no prejudice in this matter stemming from the [insured's] failure to submit the proffered proof of claim form," and it "did not meet this burden of showing that [the insured's] failure to comply with his contractual duties was prejudicial to it," and, thus, denied the insurer's Petition to Stay Arbitration, even without a hearing (*contra Rinaldi*, *supra*).[22]

It remains to be seen whether the courts will continue to erode the "no-prejudice" rule further, until nothing of that traditional doctrine remains.

Endnotes

1. As noted by Chief Judge Kaye in footnote 3 of her decision in *Brandon v. Nationwide Mutual Ins. Co.*, 97 N.Y.2d 491, 496, 743 N.Y.S.2d 53, 55-56 (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.*, 16 P. 3d 223, 230 [Colo 2002]).

2. 31 N.Y.2d 436, 440, 340 N.Y.S.2d 902, 905 (1972).
3. 97 N.Y.2d 491, 743 N.Y.S.2d 53 (2002).
4. The standard SUM endorsement, prescribed by Regulation 35-D, 11 N.Y.C.R.R. § 60-2.3, *et seq.*, provides, in pertinent part, as follows: "Notice of Legal Action: If the insured or the insured's legal representatives bring any lawsuit against any person or organization legally responsible for the use of a motor vehicle involved in the accident, a copy of the summons and complaint or other process served in connection with the lawsuit shall be forwarded immediately to us by the insured or the insured's legal representative."
5. 93 N.Y.2d 487, 492-93, 693 N.Y.S.2d 81, 83-84 (1999).
6. 79 N.Y.2d 576, 584 N.Y.S.2d 290 (1992).
7. 90 N.Y.2d 433, 441-42, 661 N.Y.S.2d 584, 16-17 (1997); *Unigard*, 79 N.Y.2d at 581-582, 584 N.Y.S.2d at 292-293.
8. 312 F.3d 544 (2d Cir. 2002).
9. *See* 99 N.Y.2d 545 (2002), 753 N.Y.S.2d 805 (2000).
10. *See* 328 F.3d 50 (2d Cir. 2003); 100 N.Y.2d 527, 760 N.Y.S.2d 761 (2003).
11. 4 N.Y.3d 332, 794 N.Y.S.2d 704 (2005).
12. 4 N.Y.3d 468, 796 N.Y.S.2d 13 (2005).
13. 27 A.D.3d 751, 813 N.Y.S.2d 158 (2d Dep't 2006).
14. 12 Misc. 2d 750, 814 N.Y.S.2d 849 (S. Ct., N.Y. Co. 2006).
15. It is interesting to note that neither the Supreme Court nor the Appellate Division (39 A.D.3d 432, 835 N.Y.S.2d 106 (1st Dep't 2007)) in *American Transit v. B.O. Astra Management Corp., supra*, cited to or relied upon any of the pre-*Brandon* decisions in non-SUM cases, in which it was held or, at the very least, implied, that a showing of prejudice was required in order for the insurer to rely upon a breach of the notice of lawsuit provisions of its liability policy. *See Aetna Ins. Co. of Hartford, Conn. v. Millard*, 25 A.D.2d 341, 269 N.Y.S.2d 588 (3d Dep't 1966), a case involving a third-party liability policy, wherein the court noted that no prejudice had resulted to the insurer from its insured's failure to timely provide it with notice of the suit brought against him; *Melhado v. Catsimatidis*, 182 A.D.2d 576, 582 N.Y.S.2d 434 (1st Dep't 1992), also involving a liability policy, where the court specifically found that the insurer was prejudiced, i.e., "irreparably harmed," by the insured's failure promptly to forward the legal process served upon him; and *New York Mutual Underwriters v. Kaufman*, 257 A.D.2d 850, 685 N.Y.S.2d 312 (3d Dep't 1999), involving a homeowner's policy, where the court held that in the case of a failure to comply with the requirement to provide timely notice of suit, "late notice shall be excused where no prejudice has inured to the insurer." *But see Centennial Ins. Co. v. Hoffman*, 265 A.D.2d 629, 695 N.Y.S.2d 774 (3d Dep't 1999), where the insured did not forward the summons and complaint until 4½ months later, the court held that "since a policy's notice provision operates as a condition precedent, an insurer need not demonstrate prejudice to successfully assert the defense of non-compliance."
16. 39 A.D.3d 654, 835 N.Y.S.2d 247 (2d Dept. 2007).
17. 38 A.D.3d 649, 831 N.Y.S.2d 545 (2d Dep't 2007).
18. 25 A.D.3d 905, 808 N.Y.S.2d 797 (3d Dep't 2006).
19. 27 A.D.3d 476, 810 N.Y.S.2d 346 (2d Dep't 2006).
20. 32 A.D.3d 947, 821 N.Y.S.2d 53 (2d Dep't 2006).
21. 38 A.D.3d 898, 833 N.Y.S.2d 182.
22. The court in *New York Central Mutual 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.

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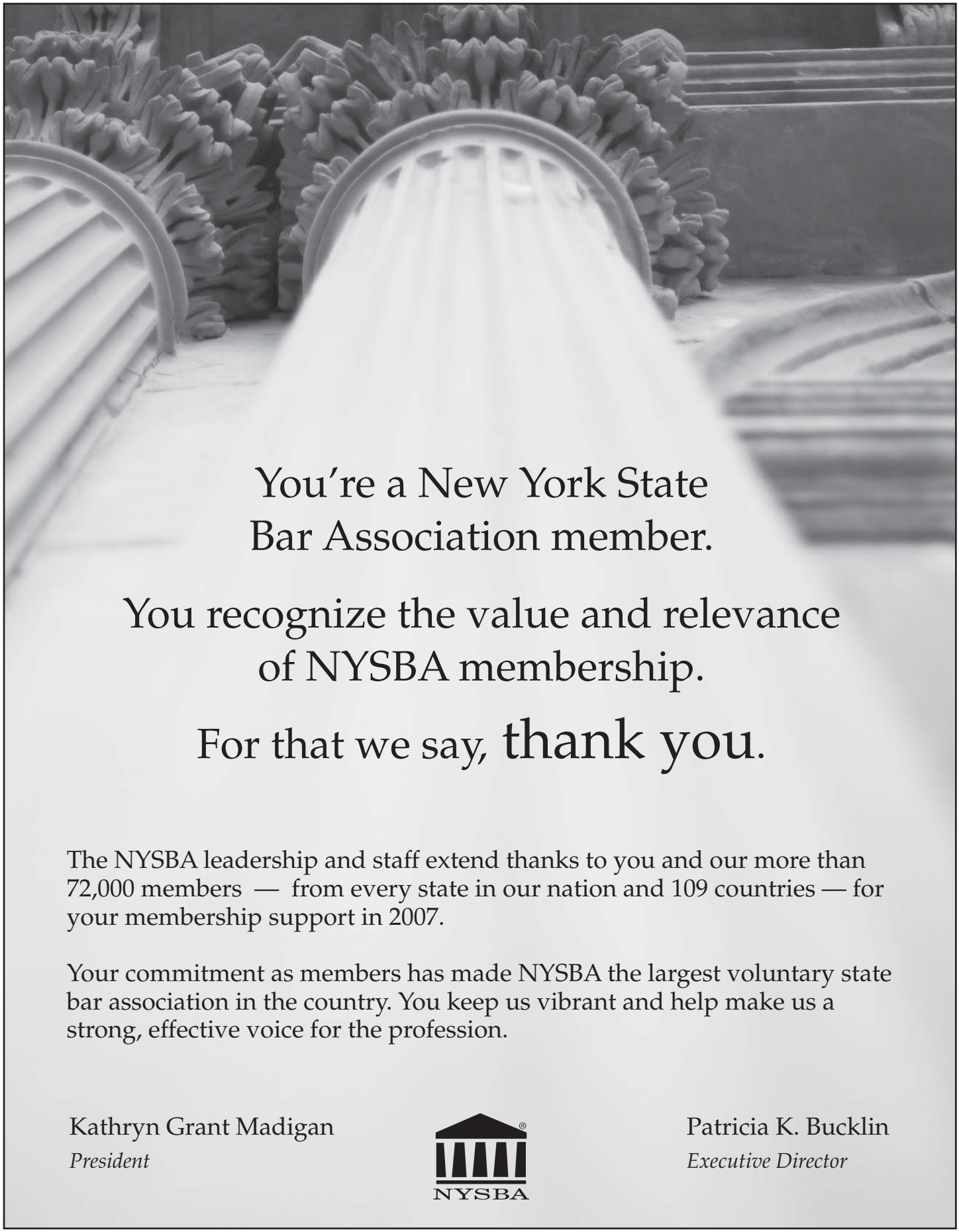

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