

NOTICE OF LEGAL ACTION AND THE REQUIREMENT OF PREJUDICE

In our last column (May 14, 2002), we briefly mentioned the Court of Appeals' April 30, 2002 decision in Brandon v. Nationwide Mutual Insurance Company, 97 NY2d 491, 743 NYS2d 53 (2002), dealing with one of the most important, but, perhaps, least recognized, notice provisions, applicable to both Uninsured and Supplementary Uninsured/Underinsured Motorist coverage -- the one entitled "Notice of Legal Action." As promised, we discuss that important decision in greater detail in this column

The Notice of Legal Action provision, which appears in one form or another in the old and new mandatory uninsured motorist endorsements,¹ and the pre- and post-Regulation 35-D Supplementary Uninsured Motorist Endorsements,² essentially requires the insured "immediately" to forward to the insurer "a copy of the summons and complaint or other process served" in connection with a lawsuit brought by the insured against the tortfeasor.

Despite the fact that compliance with the Notice of Legal Action provision constitutes a condition precedent to coverage, the breach of which may vitiate the policy, claimants and their attorneys have often ignored this provision, putting themselves at significant risk of vitiating otherwise available coverage. Fortunately, for them, insurers and their attorneys have also often overlooked this provision and its violation, and, as such, have failed to take advantage of an opportunity to deny or disclaim on an otherwise valid and effective policy.

Provision Applied

Over the past several years, the Notice of Legal Action condition has been applied to defeat the insured's claim for uninsured motorist benefits in numerous cases.³ In many other cases, insurers that have attempted to deny or disclaim coverage on the basis of a breach of the Notice of Legal Action condition have been precluded from doing so because they failed to comply with Ins. L. §3420(d)'s requirement of a timely written notice of denial or disclaimer.⁴

The "No-Prejudice" Rule

Perhaps the most interesting question that has arisen in the Notice of Legal Action context – and the issue addressed head-on by the Brandon Court – is whether an insurer that seeks to rely upon a breach of that condition must establish prejudice as a result thereof.

It is settled New York law that the notice of accident or claim provision of a primary insurance policy operates as a condition precedent and that the insurer need not show prejudice to rely upon the defense of late notice of accident or claim.⁵ This is because “the insurer [must have] an opportunity to protect itself”⁶; without timely notice “an insurer may be deprived of the opportunity to investigate a claim and is rendered vulnerable to fraud”⁷; and late “notification may . . . prevent the insurer from providing a sufficient reserve fund.”⁸

This “no prejudice” rule 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 prejudice⁹; 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.¹⁰

Given the exceptional nature of this rule, it might reasonably have been expected that the courts would narrowly apply it; *i.e.*, they would hold that the “no-prejudice” rule should not be applied where the specific reason therefor does not exist. Thus, for example, in *Unigard Security Ins. Co. v. North River Ins. Co.*,¹¹ the Court of Appeals held that the “no-prejudice” rule was inapplicable to the failure to comply with the prompt written notice in a reinsurance contract. Under such policies, the insurer must demonstrate how it was prejudiced by the late notice and may not rely upon a presumption of prejudice.

By the same logic, a reasonable argument may, therefore, follow that the “no prejudice” rule should also be inapplicable to the breach of the Notice of Legal Action provision because the reasons for that rule do not pertain to that separately stated and distinct type of notice. In *Lauritano v. American Fidelity Fire Ins. Co.*¹², the court compared the effect of a delayed notice of an accident to the consequences resulting from a delayed notice of suit. Therein, the court, in substance, stated that immediate notice of suit “is by no means of comparable value to the carrier” as prompt notice of the accident, the former being “less likely to cause irremediable harm.”¹³ As explained by the court, “It would be a rare occasion indeed when the carrier could not be placed in just as good a position as it would have enjoyed had the insured complied fully with his obligations.”¹⁴

Significantly, the *Lauritano* court was discussing notice to the insurer of legal papers served upon and received by the insured, pursuant to which the insurer would become obligated to undertake and impose a defense to its insured. By contrast, the Notice of Legal Action involved in UM and SUM cases is notice of legal papers served by the insured

upon another, for whom no defense obligations exist in the insurer. If the distinction exists between the notice of accident or claim and notice of legal action of the type involved in *Lauritano*, it would seem that, a fortiori, a distinction should exist between notice of accident or claim and notice of legal action of the UM/SUM variety. Unlike those cases involving notice of legal action served upon the insured, where prejudice may actually occur if, for example, the failure to provide notice of suit deprives the insurer of the opportunity to participate meaningfully in pre-trial discovery proceedings,¹⁵ under the UM/SUM scenario, it may be argued, there is and can be no such deprivation because the insurer has no direct role to play in the action against the tortfeasors.

Purpose of the Provision

The notice of legal action envisioned and required by the UM and SUM endorsements is for informational purposes and not for the purposes of investigation or defense. It is presumably for that reason that it is set forth in a separate and distinct section of the policy. There is no act or position which could be taken by the UM/SUM insurer which would change based upon the fact of the insured's/claimant's commencement of an action against the tortfeasors and/or the allegations of the pleadings in such action. Nor is there any particular investigation that would be prompted by receipt of the pleadings in such action that would not already have been prompted by prior notice of the accident and/or claim. Indeed, as noted by one court, "commencement of an action against the tortfeasor works to the ultimate benefit of the insurance company since recovery will avoid any claim against it"¹⁶) or, in some cases, will reduce the amount of the claim against it.

Modern Trend

In Aetna Ins. Co. v. Hartford, CT v. Millard,¹⁷ a case involving a third-party liability policy, 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. In Melhado v. Catsimatidis,¹⁸ also involving a liability policy, the court specifically found that the insurer was prejudiced, i.e., "irreparably harmed," by the insured's failure to promptly forward the legal process served upon him. More recently, in New York Mutual Underwriters v. Kaufman,¹⁹ involving a homeowner's policy, the court held that in the case of a failure to comply with the requirement to provide timely notice of suit, "late notice will be excused where no prejudice has inured to the insurer."

Indeed, it should be noted that there is a modern trend in a substantial number of jurisdictions away from the view that prejudice to a liability insurer is immaterial and/or to be presumed. Numerous cases in numerous states have held that in order to escape liability or the duty to defend on account of the insured's omission or delay in, inter alia, forwarding suit papers, the insurer is required to show that it was prejudiced by that delay. See 32 ALR 4th 141, "Modern Status of Rule Requiring Liability Insurer to Show Prejudice to Escape Liability Because of Insured's Failure or Delay In Giving Notice of Accident or Claim or in Forwarding Suit Papers," and cases cited therein.

UM/SUM Cases

Notwithstanding the foregoing, in the context of UM/SUM coverage, in Allcity Ins. Co. v. DiNoto,²⁰ the court specifically noted that the petitioner insurer had not shown

prejudice by not receiving immediate notice of the lawsuit commenced by the insured against the tortfeasor. The court further noted that “It would frustrate the purpose of Section 167, sub. 2-a of the Insurance Law [now §3420(f)(1)] to deny the claimant the right to correct the failure to give notice of the action against the tortfeasor.” In Snyder v. Nationwide Mut. Ins. Co.,²¹ in the context of an application by the insurer to vacate an arbitrator’s award against it, the court noted that insofar as the insurer was aware, prior to the arbitration hearing, of the existence of the action, “it cannot be deemed prejudiced by petitioner’s failure to so inform it, and, therefore, ”While we do not condone petitioner’s failure to immediately notify Nationwide of the commencement of his action, the arbitration award should not be vacated as a result thereof.”

However, more recently, in Allstate v. Kruger,²² the Second Department explicitly rejected the insured’s/claimant’s contention that in the absence of prejudice to the insurer, she did not breach her SUM policy. In the words of the court, “Contrary to Kruger’s contention, the absence of prejudice on the part of Allstate cannot cure her failure to forward a copy of the summons and complaint to Allstate as required under the policy.” Similarly, in Nationwide Mutual Ins. Co. v. Vivas,²³ the court held that “ the insurer need not show prejudice before it can assert the defense of noncompliance” with the Notice of Legal Action condition of the policy.

Brandon

It was against this backdrop that the Court of Appeals decided the Brandon case in April of this year.

In Brandon, the Court of Appeals, after noting that it has applied the “no-prejudice” exception when insurers have received late notice of SUM claims, addressed the question of “whether late notice of legal action should be given the same preclusive effect as late notice of claim.” The Court noted that the rationales for the “no-prejudice” exception included: “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,” and found that the same factors do not support “allowing insurers to evade their obligations, without showing prejudice, when insureds seeking SUM coverage provide late notice of legal action.” Specifically, the Court observed that “While immediate notice of legal action may indeed 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. More is required to justify extending the Security Mutual no-prejudice exception further.”

Notably, the Court specifically rejected as not sufficiently proven Nationwide’s contention that “personal injury claims that result in litigation are especially likely to involve ‘questionable injuries’ or fraud.” Moreover, the Court noted that the particular facts and details of the Brandon case did not help Nationwide’s position because there was no allegation of collusion between the claimant and the tortfeasor or his insurer, that Brandon settled without Nationwide’s permission, or that “Nationwide could have managed a better disposition of the claim if it had known of the tort action sooner.”

Finally, the Court noted that the insured’s action against the tortfeasor is a moment that “varies widely from case to case,” and that “unlike most notices of claim – which must be submitted promptly after the accident, while an insurer’s investigation has the greatest

potential to curb fraud – notices of legal action become due at a moment that cannot be fixed relative to any other key event, such as the injury, the discovery of the tortfeasor’s insurance limits or the resolution of the underlying tort claim. Contrary to Nationwide’s position, then, the timing of the notice of legal action requirement does little to make performance of this requirement stand out as an event that informs the insurer of its ‘ripened’ need to investigate, set reserves or take charge of settlement.”

Under the circumstances, the Court held that “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.” The Court felt comfortable placing the burden of proving prejudice upon 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.”

Conclusion

While it would certainly seem that the *Brandon* decision sounds the death knell of insurers’ reliance upon the breach of the Notice of Legal Action condition as a basis for denying or disclaiming SUM coverage, the Court did leave carriers one small glimmer of hope. The Court stated that “Possibly another insurer will show that a policyholder’s failure to deliver timely notice of action prejudiced it by hindering it from addressing this need [to investigate, set reserves or take charge of settlement].” It appears that it will take a very creative insurer to be able to make a valid and sufficient showing of prejudice in the UM/SUM context to justify a denial or disclaimer of coverage based upon an untimely

Notice of Legal Action. In the absence of facts to support such a showing, it is likely that Claimants and their attorneys will have one less thing to worry about inasmuch as fewer and fewer insurers will raise the breach of the Notice of Legal Action condition as a ground for denying or disclaiming coverage, or for staying arbitration in the future.

Still, it is good practice and should be made a matter of routine for claimant's/insured's attorneys to ensure that copies of the summons and complaint are forwarded to the UM/SUM insurer as soon as possible, and thus, leave it to "someone else's case," as Professor Siegel likes to say, to test the issue. Since in most cases, especially those involving underinsured motorist coverage, the lawsuit will have been commenced against the tortfeasor before the claim is made against the SUM insurer, a copy of the pleadings in that action should be sent to the SUM insurer at the same time as, and together with, the initial notice of claim. In cases in which the UM/SUM insurer has been put on notice before any action has been commenced against the tortfeasor, the practice should be to send the UM/SUM insurer a copy of the summons and complaint at the same time as those pleadings are served or filed.

ENDNOTES

1. As set forth as Condition 4 in the old, mandatory uninsured motorist endorsement, i.e., the New York Motor Vehicle Accident Indemnification Endorsement, applicable from 1959 through August 31, 1996, that provision reads as follows: "If, before the company makes payment of loss hereunder, the insured or his legal representative shall institute any legal for bodily injury against any person or organization legally responsible or the use of an automobile involved in the accident, a copy of the summons and complaint or other process served in connection with such legal action shall be forwarded immediately to the company by the insured or his legal representative."

As set forth as Condition 5, in the Revised Uninsured Motorist Endorsement -- New York, effective, September 1, 1996, the provision reads as follows: "If the insured or such insured's legal representative brings any lawsuit against any persons or organizations legally responsible for the use or 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."

2. As set forth as Condition 4 of Regulation 35-D's SUM endorsement, the provision reads as follows: "If the insured or insured's legal representative brings any lawsuit against any persons or organizations 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."

3. See Brown v. MVAIC, 33 AD2d 804 (2d Dept. 1969) (copies of summons and complaint never forwarded to UM carrier); Preferred Mutual Ins. Co. v. Sullivan, 199 AD2d 719 (3d Dept. 1993) (copies of summons and complaint forwarded to SUM carrier more than two years following the institution of legal action); Shutter v. Nationwide Mutual Ins. Co., 205 AD2d 817 (3d Dept. 1994) (failure to immediately forward copies of summons and complaint); Lumbermens Mutual Cas. Co. v. Moyler, 211 AD2d 401 (1st Dept. 1995) (copies of summons and complaint not forwarded to UM insurer until three years after action commenced); Allstate Ins. Co. v. Kruger, 264 AD2d 443, 694 NYS2d 132 (2d Dept. 1999) (failure to forward a copy of the summons and complaint); Nationwide Ins. Co. v. Lukas, 264 AD2d 778, 695 NYS2d 132 (2d Dept. 1999) (delay of approximately 2½ years in forwarding copies of summons and complaint to insurer); Nationwide Ins. Co. v. Shedlick, 274 AD2d 519, 711 NYS2d 181 (2d Dept. 2000) (delay of approximately 2 ½ years in forwarding copies of pleadings to insurer); Nationwide Mut. Ins. Co. v. Charles, 275 AD2d 324, 712 NYS2d 578 (2d Dept. 2000) (9 month delay).

4. See Merchants Mutual Ins. Co. v. Falisi, ___ AD2d ___, 741 NYS2d 273 (2d Dept. 2002); Valley Forge Ins. Co. v. Schofield, 283 AD2d 507 (2d Dept. 2001); Hess v. Nationwide Mut. Ins. Co., 283 AD2d 507 (2d Dept. 2001).

5. See Security Mut. Ins. Co. v. Acker-Fitzsimons Corp., 31 NY2d 436, 440 (1972); White v. City of New York, 81 NY2d 955 (1993).
6. See Security Mut. Ins. Co. v. Acker-Fitzsimons, *supra*, 31 NY2d at 440.
7. See Power Authority v. Westinghouse Elec. Corp., 117 AD2d 336, 339 (1st Dept. 1986).
8. Id. at 339; see also Security Mut. Cas. Co. v. Century Cas. Co., 531 F.2d 974, 978 (prompt notice permits the primary insurer to make an early estimate of potential exposure, to investigate the claim while witnesses and facts are available, and to take steps to prevent fraud).
9. See Unigard Security Ins. Co. v. North River Ins. Co., 79 NY2d 576, 581, 584 NYS2d 290 (1992); Restoration Realty Corp. v. Robero, 58 NY2d 1089, 1091 (1983); J.N.A. Realty Corp. v. Cross Bay Chelsea, 42 NY2d 392, 395 (1977); American Power Indus. v. Rebel Realty Corp., 145 AD2d 454 (2d Dept. 1988); 11 Williston, Contracts, §1292, at 8 [3d ed.]; Restatement [Second] of Contracts, §237 (1979).
10. See Manning v. Michaels, 149 AD2d 897, 898 (3d Dept. 1989); F.H.R. Auto Sales v. Scutti, 144 AD2d 956 (4th Dept. 1988); 22 NYJur.2d, Contracts, §§234, 237). See Unigard Security Insurance Co. v. North River Ins. Co., *supra*.
11. 79 NY2d 576 (1992).
12. 3 AD2d 564 (1st Dept. 1957) affd. 4 NY2d 1028 (1958).
13. 3 AD2d at 571.
14. Id.
15. See e.g., Melhado v Catsimitidis, 182 AD2d 576 (1st Dept. 1992).
16. Allcity Ins. Co. v. DiNoto, 80 Misc.2d 1022 (Sup. Ct. N.Y. Co. 1975).
17. 25 AD2d 341 (3d Dept. 1966).
18. 182 AD2d 576 (1st Dept. 1992).
19. 257 AD2d 850 (3d Dept. 1999). But see, Centennial Insurance Co. v. Hoffman, 265 AD2d 629, 695 NYS2d 774 (3d Dept. 1999), where the defendant did not forward the summons and complaint served upon him 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.”

20. 80 Misc.2d 1022 (Sup. Ct. N.Y. Co. 1975).
21. 106 AD2d 388 (2d Dept. 1984).
22. 694 NYS2d 132 (2d Dept. 1999).
23. 267 AD2d 105, 699 NYS2d 410 (2d Dept. 1999).