LATE IS ENOUGH – OR NOT: ANALYZING THE NOTICE-PREJUDICE RULE

Charles Lemley and Kimberly Ashmore

A BRIEF DISCUSSION OF THE NOTICE-PREJUDICE RULE

Most insurance policies – including both claims-made and occurrence policies – require that notice of a claim be given within a specified period of time, typically, "as soon as practicable," or a similar formulation. Insureds have convinced some courts, legislatures, and regulatory bodies that strict application of timely notice requirements results in an inequitable "gotcha" situation for the insured, where its delay in notifying the carrier of a claim was the result of unavoidable circumstances or simply an innocent mistake. As a result, many jurisdictions have adopted rules requiring that an insurer must be prejudiced by the insured's late notice in order to deny coverage based on the insured's untimely reporting. These requirements often are referred to as "notice-prejudice rules."

This article explores the various kinds of notice-prejudice rules that exist in different jurisdictions, how the rules vary depending on whether the policy is a claims-made or occurrence policy, and the kinds of factors courts generally have examined in order to find that an insurer was (or was not) prejudiced by the insured's untimely notice.

Although the law varies from one jurisdiction to the next, generally, the insured bears the burden of proving that proper notice of a claim was given, and constructive or verbal notice to the insurer usually will not suffice where the policy requires written notice. That said, where the insured does not provide notice in accordance with the policy's terms, but the insurer is shown to have actual or constructive knowledge of the claim, that fact can weigh against the insurer in analyzing whether it has been prejudiced by the insured's failure to comply with the policy's notice requirements.

Timely reporting of claims is especially important in connection with claims-made policies. Claims-made policies[1] typically feature three types of notice provisions. First, notice generally must be given within a "reasonable time," a requirement that is similar to the notice provision included in a typical occurrence policy. Second, notice must be given no later than the end of the policy period in which the claim is made, or within some specified grace period (often 30-60 days) thereafter. Third, claims-made policies typically provide that, if the insured gives notice during the policy period of a claim, or of facts or circumstances that may later give rise to a claim, a subsequent claim arising out of the same or related facts or circumstances will be deemed to have been first made during the policy period when the insured gave the initial notice. This holds true, even where notice of the later claim is provided months or even years after that policy period has expired.

[1] Claims-made policies that require reporting during the policy period or grace period are sometimes referred to as "claims-made and reported" policies. We do not use that description here because, in practice, we have found that policies do not always fall neatly into "claims-made" vs. "claims-made and reported" categories.

Both claims-made and occurrence policies often specify that timely reporting of claims is a condition precedent to coverage. In the case of claims-made policies, the requirement is considered a fundamental element of the insurance contract, and it typically is included in the policy's insuring agreement. Failure to provide timely notice – especially failure to provide notice within the policy period or grace period of a claims-made policy – can result in a loss of coverage regardless of whether the insurer is prejudiced by the delay in giving notice.[2] But, as explained below, even where a policy specifies that timely notice is a condition precedent to coverage, many jurisdictions require an insurer to prove that it was prejudiced by the insured's delay in order to deny coverage for an insured's failure to give notice as soon as practicable.

VARIATIONS OF NOTICE-PREJUDICE RULES

Notice-prejudice rules may be established by statutes, regulations, or judicial rulings. In many jurisdictions, courts have concluded that an insured should not be denied coverage simply because notice was untimely, if the insurer was not prejudiced by the insured's delay in reporting the claim. For example, the Colorado Supreme Court has explained that the purpose of a timely notice requirement is to "allow an insurer to adequately investigate and defend a claim," and if the insurer cannot establish that late notice defeated that purpose (and therefore prejudiced the insurer), it should not be permitted to deny coverage based solely on late notice.[3]

A few states have adopted a notice-prejudice rule by statute or regulation.[4] In at least one state, New York, the statutory notice-prejudice rule effectively overrules prior court opinions that refused to impose a prejudice requirement. New York courts consistently had held that state law did not require prejudice in order for an insurer to rely upon late notice as a defense to coverage.[5] The state legislature reacted to those rulings by amending New York Insurance Law § 3420 to impose a notice-prejudice rule for policies issued on and after January 17, 2009 (although the prejudice requirement did not apply retroactively to policies issued before that date).[6]

In other states, the statutory or regulatory notice-prejudice rule may complement a notice-prejudice requirement imposed by case law. For example, Missouri courts consistently have applied a prejudice requirement in the context of occurrence policies since at least 1969.[7] Nonetheless, Missouri's Director of Insurance adopted the following regulation pursuant to the

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[2] *See, e.g., AIG Centennial Ins. Co. v. Fraley-Landers*, 450 F.3d 761, 767 (8th Cir. 2006) (Arkansas law); *Hosp. Underwriting Grp. v. Summit Health, Ltd.*, 63 F.3d 486, 493 (6th Cir. 1995) (Tennessee law); *Greycoat Hanover F. Street Ltd. P'ship v. Liberty Mut'l Ins. Co.*, 657 A.2d 764, 768 (D.D.C. 1995).

[3] *Craft v. Philadelphia Indem. Ins. Co.*, 343 P.3d 951, 952 (Colo. 2015).

[4] *See, e.g.*, Wis. Stat. Ann. § 631.81(imposing prejudice requirement where notice given within one year of the time provided in the policy); Mass. Gen. Laws ch. 175, § 112 (2010) (establishing notice-prejudice rule); 20 Mo. C.S.R. 100-1.020 (establishing notice-prejudice rule).

[5] *See, e.g., Great Canal Realty Corp. v. Seneca Ins. Co.*, 833 N.E.2d 1196, 1197 (N.Y. 2005) ("The insured's failure to satisfy the notice requirement constitutes 'a failure to comply with a condition precedent which, as a matter of law, vitiates the contract.'") (quoting *Argo Corp. v. Greater N.Y. Mut. Ins. Co*., 827 N.E.2d 762, 764 (N.Y. 2005)); *Am. Home Assurance Co. v. Int'l Ins. Co*., 684 N.E.2d 14, 16 (N.Y. 1997) ("Absent a valid excuse, a failure to satisfy the notice requirement vitiates the policy and the insurer need not show prejudice before it can assert the defense of noncompliance.") (internal citation and quotation marks omitted).

[6] *Tower Ins. Co. v. Classon Heights LLC*, 920 N.Y.S.2d 58, 62 (App. Div. 2011) (notice/prejudice provision "was enacted in 2009 and does not apply retroactively" to earlier policies).

[7] *Greer v. Zurich Ins. Co.*, 441 S.W.2d 15 (Mo. 1969); *Weaver v. State Farm Mut. Auto. Ins. Co.*, 936 S.W.2d 818, 821 (Mo. 1997).

state's Unfair Trade Practice Act: "No insurer shall deny any claim based upon the insured's failure to submit a written notice of loss within a specified time following any loss, unless this failure operates to prejudice the rights of the insurer."[8]

The law varies among jurisdictions with respect to whether the insured or the insurer bears the burden of proving prejudice or lack of prejudice. Some jurisdictions require the insured to prove that the insurer was not prejudiced, reasoning that timely notice is a condition to coverage, and the insurer should not bear the difficult task of establishing prejudice.[9] Conversely, some jurisdictions place the burden on the insurer to show that it was prejudiced by the insured's reporting delay.[10] Other states have adopted hybrid burden formulations depending upon the circumstances. In Wisconsin, for example, the legislature has established that the insurer bears the burden of proving prejudice (or of proving that the insured could have given timely notice) where notice is given within one year of the time required by the policy.[11] But Wisconsin courts have held that, where notice is given outside the one-year window, the insured bears the burden of rebutting a presumption of prejudice.[12] Similarly, in Colorado, the insurer bears the burden of proving prejudice except where notice is given after the insured has been found liable in the underlying case; under this circumstance, the insurer is presumed to have been prejudiced and the insured bears the burden of rebutting the presumption.[13]

In applying notice-prejudice rules, many jurisdictions distinguish between claims-made and occurrence policies, requiring that the insurer must be prejudiced in order to deny coverage for the insured's failure to report the claim "as soon as practicable" under an occurrence policy, but concluding that prejudice is not required to deny coverage under a claims-made policy where notice is given after the applicable policy period.[14] In those jurisdictions, the notice-prejudice rule clearly does not apply to the claims-made policy requirement that a claim be both first made and reported during the same policy period. The reason for this distinction is that timely reporting of a claim within the policy period is not simply a condition of coverage of a claims-made policy; rather, it goes to the fundamental nature of the contract that the insurer and the insured negotiated. Thus, if a court were to require an insurer to provide coverage for a claim reported outside of the claims-made policy period on the grounds that the insured was not prejudiced by the insured's late notice, it would be depriving the insurer of an essential element of the exchange it bargained for in issuing a claims-made policy, and it would be granting to the insured an extension of coverage for which it did not pay.[15]

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[8] 20 Mo. C.S.R. 100–1.020.

[9] *See, e.g., Ferrando v. Auto-Owners Mut'l Ins. Co.*, 781 N.E.2d 927 (Ohio 2002).

[10] *See, e.g., Johnson Controls, Inc. v. Bowes*, 409 N.E.2d 185, 188 (Mass. 1980).

[11] Wis. Stat. Ann. § 631.81.

[12] *Gerrard Realty Corp. v. Am. States Ins. Co.*, 277 N.W. 2d 863, 872 (Wis. 1979).

[13] *See Craft*, 343 P.3d at 952 (insurer bears burden of proving prejudice); *Friedland v. Travelers Indem. Co.*, 105 P.3d 639, 643-44 (Colo. 2005) (rebuttable presumption where notice given after disposition of liability in underlying suit).

[14] *See, e.g., Craft*, 343 P.3d 951 (notice prejudice rule does not apply to a date certain notice requirement in claims-made policy). Other courts have not drawn this distinction. *See Navigators Specialty Ins. Co. v. Med. Benefits Adm'rs of Md., Inc.*, No. ELH-12-2076, 2014 WL 768822 (D. Md. Feb. 21, 2014) (holding that Maryland's notice-prejudice statute applies even to claims-made policies).

[15] *See, e.g., Prodigy Comm. Corp. v. Agric. Excess & Surplus Ins. Co.*, 288 S.W.3d 374 (Tex. 2009).

A word of caution is in order here: it is a dangerous (but not uncommon) over-simplification to say flatly that the notice-prejudice rule does not apply to claims-made policies. The notice-prejudice rule may very well apply where an insurer seeks to deny coverage on the grounds that the insured provided notice during the policy period, but not "as soon as practicable" after the claim was made. For example, in *Financial Industrial Corp. v. XL Specialty Insurance Co.*, the Texas Supreme Court held that, while an insurer need not show prejudice to deny coverage for failure to give notice within the policy period of a claims-made policy, it *would* be required to show prejudice to deny coverage where the claim is reported within the policy period but nevertheless not as soon as practicable.[16] The court reasoned that the obligation to give notice during the policy period is a material element of the bargained-for exchange under a claims-made policy, but the obligation to give notice as soon as practicable is not. Most jurisdictions have not addressed this precise issue, but the Texas court's reasoning has been found to be persuasive in other jurisdictions,[17] and insurers should exercise caution when faced with these circumstances.

Insurers also should proceed carefully when, for example, an insured gives notice of a claim under a claims-made policy very shortly after one policy period ends and another begins. Under these circumstances, courts have looked at the gap in time between when the claim was made, and when it was reported, and have suggested that they might require a showing of prejudice or otherwise find in favor of coverage if the time between the claim being made and reported was a matter of days, even if the claim was made in one claims-made policy period but not reported until the subsequent claims-made policy period.[18] If these courts confronted a situation in which they concluded that the equities weighed in the insured's favor, they might not only rule against the insurer, but also create bad law for insurers going forward. Indeed, we have seen this happen. In *Cast Steel Products, Inc. v. Admiral Insurance Co.*,[19] the insurer denied coverage where a claim was made just before the end of the first policy period, the insured "immediately" reported the claim to its broker, but, through "an unfortunate twist of fate," the broker failed to report the claim to the insurer until just hours after the first policy period expired. The court's equitable resolution – finding an ambiguity in the policy's extended reporting period language and interpreting it against the insurer in order to find coverage – has provided legal support to many insureds seeking to extend improperly the scope of their claims-made insurance policies.[20]

Thus, as the case law has demonstrated, a court very well may strain to find ambiguity in the policy, or otherwise fail to enforce strictly the reporting requirements of a claims-made policy, where an insured did not report a claim during the policy period, but the court believes it would be unfair or unjust to the insured to deny coverage.[21] One way a court may attempt to balance the equities under those circumstances is to require that the insurer show how it was prejudiced

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[16] *Fin. Indus. Corp. v. XL Specialty Ins. Co.*, 285 S.W.3d 877 (Tex. 2009); *Prodigy*, 288 S.W.3d 374.
[17] *Fulton Bellows, LLC v. Fed. Ins. Co.*, 662 F. Supp. 2d 976 (E.D. Tenn. 2009) (predicting that the Tennessee Supreme Court would adopt the Texas Supreme Court's rule in *FIC* and *Prodigy*).
[18] *See, e.g., Julio & Sons Co. v. Travelers Cas. & Sur. Co.*, 684 F. Supp. 2d 330, 342 n.13 (S.D.N.Y. 2010). Similarly, the court in *Fulton Bellows* suggested that the outcome might depend on whether the claim was reported sufficiently after the policy period such that the insurer would have had time to "close the books" on the applicable policy period. 662 F. Supp. 2d at 995.
[19] 348 F.3d 1298 (11th Cir. 2003).
[20] *See* Kimberly Ashmore and Charles Lemley, *Do Consecutive Claims-Made Policies Create a Multi-Year Period of Seamless Coverage*, 28 Prof'l Liab. Underwriting Soc'y J., No. 7 (July 2015).
[21] *See, e.g., Root v. Am. Equity Specialty Ins. Co.*, 130 Cal. App. 4th 926 (2005).

by the late reporting, even though prejudice should not properly be part of the coverage analysis where a claim was not reported during the applicable claims-made policy period.

WHERE PREJUDICE IS REQUIRED, WHAT SHOWING IS REQUIRED?

Assuming a showing of prejudice is required, what exactly does it mean for an insurer to be prejudiced by an insured's untimely notice? And, more importantly, how concrete must the evidence be for prejudice to be established? On these issues, our discussion is not intended as a survey of the law, which would be a sizeable undertaking given the number of cases, statutes, and regulations involved. Rather, we highlight key factors that courts have weighed in considering the prejudice issue.

As a general matter, whether an insurer has been prejudiced by late notice of a claim is highly fact-dependent, and our analysis of the case law suggests that courts have been all over the map in determining what qualifies as prejudice. Accordingly, in weighing issues of prejudice, it is absolutely critical to be aware of the specific law of the jurisdiction in which you are operating. That said, and although the outcomes that courts ultimately reach regarding prejudice may vary significantly, several themes emerge from the case law regarding the kinds of factors that courts typically consider when analyzing the issue.

First, myriad cases discuss whether the insured's late notice impeded the carrier's ability to investigate the claim fully.[22] One key question is whether the passage of time has destroyed the insurer's access to information about the claim?[23] For example, in *Great American Insurance Co. v. C.G. Tate Construction Co.*, 279 S.E.2d 769, 776 (N.C. 1981), the court enumerated several factors it found to be relevant for determining prejudice, including:

> [1] the availability of witnesses to the accident; [2] the ability to discover other information regarding the conditions of the locale where the accident occurred; [3] any physical changes in the location of the accident during the period of delay; [4] the existence of official reports concerning the occurrence; [5] the preparation and preservation of demonstrative and illustrative evidence, such as the vehicles involved in the occurrence, or photographs and diagrams of the scene; [and 6] the ability of experts to reconstruct the scene and the occurrence;…..

This ability to investigate may encompass the carrier's ability to analyze both the merits of the claim and whether the claim is covered under the insured's policy. For example, in *Smagala v. Sequoia Ins. Co.*, 969 F. Supp. 2d 1271, 1282 (D. Or. 2013), the court concluded that an insurer was prejudiced by the insured's failure to provide notice of a ceiling collapse for nearly three years, during which time the ceiling had been repaired, and the insurer thus had lost the opportunity to investigate and the ability to determine whether the cause of the damage was

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[22] *See, e.g., S. Farm Bureau Cas. Ins. Co. v. Robinson*, 365 S.W.2d 454, 458 (Ark. 1963) (no prejudice when, despite a delay in notice, the insurer had ample opportunity to investigate the case); *C.G. Tate*, 279 S.E.2d at 776 (noting the relevant factors in determining prejudice to include the availability of witnesses and the ability of the insurer to discover information about the conditions where the accident occurred); *Metal Bank of Am., Inc. v. Ins. Co. of N. Am.*, 520 A.2d 493 (Pa. 1987) (concluding that insurers were prejudiced where they were denied the ability to conduct an investigation because it was undisputed that evidence had been dissipated and had disappeared and the passage of time had resulted in the unavailability of witnesses).

[23] *See C.G. Tate*, 279 S.E.2d at 776; *Metal Bank*, 520 A.2d 493.

covered.[24] One court also concluded that a carrier's inability to set appropriate reserves constituted prejudice. *See Arrowood v. Macon Cnty. Greyhound Park*, 757 F. Supp. 2d 1219, 1228 (M.D. Ala. 2010). However, an insurer's failure to raise premiums on subsequent policies was not found to constitute sufficient prejudice to the insurer to support the carrier's late notice denial of coverage. *See Operating Eng'rs Health & Welfare Trust Fund v. Mega Life & Health Ins. Co.*, No. C 02-04072 CRB, 2003 WL 22416395, at *7 (N.D. Cal. Oct. 21, 2003).

Second, courts have examined whether the insurer has been prejudiced because an outcome has been reached in the underlying claim by the time the insurer receives notice. For example, courts often conclude that an insurer has been prejudiced when judgment already has been entered against the insured, or when the insured unilaterally has settled the claim before the insurer receives notice.[25] Even under these circumstances, however, some courts still require a specific showing of how the carrier would have obtained a better result had it timely been notified of the claim, concluding that it is insufficient simply to assert that judgment had been entered or a settlement had been reached without the insurer's involvement.[26] For example, in *North Star Mutual Insurance Co. v. Midwest Family Mutual Insurance Co.*, the Minnesota Court of Appeals concluded that an insurer had not been prejudiced, despite not receiving notice until after the case was settled, where there was no dispute over the amount of damages and the insurer failed to show how it would have avoided liability or settled the claim for lower than its policy limits had it timely been notified of the claim.[27] Conversely, a Nebraska court confirmed that the carrier *had* been prejudiced where it received notice of the claim after default judgment was entered against the insured, finding it relevant that the carrier had been precluded from raising a contributory negligence defense on behalf of the insured.[28]

Third, courts have found relevant arguments that the insured's untimely notice has deprived the insurer of rights it otherwise would have had under the insurance policy – *e.g.*, with respect to defense of the claim or the insurer's ability to recover amounts from third parties. Carriers successfully have argued that they have been deprived of opportunities to settle the case before litigation ensued; [29] to select defense counsel and control defense strategy; [30] to pursue judicial

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[24] *See also Aero-Motive Co. v. Great Am. Ins.*, No. 1:03-CV-55, 2004 WL 3457630, at *9 (W.D. Mich. Nov. 23, 2004) (insured's delay in removing a leaking tank prior to notifying the insurer of an environmental contamination prejudiced the insurer because the insurer was deprived of an opportunity to ascertain whether the pollution was "sudden and *accidental*" within the meaning of the policy).

[25] *See, e.g., MacLean Townhomes, LLC v. Am. States Ins. Co.*, 156 P.3d 278, 280 (Wash. Ct. App. 2007) (insurer is prejudiced where insured submits its claims to binding arbitration or settles the claim prior to giving notice); *S.C. Ins. Co. v. Hallmark Enters.*, 364 S.E.2d 678 (N.C. Ct. App. 1988) (insurer prejudiced where it did not receive notice of claim until more than one year after default judgment was entered against insured).

[26] *See, e.g., City of Glendale v. Nat'l Union Fire Ins. Co.*, No. CV-12-380, 2013 WL 1296418, at *17 (D. Ariz. Mar. 29, 2013) (insurer does not show sufficient prejudice merely by arguing that the insured's late notice deprived it of an opportunity to control the defense of the claim, without adducing evidence that the insurer's involvement would have altered the result of the litigation).

[27] 634 N.W.2d 215, 221-222 (Minn. Ct. App. 2001).

[28] *Meffer v. Siegler & Co.*, 676 N.W.2d 22, 28 (Neb. 2004). *See also Hercules Inc. v. AIG Aviation, Inc.*, 776 A.2d 550, 567-68 (Del. Super. Ct. 2000) (insurer suffered "inherent prejudice as a matter of law" where the insured had already settled the underlying litigation and spent considerable sums on defense before notifying the insurer, where the underlying claim appeared to have no merit)

[29] *See Ingalls Mem'l Hosp. v. Executive Risk Indem., Inc.*, No. 1-10-0831, 2011 WL 10069004, at *9 (Ill. App. Ct. June 30, 2011).

[30] *Town of Mount Pleasant v. Hartford Acc. & Indem. Co.*, 625 N.W.2d 317, 321 (Wisc. 2001).

remedies in lieu of arbitration; [31] and to assert subrogation claims against third parties.[32] Again, however, some courts have required more than just an assertion that a right has been lost, concluding that there must be specific evidence that the insurer realistically would have been able to assert the right and reach some beneficial result (*e.g.*, the insurer must show that its subrogation claim had a realistic chance of success[33]).

Finally, in analyzing prejudice, some courts have considered what actions the insurer took *after* it learned of a claim to mitigate the harm to it from the insured's late notice. In some instances, what the insurer does post-notice can negate any assertion of prejudice. For example, courts have ruled against insurers where, upon being notified of the claim, the insurer did not seek to: investigate the matter[34] or have a default judgment or settlement set aside.[35] Thus, the insurer's actions post-notice may directly impact the strength of its late-notice coverage defense.

CONCLUSION

The key takeaway, therefore, is that, although there are general rules as to when prejudice is required, and what evidence must be adduced to establish prejudice, one must look at the specific policy language and the law of jurisdiction, as applied to the particular set of facts at issue, before reaching any conclusions about the proper coverage analysis.

If prejudice is required, in most jurisdictions, a carrier must show something more than simply a generalized notion that it could have done better if notice was earlier or that was deprived of some right. The required showing to establish prejudice may not be insignificant, and coming up with specific and concrete evidence to prove prejudice (or a lack thereof) may be difficult. Accordingly, the key question may come down to which party has the burden to prove (or disprove) that the carrier has been prejudiced by the untimely reporting.

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[31] *MacLean Townhomes*, 156 P.3d at 280.
[32] *Pa. Gen. Ins. Co. v. Becton*, 475 A.2d 1032, 1036 (R.I. 1984).
[33] *State Farm Mut. Auto Ins. Co. v. Green*, 89 P.3d 97, 104 (Utah 2003).
[34] *Coop. Fire Ins. v. White Caps*, 694 A.2d 34 (Vt. 1997); *Emp'rs Liab. Assur. Corp. v. Hoechst Celanese Corp.*, 684 N.E.2d 600, 608 (Mass. Ct. App. 1997).
[35] *See Franco v. Selective Ins.*, 184 F.3d 4 (1st Cir. 1999); *Palmer v. Hawkeye*, 1 S.W.3d 591 (Mo. Ct. App. 1999)