Joe Ramirez

Partner
303.290.1605
Denver
jramirez@hollandhart.com

Colorado Adopts the Notice-Prejudice Rule

Colorado Adopts the Notice-Prejudice Rule

Insight — 3/31/2005

Any contractor who has ever turned in a claim to his general liability carrier has been met by the standard ten page letter from the insurance company reserving the insurance company's right to deny coverage for a litany of reasons. These daunting letters contain multiple excerpts from the policy and lead the reader to believe that his claim is being denied. Buried in the middle of such letters is an allegation that the policyholder breached its duty to provide timely notice of the claim and based on this breach the insurer reserves the right to deny its obligations under the policy. On January 31, 2005, the Colorado Supreme Court delivered a blow to this practice.

Most insurance policies contain a provision that, as a condition to coverage, the policyholder must provide prompt notice to his insurer of an occurrence which may result in a claim. Notice provisions are designed to allow the insurer to conduct a timely and adequate investigation while facts are still freshly available. While this is necessary and easy to accomplish when a loss involves an accident resulting in bodily injury or damage to property, most claims in the construction field are not that clearly defined in time.

Construction defect claims in particular can involve repeated contact between the property owner and the construction professional, as the parties spend time trying to resolve any differences. It is not uncommon for months to pass before the parties break off talks and a formal claim ensues. Sometimes, contractors believe that problems have been resolved only to be served with a notice of defect letter or a formal complaint. Either way, the policyholder is certain to receive a letter from his insurance company alleging that he breached his duty to provide timely notice and that the company is reserving the right to deny coverage based on this late notice.

To add to the confusion, most insurance policies do not define the term "as soon as practicable." Does this mean that a policyholder must notify its insurance carrier as soon as it realizes that it has an unhappy customer? Or, does it require an insured to wait until his customer has filed a lawsuit. The former would result in a flood of frivolous claims to insurance companies and the latter would possibly lead to the loss of helpful evidence. Because of the uncertainty created by this common policy language, courts across the country have had to interpret its meaning and decide what constitutes timely notice.

Prior to January 31, 2005, Colorado held that an insured's unexcused delay in providing notice to its insurer, relieved that insurer from any

obligations under the policy. If a policyholder could not establish that its delay was reasonable or excused, the insurance company could walk away from the claim without defending or indemnifying its policyholder. Delays of weeks and sometimes only days triggered a late notice reservation of rights letter from insurers. Coverage for claims that clearly were covered under the policy terms could be denied on a technicality. Realizing the potential windfall, insurance carriers made it standard practice to include late notice as a possible defense against coverage.

For 24 years, Colorado adhered to this principle despite the rest of the country recognizing the injustice of such a rule. The majority of states required that the insurance company demonstrate by a preponderance of the evidence that it was prejudiced by an unreasonable delay in receiving notice from its insured. Insurers could deny coverage based on late notice where they could prove that they lost the opportunity to investigate, defend or settle a claim because of the policyholder's late notice of claim. This principle became known as the notice-prejudice rule.

In *Friedland v. The Travelers Indemnity Co*. No. 03SC681, the Plaintiff, Robert M. Friedland, was an officer and director of Summitville Consolidated Mining Company Inc. (SCMCI). The United States and the State of Colorado filed an environmental lawsuit against him for pollution caused by a mining operation in Conejos County, Colorado. Friedland incurred defense costs and eventually paid $20 million to settle the suit against him. Freidland alleged that SCMCI had obtained general liability insurance coverage through Travelers and that he was an additional insured under the policies, but that he did not discover the policies until six months after he had settled the lawsuit. Friedland filed suit against Travelers seeking reimbursement of defense costs and the $20 million he paid to settle the suit.

The trial court, relying on the *Marez* decision found that Friedland's notice to Travelers more than six years after the lawsuit was filed, and six months after he settled it, was unreasonably late and constituted a material breach of the policies' notice provisions. The trial court's analysis did not include whether Travelers had been prejudiced by the late notice. Friedland's lawsuit was disposed of on summary judgment—the trial court finding that Travelers was entitled to a judgment in its favor as a matter of law.

The Colorado Supreme Court agreed to hear *Friedland* to determine whether *Marez* should remain the law of the State or whether Colorado should join the majority of states and adopt the notice-prejudice rule for liability policies. The Court found three factors vital to its decision: 1) insurance contracts are contracts of adhesion--the policyholder has an unequal bargaining position and must take or leave the insurance contract as the company drafts it; 2) the public policy objective of compensating tort victims, and 3) the injustice of allowing an insurance company to receive a windfall and the insured being denied policy benefits due to a technicality. The Court found that people enter liability insurance contracts to obtain peace of mind and not to secure commercial advantage as with negotiated business contracts. Insureds are given form policies and they do not have the bargaining strength to negotiate policy language. Additionally, the Court found that Colorado has a strong public policy in favor of protecting

tort victims and invalidating insurance policies on a technicality violates public policy. Relying on these three factors, the Supreme Court overruled *Marez* and established the notice-prejudice rule for liability policies in Colorado.

The Court did not stop there. Because of the peculiar facts of *Friedland*, the Court found that where an insured settles a lawsuit before providing notice, a presumption exists that the insurance company has been prejudiced. However, the Court ruled that such a presumption is rebuttable. If the policyholder can show that: 1) all material information was obtained in the defense of the case; 2) all legitimate defenses were raised; 3) liability in the case was reasonably clear and; 4) the insurer could not have achieved a materially better result, the presumption disappears and the burden shifts to the insurance company to prove actual prejudice. The Court also found that where an insurer has received unreasonably late notice but the suit has not been settled, there is no presumption of prejudice and the insurer must prove prejudice by the preponderance of evidence before coverage is precluded.

Friedland relieves general liability policyholders from the ambiguity of notice provisions in their policies. *Friedland* does not abrogate the loss notice provisions of general liability policies, but it reduces their effectiveness as a means to deny coverage to the policyholder. Contractors do not have to report every dispute with its customers, business partners or the public to its insurance carriers for fear that they will void coverage by providing late notice. The standard has changed and absent a showing by the insurance company that late notice resulted in actual prejudice, insurance companies can no longer deny coverage for untimely notice. Will *Friedland* result in a reduction of reservation of rights letters from insurers? Not likely, but without the late notice language, they may whittle them down to 9 pages.
