

MIRANDA & SOKOLOFF LLP

240 Mineola Boulevard, Mineola NY 11501 (516) 741-7676
450 Seventh Avenue, New York, NY 10123 (212) 584-0001
313 South Avenue, Fanwood, New Jersey 07023 (908) 889-0808

Michael A. Miranda
Brian S. Sokoloff
Steven Verveniotis
Ondine C. Slone
Neil L. Sambursky

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COVERAGE UPDATE

Bruce R. Calderon
Meredith L. Bernstein
Jason B. Gurdus
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Benjamin P. Malerba III
Frank A. Valverde
Matthew J. Minero
Steven Seltzer

Mark R. Osherow
Of Counsel

LATE NOTICE OF LAWSUIT IN NEW YORK

Varrichio v Chicago Insurance Company

New York's "no prejudice" rule for an insurer's disclaimer of coverage based upon late notice of lawsuit was rejected last year by the Court of Appeals of the State of New York in the case of Brandon v Nationwide, 97 N.Y.2d 491 (2002) in the context of a late notice of lawsuit for Supplemental Uninsured Motorist coverage. On May 1, 2003, the Court will hear oral argument on the case of Varrichio v Chicago Insurance Company, concerning late notice of lawsuit under an attorney professional liability policy.

In Varrichio, there is no dispute that in spring of 1999, the insured, attorney Mark Varrichio, complied with the provision under his professional liability policy requiring him to provide notice of circumstances which might give rise to a lawsuit. Varrichio informed Chicago that, in his representation of a client, Joseph Olivera, in an action against the City of New York, the action had been dismissed because of Varrichio's failure to meet the statutory condition precedent of filing a timely notice of claim against the City. Upon being given timely notice of such circumstances, Chicago immediately hired counsel, investigated the claim, evaluated the claim so as to place a reserve, and was even in settlement negotiations to resolve the claim. Then, on July 19, 2002, Varrichio was served with a lawsuit by Olivera against Varrichio. Varrichio claims that he called Chicago about the lawsuit and/or that he assumed that Chicago had the lawsuit papers, but he did not comply with the policy requirement that, upon being served with a summons and complaint, he was to provide same to Chicago.

THE CERTIFIED QUESTION TO BE DECIDED BY THE COURT OF APPEALS

After Chicago disclaimed coverage, Varrichio commenced a declaratory judgment action in the United States District Court for the Southern District of New York. The District Court upheld Chicago's disclaimer, rejecting Varrichio's excuses for the failure to give notice of the lawsuit and finding that Chicago did not need to show prejudice. Varrichio, 2001 WL 1524475 (SDNY 2001). The Second Circuit, 312 F.3d 544 (2d Cir. 2002), however, referring to the Brandon decision, held:

We believe that a recent decision by the New York Court of Appeals casts doubt on whether New York's no-prejudice rule applies to notice of suit provisions in cases like the one before us. Because this issue is recurrent and involves important public policy considerations for New York, we certify to the New York Court of Appeals the question of whether, where an insured duly complied with an insurance policy's notice of claim clause, New York requires 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.

On December 12, 2002, the New York Court of Appeals accepted the certified question presented (see 2002 N.Y. Slip Op. 09250, 2002 WL 31770505 (2002), and oral argument for the appeal is scheduled for argument on May 1, 2003. Varrichio's brief was filed on January 24, 2003, and Chicago's brief is to be filed March 24, 2003.

Varrichio's brief relies extensively on the Court's Brandon decision. Varrichio argues:

A careful analysis of this Court's opinion in Brandon v Nationwide Mutual Insurance Company 97 NY2d 491, reveals that after a thorough review of all the pertinent law, this Court decided that "insurers relying on the late notice of legal action defense should be required to demonstrate prejudice" Id. at 498, for them to have the right to disclaim coverage. The plaintiffs-appellants respectfully contend that by using the word "insurers" in Brandon, this Court was indicating that the rule of law above-stated was to apply to all insurers, regardless of the type of insurance contract that was being considered. Further, by embracing this rule of law, New York has expressed its decision to join the vast majority of states who have abandoned the antiquated "no-prejudice" rule, and join the modern trend in the law, which seems to provide justice to the general public and to insureds who have purchased insurance contracts.

THE BRANDON DECISION

In Brandon, the Court of Appeals decided that an automobile insurer, which had notice of an accident and personal injuries, could not disclaim for uninsured benefits based upon late notice of lawsuit unless the insurer could show prejudice.

Brandon recognized the validity of a "no prejudice exception" for late notice of "claims:"

Nationwide relies on cases holding that an insured's failure to provide timely notice of claim relieves the insurer of its obligation to perform, whether or not it can show prejudice (see Security Mut. Ins. Co. v. Acker-Fitzsimons Corp., 31 N.Y.2d 436, 440, 340 N.Y.S.2d 902, 293 N.E.2d 76 [1972]). This is known as a "no-prejudice" exception. We have, indeed, followed Security Mutual, and the "no-prejudice" exception, when the insurers had received late notice of SUM claims (see Matter of Metropolitan Prop. & Cas. Ins. Co. v. Mancuso, 93 N.Y.2d 487, 492-493, 693 N.Y.S.2d 81, 715 N.E.2d 107 [1999]). The issue here, however, is whether late notice of legal action should be given the same preclusive effect as late notice of claim.

Because of the existing "no prejudice exception" for late notice of "claims," the Court, in requiring a showing of prejudice to disclaim for late notice of lawsuit as to Supplemental Uninsured Motorist benefits, reasoned that the Brandon facts did not warrant another "no prejudice exception" for late notice of lawsuit, as follows:

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 Riv. Ins. Co., 79 N.Y.2d 576, 581, 584 N.Y.S.2d 290, 594 N.E.2d 571 [1992]). 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., 90 N.Y.2d 433, 441-442, 661 N.Y.S.2d 584, 684 N.E.2d 14 [1997]; Unigard, 79 N.Y.2d at 581-582, 584 N.Y.S.2d 290, 594 N.E.2d 571). Finding these factors inapposite when a reinsurer asserts a late notice of claim defense against a primary insurer, we declined to extend the Security Mutual no-prejudice exception to the reinsurance context (see Unigard, 79 N.Y.2d at 584, 584 N.Y.S.2d 290, 594 N.E.2d 571; cf. American Home, 90 N.Y.2d at 442, 661 N.Y.S.2d 584, 684 N.E.2d 14).

Here, Nationwide has not shown that the same factors support allowing insurers to evade their obligations, without showing prejudice, when insureds seeking SUM coverage provide late notice of legal action. 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.

CONCLUSION

The Varrichio Court, thus, is expected to announce that the Brandon requirement of prejudice for late notice of lawsuit applies to all policies of insurance, not just SUM coverage, but the Varrichio Court is expected to maintain the "no prejudice exception" as to late notice of occurrence or late notice of circumstances which may give rise to a lawsuit or "claim."

Second Circuit:

Brandon "casts doubt on whether New York's no-prejudice rule applies to notice of suit provisions...."

Varrichio's brief:

In Brandon, "New York has expressed its decision to join the vast majority of states who have abandoned the antiquated "no-prejudice" rule"

Brandon:

"We have, indeed, followed Security Mutual, and the "no-prejudice" exception, when the insurers had received late notice of SUM claims 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."

Court of Appeal's
timeline for Varrichio

appeal:

Plaintiff's

Brief.....filed

Defendant's

Brief.....3/24/2003

Oral

Argument..5/1/2003