

OPENING STATEMENT

New York's highest Court is the Court of Appeals. Its holdings take precedence over the holdings of all other Courts in the State. When the Court of Appeals has ruled on a legal issue, its holding can only be changed by an act of the Legislature or by the Court of Appeals reversing itself.

That is why the recent decision of the Appellate Division, First Department, in *Great Canal Realty Corp. v. Seneca Insurance Company*, is so unusual. That case involves the question of whether an insurer must establish that it has been prejudiced by the insured's late notice of an occurrence to sustain a declination of coverage. In *Great Canal*, two of the five Justices affirmed the denial of the insurer's motion for summary judgment because the insurer had not proven that it had been prejudiced by the insured's failure to provide prompt notice – in direct contradiction of well-settled, long standing Court of Appeal's rulings. The *Great Canal* case, and what, if anything, it augers for the "no prejudice" rule is the subject of our lead article

Late Notice – Is the "No Prejudice" Rule Dead in New York?

By: Tina M. Fugazzi and Michael E. Gorelick

As long as most attorneys can remember, it has been law in New York that an insurer does not need to establish that it has been prejudiced by the insured's failure to promptly report a loss or claim in order to support a late notice defense.

The "no prejudice" rule has been consistently upheld by New York's trial level and appellate courts since the Court of Appeals' landmark ruling in *Security Mutual Insurance Company v. Acker-Fitzsimons Corp.* (31 N.Y.2d 436)

The *Acker-Fitzsimons* case, decided in 1972, squarely held that New York was a "no prejudice" state and that, absent a reasonable excuse, where the insured failed to provide timely notice of an occurrence, claim or suit, coverage was void.

Various rationale for the 'no prejudice' rule were set forth by the Court in *Acker-Fitzsimons* and in later cases interpreting the rule, to include that timely notice: protects the insurer from fraudulent claims; gives the insurer the opportunity to investigate claims while documents and evidence are still available and before witnesses die or their memories fade; allows the insurer to establish adequate reserves; and, enhances settlement possibilities.

The 'no prejudice' rule remained the unquestioned law of New York for more than 30 years. The rule has been applied and followed, time and again, in a wide variety of situations. For example, it has been held that the "no prejudice" rule barred coverage where an insured failed to provide prompt notice, even though the insurer already had actual knowledge of the occurrence (*National Casualty Co. v. Paxson Communications*, 757 N.Y.S.2d 549 (1st Dep't 2003)); where an additional insured seeking coverage under the policy of another failed to provide prompt notice to the

insurer, even though the insurer had been provided with timely notice of the same claim against its named insured (*Blackman v. American Home Ins. Co.*, 396 N.Y.S.2d 291 (3rd Dep't 1977)); as well as to claims by insureds against excess insurers, where the primary insurer had been provided with timely notice (*American Home Insurance Co. v. International Insurance Co.*, 90 N.Y.2d 433 [1997]).

Over the past few years, however, the Court of Appeals has issued decisions which have chipped away at the, once absolute, "no prejudice" rule. First, the Court held that a reinsurer seeking to avoid coverage to the reinsured because of late notice is required to establish that it had been prejudiced (*Unigard Security Ins. Co. v. North River Ins. Co.*, 79 N.Y.2d 581(1992). That case stood as the only exception to the "no prejudice" rule for 10 years. Then, in 2002, the Court held that where the insured had provided prompt notice of the occurrence to its insurer but thereafter failed to promptly advise the insurer that a lawsuit has been commenced against it, the insurer must establish that it has suffered prejudice by the insured's late notice of the law suit before it could deny coverage (*Brandon v. National Ins. Co.*, 97 N.Y.2d 496 (2002).

On December 21, 2004, in *Great Canal Realty Corp. v. Seneca Insurance Company*, 2004 WL 2952794 (1st Dep't 2004), in a 3-2 decision, the Appellate Division, First Department, upheld the trial court's denial of the insurer's motion for summary judgment on its late notice defense.

What is unusual is that in doing so, two Justices of the Appellate Division, First Department, J. Catterson and J. Ellerin, concurred, refusing to apply to the "no prejudice" standard despite the absence of any Court of Appeals case overturning the long-standing "no prejudice" rule. This decision is the latest step towards, what might be, the eventual abolition of New York's "no-prejudice" rule.

INSIDE THIS ISSUE

Opening Statement	1
Late Notice - Is the "No Prejudice" Rule Dead in New York?	1
Recent Labor Law Decisions of Interest	2
Recent Insurance Law Decisions of Interest	3
AGFJ Developments Public Education Service	4

AGF&J

115 Broadway
11th Floor
New York, New York 10006
Phone: 212 422-1200
Fax: 212 968-7573

www.agfjlaw.com

In his opinion, Judge Catterson questioned whether insurance companies are given too much leeway to disclaim coverage if they are not promptly notified of a possible claim against a policy-holder. He opined that while New York Courts have historically been reluctant to inhibit freedom of contract, the time has come to “acknowledge that freedom of contract is a fiction when applied to insurance policies..., an insurance contract is not a negotiated agreement; rather its conditions are by and large dictated by the insurance company to the insured.”

Judge Catterson also noted that most other jurisdictions require insurance companies to show how they were prejudiced by a delay in notice and suggested that the Court of Appeals had already shown distaste for New York’s strict no-prejudice rule in favor of insurance companies.

The plaintiff in the underlying action giving rise to the *Great Canal* declaratory action was injured when he fell from a ladder in the course of his work on May 7, 2002. The suit was commenced on August 14, 2002 and alleged various Labor Law allegations. Great Canal, the owner of the premises where the accident occurred, had been told that the situation would be handled by the general contractor’s insurer. Thus, Great Canal did not notify its insurer, Seneca, of the occurrence until September 10, 2002, four months after the occurrence, but shortly after being served with plaintiff’s Summons and Complaint. Seneca disclaimed coverage based upon Great Canal’s late notice. The insured commenced a declaratory judgment action seeking a declaration that the insurer was required to defend and indemnify Great Canal. Seneca moved for summary judgment, based upon the insured’s failure to provide timely notice of the occurrence. In opposition to the insurer’s motion for summary judgment, the insured argued that it had a reasonable belief in non-liability because it did not know how the accident happened or the nature of the injury prior to being served with process. The trial court denied the insurer’s motion, holding that triable issues of fact existed as to whether the insured had a valid excuse for the delay in affirming the trial court’s denial of the insurer’s motion for summary judgment.

On appeal, Justice Catterson (with Justice Ellerin concurring), relied heavily upon the Court of Appeals’ decision in *Brandon v. Nationwide Mutual Ins.*, 97 N.Y.2d 491, 743 N.Y.S.2d 53 (2002), which criticized, but did not reverse, New York’s “minority” position in adhering to the “draconian” “no prejudice” rule and the “inequities” such rule creates by virtue of its “conclusive presumption of prejudice in derogation of fundamental principles of the law of contracts.” Thus, the two Justices affirmed the denial of summary judgment on the ground that a triable issue of fact existed as to whether the insurer was prejudiced by the insured’s failure to provide it with notice until 4 months after the date of the occurrence.

Significantly, the *Great Canal* decision includes a strong dissent from Justices Marlow and Tom, wherein they opined that it was inappropriate for an intermediate appellate court to “abandon our own precedent” and found it inappropriate for the Appellate Division to hold as it did in face of “long standing, clear and decisional authority from our State’s highest Court”.

Conclusion

For now, the “no prejudice” rule remains the law in New York. All New York Courts are bound to apply the “no prejudice” rule. Similarly, Federal Courts sitting in diversity and deciding cases under New York law must also continue to follow the “no prejudice” rule articulated by New York’s Court of Appeals. However, two cases are scheduled for

“dice” rule. We will monitor these cases and report the decisions and their effect on the “no prejudice” rule in future issues of *Cases & Points*.

Recent Labor Law Decisions of Interest

• **Meaning of “Grave Injury”**

The question of whether an acquired brain injury is a “grave injury” under § 11 of the Labor Law (thus constituting an exception to the prohibition against third-party claims for common-law indemnification against the employer of injured/employees) was recently addressed by the Court of Appeals in appeals from three different Appellate Division decisions. Workers Compensation Law § 11 sets forth the various enumerated “grave injuries” which permit the third-party action for common law indemnification or contribution against an injured worker’s employer. Of those injuries “an acquired injury to the brain caused by an external physical force resulting in permanent total disability” has caused litigants and Courts the most confusion. That confusion has been resolved by the Court of Appeals in *Rubeis v. The Aqua Club, Inc., et al.*, 3 N.Y.3d 401 (2004).

Rubeis

Alda Rubeis, an iron worker, sustained a brain injury when he fell approximately 19 feet from a ladder while installing a steel cupola at the Aqua Club. At the time of the accident he was employed by Venezia Iron Works, Inc. Rubeis brought action against the Aqua Club which then impleaded Venezia, alleging a cause of action for common law indemnification and contribution. Aqua Club claimed that the plaintiff had sustained a “grave injury” under Workers Compensation Law § 11 and thus, plaintiff’s employer was liable to it based upon the doctrine of common law indemnification.

At the close of the liability phase of the *Rubeis* trial, the Court granted Aqua Club judgment on its claim against Venezia, subject to the jury’s resolution of the question whether plaintiff sustained a grave injury. The jury found that the plaintiff sustained a grave injury and awarded him approximately \$3.2 million in damages. On appeal, the Appellate Division, Second Department, reversed and granted Venezia’s motion to dismiss relying upon that Court’s prior holdings interpreting “grave injury” resulting from an acquired brain injury to not include cases where the employee is able to “perform day to day functions”. Thus, the Appellate Division concluded that plaintiff had not suffered a brain injury under Workers Compensation Law § 11.

Largo-Chicaiza

At the same time that *Rubeis* was argued, the Court of Appeals also heard *Largo-Chicaiza v. Westchester Scaffold Equipment Corp.* Largo-Chicaiza, a day laborer, sustained brain injury when he fell from the roof of a six story house owned by Peter and Catherine McCaffrey while removing shingles. At the time of the accident he was employed by the general contractor, Sanzo. Largo-Chicaiza brought a personal injury action against the McCaffreys, Sanzo and the roofing subcontractors. In their Answers, defendants cross-claimed for indemnification and contribution against Sanzo pursuant to Workers Compensation Law § 11.

Sanzo sought summary judgment against plaintiff and the dismissal of all cross-claims on the ground that he was plaintiff’s employer and thus plaintiff’s sole recovery against him was limited to Workers Compensation benefits. The trial Court granted the motion for summary judgment as against plaintiff but denied Sanzo’s motion seeking to prohibit the common law indemnification claims brought against him by the

ment, reversed, citing its decision in *Rubeis*, and concluded that plaintiff's injuries were not a "grave injury" under § 11.

Knauer

At the same time, the Court also considered *Knauer v. Anderson*. There, Thomas Knauer, an electrician employed by Knauer Electric sustained a brain injury when he fell 17 feet from a ladder and struck his head on a gravel floor. Knauer commenced action against the general contractor and the property owner. The defendants brought a third-party action against his employer, Knauer Electric, for common law indemnification. The trial Court denied the employer's motion for summary judgment, finding a triable issue of fact as to whether plaintiff had sustained a grave injury. After trial, the jury found in plaintiff's favor, awarding him \$11 million. The Appellate Division, Fourth Department, affirmed, finding that "evidence that a plaintiff has suffered the specified injury to the brain resulting in permanent total disability relates to his or her permanent total disability from employment, not to his or her ability to otherwise care for himself or herself and function in a modern society".

In deciding these three cases, simultaneously, the Court of Appeals has attempted to resolve the confusion caused by the conflicting standards employed by the different Appellate Divisions. The Court held that the question of whether an acquired brain injury is a "grave injury" under Section 11 relates not to the injured person's ability to take care of himself but, instead, to his employability. The Court went further and clearly stated that "we make clear that the test we adopt for permanent total disability under Section 11 is one of unemployability in any capacity" (emphasis supplied by the Court). Thus, it appears that if the injured party is employable in any capacity, his acquired brain injury will not constitute a grave injury. If the plaintiff is totally unemployable as the result of the brain injury, his injury will be a "grave injury" under the meaning of the statute, even if the plaintiff is otherwise able to care for himself or herself.

Accordingly, the Court reversed the Second Department's holdings in *Rubeis* and *Largo-Chicaiza*, finding that the injuries presented in those cases did, in fact, constitute grave injuries and affirmed the Fourth Department's holding in *Knauer*, finding that the injury suffered by the plaintiff also constituted a "grave injury". It remains to be seen if the Court will further expand the definition of "serious injury" if a case is presented where a previously skilled, high earning plaintiff is now, as a result of his acquired brain injury, still employable, but only in a very menial, minimum wage earning capacity.

• **The "Recalcitrant Worker" Doctrine**

In *Cahill v. Triborough Bridge & Tunnel Authority*, 4 N.Y.3d 35 (2004), New York's Court of Appeals expressly accepted the "recalcitrant worker" defense that the Appellate Divisions have previously recognized as a valid defense to claims under Labor Law § 240(1).

In *Cahill*, the plaintiff had been granted summary judgment below. There, it was a defendant's contention that the accident was caused entirely by the plaintiff's own fault. The defendant contended that Mr. Cahill had full safety apparatus available for his work climbing and working on forms, was instructed in their use and had been directed by him employer to use them. Defendant contended, however, that plaintiff failed to make use of the apparatus or follow his employer's instructions and that his failure to do so brought about the fall and personal injuries which could have been avoided had followed orders.

The Court of Appeals found that the defendant's contentions that

the plaintiff constituted a "recalcitrant worker" raised questions of fact which required a trial and could not be decided on a motion for summary judgment in plaintiff's favor. The Court declared that the controlling question is whether a jury could have found that plaintiff's own conduct, rather than any violation of Labor Law § 240(1), was the sole proximate cause of his accident. Thus, the Court held that a jury could have found that plaintiff had adequate safety devices available, that they were available and that he was expected to use them, that he chose for no good reason not to do so, and that had he not made that choice, he would not have been injured. Accordingly, the Court held that since those factual findings could lead to the conclusion that defendant had no liability under Labor Law § 240(1), summary judgment should not have been granted in plaintiff's favor.

Recent Insurance Law Decisions of Interest

• **Insured's Right to Recover Attorneys' Fees**

It has long been the law in New York that an insured who successfully prosecutes a declaratory judgment action for coverage against his insurer is not entitled to recover the attorneys' fees of the declaratory action, while an insured who successfully defends such an action brought by his insurer is entitled to do so. The rationale for this principle is that by commencing a declaratory judgment action against its insured, the insurer has placed its insured "in a defensive posture" and thus, should be responsible for the costs incurred by the insured in defending against that declaratory action.

However, New York's Court of Appeals had not previously ruled on the question of whether an insured who successfully defends against the insurer's declaratory judgment action is entitled to recover declaratory judgment attorneys' fees where the insurer has provided the insured with a defense in the underlying action. The rule followed in most States (the "American Rule") is that where the insurer has provided its insured with a defense of the underlying action, the insured is not entitled to recovery of declaratory judgment attorneys' fees, even where it successfully defends against the insurer's declaratory judgment action. New York's Court of Appeals has recently been called upon to determine that issue in *U.S. Underwriters Ins. Co. v. City Club Hotel*, 3 N.Y.3d 592 (2004).

The *City Club* case arose out of an action involving a construction accident which occurred in April of 2000. In that case, a worker was hurt while renovating a building owned by Shelby Realty where City Club Hotel was a tenant.

U.S. Underwriters Insurance Company had issued a general liability policy to City Club and Shelby. The insurer disclaimed coverage to Shelby and City Club for the injured worker's suit, based on an exclusion in the policy and commenced a declaratory judgment action in the United States District Court seeking a determination that it has no duty to defend or indemnify Shelby in the underlying action. However, the insurer assigned counsel to defend Shelby in the underlying action, subject to a reservation of its right to disclaim coverage.

In the declaratory action, the District Court ultimately found that the insurer did, in fact, have a duty to defend and indemnify its insured in the underlying personal injury action. However, it denied the insured's application for declaratory judgment attorneys' fees and costs because the insurer had provided the insured with a defense in the underlying action. On appeal, the Second Circuit Court of Appeals found that it was unclear, under New York law, whether the insureds were also entitled to recover their declaratory judgment attorneys' fees. Thus, the Second Circuit certified that question to New York's Court of Appeals.

In determining the issue, New York's Court of Appeals refused to join the majority of States following the American Rule and, instead, declared that "given that the expenses incurred by Shelby in defending against the declaratory judgment arose as a direct consequence of the insurer's unsuccessful attempt to free himself of policy obligations, it is entitled to recover its declaratory judgment attorneys' fees and defense expenses".

Thus, New York law has now been finally settled and New York has joined the minority of States which hold that an insured is entitled to recover its declaratory judgment attorneys' fees and defense expenses incurred when it successfully defends the insurer's declaratory judgment action, regardless of whether the insurer has provided it with a defense in the underlying action.

• **Standard of Proof Required for Lack of Cooperation Defenses**

New York Courts continue to require insurers seeking to disclaim coverage because of the insured's lack of cooperation to satisfy a high burden of proof.

In that connection, New York's Court of Appeals long ago established the standard which must be met by an insurance carrier seeking to disclaim coverage on the ground of lack of cooperation. That insurer "must demonstrate that it acted diligently in seeking to bring about the insured's cooperation . . . that the efforts employed by the insurer were reasonably calculated to obtain the insured's cooperation . . . and that the attitude of the insured, after his cooperation was sought, was one of "willful and avowed obstruction". *Thrasher v. United States Liability Insurance Co.*, 19 N.Y.2d 159 (1967).

New York Courts' continued reluctance to void coverage due to the insured's lack of cooperation was exemplified by a recent Second Department decision. In *Eveready Insurance Company v. Mack, et al.*, 790 N.Y.S.2d 48 (decided February 7, 2005), the Appellate Division, Second Department, was called upon to determine the validity of an insurer's attempt to disclaim coverage because of the insured's failure to cooperate in connection with a petition brought by the insurer under CPLR Article 75 to stay arbitration of an uninsured motorist claim.

In *Eveready*, respondent, Greta Mack, was involved in an automobile accident. At the time of the accident, Mack's vehicle was insured by Eveready. The other vehicle (owned by Diogenes Nunez, and operated by Israel Serrano) was insured by respondent, General Assurance Company. General Assurance disclaimed coverage on the basis that Nunez failed to report the loss or to cooperate with General Assurance in the investigation, settlement or defense of the claim. Thereafter, Mack filed a Demand for Uninsured Motorist Arbitration against her insurer, Eveready. Eveready commenced the proceeding to stay arbitration and sought to have General Assurance and its insureds joined as additional respondents. At a Framed Issue Hearing on the question of General Assurance's disclaimer for lack of cooperation, the trial court found that it had met its burden of proving its insured's lack of cooperation, thereby voiding coverage under the General Assurance policy. However, on appeal, the Second Department reversed finding that General Assurance had failed to demonstrate that it met the requirements set forth in *Thrasher* to disclaim coverage on the ground of lack of cooperation. Thus, General Assurance's disclaimer of coverage was found to be inadequate and, accordingly, Eveready's petition to stay its insured's uninsured motorist arbitration was granted.

AGFJ DEVELOPMENTS

• AGF&J is representing a marine reservist whose civilian employment was terminated by his employer as a result of actions occurring during his active duty in Iraq. Although his court martial acquitted him of all serious charges, he was found guilty of only minor charges. He was not dishonorably discharged and still serves in the Marine Reserves. However, as a result of his court martial, his civilian employer, the Federal Department of Corrections, terminated his employment.

This Marine was, in AGF&J's opinion, not only unfairly treated by the Marines; he was unlawfully terminated by his employer. AGF&J has agreed to represent him in his effort to regain his employment, under the Uniform Services Employees Rights and Reemployment Act (USERRA). The case is scheduled for a hearing shortly. For more information on USERRA and the employment rights of service men and women returning from active duty, contact John Fronce at jfronce@agfjlaw.com.

• AGF&J has been successful in obtaining summary judgment for its client in an automobile liability suit where the plaintiff actually underwent cervical fusion surgery. Despite the voluminous medical records submitted by plaintiff, the Court granted AGF&J's threshold motion, finding that plaintiff did not suffer "serious injury", as a matter of law, based upon the objective medical evidence submitted in support of defendant's motion (*Cebularz v. Dioriq* [Sup. Ct., Kings Co., 1/24/05]). For more information on *Cebularz* or the "serious injury" standard contact Barry Jacobs or John Fronce.

• In an insurance coverage action, AGF&J was successful in protecting its insurance company client's confidential documents (including its underwriting manual) from disclosure. In *Y. Hers Bedford Realty Co. v. QBE Ins. Corp.*, the question involved in the case was whether plaintiff's claim was covered under the language of defendant's policy. Since the issues in the case were not the insurer's alleged bad faith or its underwriting practices, plaintiff's request for production of the insurer's employee compensation plan documents and underwriting manual was declined. The Court agreed and granted AGF&J's motion for a Protective Order, ruling that the documents were not discoverable. (Sup. Ct., Kings Co., 2/22/05). For more information on the *Y. Hers* decision or requests for discovery of insurer's personnel and underwriting files and manuals, contact Dan Friedman or Tina Fugazzi.

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