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Timothy S. Menter

Jeffrey W. Stempel

University of Nevada, Las Vegas -- William S. Boyd School of Law

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The Status of the Notice/Prejudice Rule for Liability Insurance Claims in Nevada

BY TIMOTHY S. MENTER, ESQ., AND PROFESSOR JEFFREY W. STEMPEL



Insurers in Nevada often argue that timely notice is a necessary pre-condition to coverage and that they need not suffer prejudice in order to invoke a "late notice defense." Property insurance and general liability insurance policies usually state that notice of claims or suits be "prompt," made "as soon as practicable," or "immediate." Liability insurance policies, however, normally do not set forth specific deadlines. Nonetheless, insurers in Nevada regularly argue that late notice bars coverage, even when the policy lacks a specified time limit for providing notice and even when there is no harm to the insurer due to late notification.

Initially, in order to enforce a notice condition in an insurance policy, it should be raised as a reason for denial. See Nevada Administrative Code ("NAC") 686A.675(1). Insurers must carefully and specifically state late notice as a reason for denial of coverage or risk waiver of this defense. See, e.g., *Mapes Casino, Inc. v. Maryland Cas. Co.*, 290 F. Supp. 186, 191-192 (D. Nev. 1968) (failure to include late notice as reason for denial results in waiver of this coverage requirement). Likewise, policyholders should thoroughly review all coverage position letters issued by insurers to determine the grounds that the insurer is relying upon.

Insurers typically argue that Nevada law applies a strict late notice defense with "no prejudice required" to bar coverage on the basis of a 57-year-old Nevada Supreme Court decision, *State Farm Mutual Auto. Ins. Co. v. Cassinelli*, 67 Nev. 227, 216 P.2d 606 (1950), that has now become outdated. Even when *Cassinelli* was authored, the traditional, strict late notice defense was under attack. In the half-century since *Cassinelli*, almost all states have adopted the view that late notice defeats insurance coverage only when the insurer is significantly prejudiced by the late notice in terms of its ability to investigate a loss or defend a claim.¹

Further, the clear majority of states require that the insurer bear the burden to establish prejudice from late notice, with a handful of states requiring the policyholder to prove lack of prejudice.²

New York and a few other states can be said to have rendered "modern" or "recent" decisions continuing to maintain the historical view that since timely notice is a condition precedent to coverage, any breach of the notice condition makes coverage unavailable, even if the late notice works no impairment to the insurer.³ Neighboring California has a longstanding "notice-prejudice" rule for insurance claims that has been deemed by the U.S. Supreme Court to be part of the core-content of the state's insurance law.⁴ In this area, of course, insurance policyholders would prefer that Nevada expressly follow California's longstanding approach, as this will make coverage more available in situations where a policyholder or its agent may have delayed too long before providing notice to an applicable insurer. Insurers, by contrast, prefer the old rule that no prejudice be shown to sustain a late notice defense as this will enable insurers to avoid coverage more frequently. The modern "notice-prejudice" or "prejudice-required" rule is widely preferred by courts and insurance scholars for sound reasons of public policy. Requiring the insurer to demonstrate prejudice in order to avoid coverage that was otherwise purchased by the policyholder (who may have paid premiums for years as part of a risk management program) avoids unnecessary forfeiture of contractual rights. Utilizing a notice-prejudice rule protects the legitimate interests of the policyholder and society with no unfairness to the insurer, who remains free to raise any other applicable defenses to coverage, such as the applicability of a specific exclusion related to the loss or claim.

Nonetheless, insurers have had some success in Nevada, arguing that *Cassinelli* continues to be valid authority and controls the notice question irrespective of the compelling arguments in favor of the modern majority rule. But any successful invocation of *Cassinelli* is undeserved. The case should no longer be considered good law in Nevada. *Cassinelli* has been completely undermined by subsequent developments in both case law and insurance regulation. Changes to Nevada law regulating insurers have effectively overruled *Cassinelli* and implicitly placed Nevada in accord with the majority of jurisdictions that have adopted the modern "notice-prejudice" rule. Denials based upon late notice are invalid unless the insurer can demonstrate either a violation of a specific timeframe notice condition that is reasonable in length or that it was prejudiced as a result of the delay in notification.

The *Cassinelli* court's conclusion that prejudice was immaterial was based upon what it then determined to be the "overwhelming weight of authority." In reaching this conclusion, *Cassinelli* relied upon decisions of the high courts of Vermont, Tennessee, South Carolina, Kentucky, Rhode Island and Maryland, an Illinois intermediate court and an Eighth Circuit decision interpreting Missouri law.⁵ Today, the law of all these states except arguably Illinois recognizes that prejudice is required in order for an insurer to invoke a late notice defense to coverage.⁶ The landscape of the law throughout the United States has changed dramatically since 1950 regarding the "notice-prejudice" issue. Today, most states that have considered late notice as a defense to coverage have held that prejudice is a prerequisite for denying coverage under a liability policy.⁷

Courts applying the modern notice-prejudice rule frequently cite the public policy considerations favoring the rule, such as the nature of insurance policies as contracts of adhesion, the reasonable expectations of the policyholder, the general preference of contract law to avoid unnecessary forfeitures: protection of third party interests, and societal interests regarding availability of insurance. See, e.g., *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358, 366 (1999) (noting this rationale in California precedents under review); *Alcazar v. Hayes*, 982 S.W.2d 845, 850-53 (Tenn. 1998); *Jones v. Bituminous Casualty Corp.*, 821 S.W.2d 798, 801 (Ky. 1991); *Indiana Ins. Co. v. Williams*, 463 N.E.2d 257, 265 (Ind. 1984); *Weaver Bros. v. Chappel*, 684 P.2d 123, 125 (Alaska 1984); *Lusch v. Aetna Cas. & Sur. Co.*, 272 Or. 593, 600, 538 P.2d 902, 905 (1975); *Cooper v. GEICO*, 51 N.J. 86, 93, 237 A.2d 870, 873 (1968); *Fox v. National Sav. Ins. Co.*, 424 P.2d 19, 25 (Okla. 1967). All of these are sound public policy rationales for the modern rule.⁸

It therefore appears likely, if not certain, that if the same Nevada Supreme Court addressed the facts of *Cassinelli* today, it would come to the opposite conclusion based on the national shift in favor of a notice-prejudice rule and find that prejudice on the part of the insurer is material and necessary for enforcement of a notice condition.

Defenders of the historical "no prejudice required" version of a late notice defense can, however, point to certain post-*Cassinelli* case law as arguably being supportive of this approach. See, e.g., *S.B. Corporation v. Hartford Acc. and Indem. Co.*, 880 F. Supp. 751 (D. Nev. 1995); *Las Vegas Star Taxi, Inc. v. St. Paul Fire & Marine Inc. Co.*, 102 Nev. 11, 714 P.2d 562 (1986). However, on closer examination, these cases appear to rest on a shaky foundation, in that neither case considered modern case law on late notice or subsequent Nevada Administrative Code changes discussed below. Moreover, *Star Taxi*

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involved notice given to the insurer only 10 days prior to trial and a settlement entered into by the policyholder without the insurer's consent a mere seven days later on the cusp of trial. In this sort of situation, an insurer would presumably be able to establish prejudice from the late notice. The *Star Taxi* insurer likely did not need the benefit of the now-outdated "no prejudice required" rule. The court, in fact, stated that it was not necessary to consider prejudice, as it would have found prejudice as a matter of law.

SB Corporation applied a "no prejudice required" rule without analysis of either the current state of the law, the authority underlying *Cassinelli*, or the public policy implications of continuing to cleave to the traditional approach of allowing insurers to avoid coverage even in the absence of prejudice. Neither *Star Taxi* nor *S.B. Corporation* examined Nevada administrative regulations governing insurance. Further, the court in *Star Taxi* did not even mention *Cassinelli*, again confirming that the facts of *Star Taxi* were more important to the outcome than prior precedent.

In addition to the implicit overruling of *Cassinelli* because of changes in the assumptions and facts upon which *Cassinelli* was decided, administrative developments in Nevada law now establish that an insurer show prejudice in order to enforce a notice provision of a policy. Since the Nevada Supreme Court decided *Cassinelli*, Nevada insurance regulations that effectively overrule the decision have been promulgated. NAC 686A.660 states in part (emphasis added):

No insurer may, except where there is a time limit specified in the insurance contract or policy, require a claimant to give written notice of loss or proof of loss within a specified time or seek to relieve the insurer of the obligations if the requirement is not complied with, unless the failure to comply prejudices the insurer's rights.

NAC 686A.600 specifies that NAC 686A.660 applies to all insurance contracts. Therefore, by law, Nevada requires an insurer to show prejudice in order to enforce a general, non-time specific, notice provision. Further, the term "claimant" is defined as including both first-party and third-party claimants. See NAC 686A.620.⁹

Administrative regulations such as NAC 686.660 have the force of law. See *State v. Safeway Super Service Stations, Inc.*, 99 Nev. 626, 630, 668 P.2d 291, 294 (1983). Additionally, these regulations are binding

until repealed by the agency or declared invalid by a court. See *Bing Construction Company of Nevada v. Nevada Dept. of Taxation*, 109 Nev. 275, 279, 849 P.2d 302, 305 (1993). The notice regulations cited above have existed for 20 years without repeal or even judicial criticism.

Accordingly, insurers should take into account the Nevada insurance regulations and issues, such as prejudice, when evaluating whether or not to assert or otherwise rely upon a general liability policy notice provision. This is in line with the large majority of jurisdictions that have considered this issue and is also in line with sound public policy. ■

Timothy S. Menter is a partner in the Irvine, California firm of Menter & Witkin. He regularly handles insurance matters in Nevada and throughout the western United States.

Professor Jeffrey W. Stempel is the Doris S. & Theodore B. Lee Professor of Law at the William S. Boyd School of Law, University of Nevada Las Vegas.

1 See BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 4.02(c)[2] (13th ed. 2006); EMERIC FISCHER, PETER NASH SWISHER & JEFFREY W. STEMPEL, PRINCIPLES OF INSURANCE LAW § 9.01 (3d ed. 2004 & Supp. 2006); JEFFREY W. STEMPEL, STEMPEL ON INSURANCE CONTRACTS § 9.01 (3d ed. 2006 & Supp. 2007); EUGENE R. ANDERSON, JORDAN S. STANZLER & LORELIE S. MASTERS, INSURANCE COVERAGE LITIGATION § 5.02[A] (2d ed. 2000 & Supp. 2006). See, e.g., *West Bay Exploration Co. v. AIG Specialty Agencies, Inc.*, 915 F.2d 1030, 1036 (6th Cir. 1990) (applying Michigan law); *Friedland v. Travelers Indem. Co.*, 105 P.3d 639, 643 (Colo. 2005); *Alcazar v. Hayes*, 982 S.W.2d 845, 850-53 (Tenn. 1998); *Harwell v. State Farm Mut. Auto. Ins. Co.*, 896 S.W.2d 170, 174 (Tex. 1995); *Molyneaux v. Molyneaux*, 533 A.2d 49 (N.J. 1989); *Pennsylvania Gen. Ins. Co. v. Becton*, 475 A.2d 1032 (R.I. 1984); *Johnson Controls, Inc. v. Bowes*, 381 Mass. 278, 409 N.E.2d 185 (1980).

2 See Ostrager & Newman, supra note 1, § 4.02(c)[4]; Fischer, Swisher & Stempel, supra note 1, at 520 (noting that Colorado, Florida, Ohio, Indiana, and Iowa create a rebuttable presumption of prejudice from late notice that may be overcome by the policyholder's demonstration of lack of prejudice to the insurer). The burden of establishing prejudice should logically be placed on the insurer since the insurer is in the best position to show the existence of prejudice. The insurer has a near monopoly on information regarding the actual difficulties, if any, that may have been caused by late notice as respects the investigation, adjustment, or defense of a claim. See Stempel on Insurance Contracts, supra note 1, at § 9.01, p. 9-35 ("the better approach is to assign the persuasion burden to the insurer."); see, e.g., *Prince George's County v. Local Gov't Ins. Trust*, 879 A.2d 81 (Md. 2005) (insurer has burden of showing prejudice).

- 3 See Fischer, Swisher & Stempel, *supra* note 1, at 519-20 (listing Alabama, Connecticut, New York, and Virginia as states still following the traditional "no prejudice required" rule for a late notice defense. See, e.g. *Sec. Mut. Ins. Co. v. Acker-Fitzsimmons Corp.*, 31 N.Y. 2d 436, 293 N.E.2d 76, 340 N.Y.S. 2d 902 (1972). New York does not apply the traditional rule to reinsurance and instead requires reinsurers to demonstrate prejudice from late notice to avoid coverage. See *Unigard Sec. Ins. Co. v. North River Ins. Co.*, 79 N.Y.2d 576, 584 N.Y.S.2d 290, 594 N.E.2d 571 (1992). However, excess insurers continue to enjoy the protection of the traditional rule. See *American Homes Assur. Co. v. International Ins. Co.*, 90 N.Y.2d 433, 661 N.Y.S.2d 584, 685 N.E.2d 14 (1997). Illinois takes an unusual hybrid approach requiring that notice to the insurer be "reasonable" while considering prejudice to the insurer and timeliness as factors in determining whether notice is reasonable. See *Country Mut. Ins. Co. v. Livorsi Marine, Inc.*, 222 Ill. 2d 303, 311-12, 316, 856 N.E.2d 338, 342, 345, 305 Ill. Dec. 533 (Ill. 2006).
- 4 See *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358 (1999) (reviewing origin, force, and rational of California's notice-prejudice rule and deeming it part of state insurance regulation not preempted by ERISA).
- 5 *Jefferson Realty Co. v. Employers Liability Assur. Corp.*, 149 S.W. 1011 (Ky. App. 1912); *Phoenix Cotton Oil Co. v. Royal Indem. Co.*, 205 S.W. 128 (Tenn. 1918); *Lee v. Metropolitan Life Ins. Co.*, 186 S.E. 376 (S.C. 1936); *Sherwood Ice. Co. v. United States Cas. Co.*, 100 A. 572 (R.I. 1917); *Employers Liability Assur. Corp. v. Perkins*, 181 A. 436 (Md. 1935); *St. Louis Architectural Iron Co. v. New Amsterdam Cas. Co.*, 40 F.2d 344 (8th Cir. 1930) (Missouri law); *Meyer v. Iowa Mutual Liability Ins. Co.*, 240 Ill. App. 431 (1926).
- 6 *Jones v. Bituminous Cas. Co.*, 821 S.W.2d 798 (Ky. 1991) (insurer must prove prejudice); *Alcazar v. Hayes*, 982 S.W.2d 845 (Tenn. 1998) (notice immaterial when insurer not prejudiced); *Factory Mut. Liab. Ins. Co. of Am. v. Kennedy*, 182 S.E.2d 727 (S.C. 1971) (insurer must show substantial prejudice to enforce notice provision in liability policy); *Pickering v. American Employers Ins. Co.*, 282 A.2d 584 (R.I. 1971) (insurer must show prejudice); *Prince George's County v. Local Gov't Ins. Trust*, 879 A.2d 81 (Md. 2005) (insurer must show prejudice); *Hawkeye Security Ins. Co. v. Davis*, 277 F.2d 765 (8th Cir. 1960) (citing change in Missouri law and that insurer must show prejudice). As noted above, Illinois considers prejudice to the insurer but does not make it a requirement for a successful late notice defense to coverage. See *Country Mut. Ins. Co. v. Livorsi Marine, Inc.*, 856 N.E.2d 338, 345 (Ill. 2006) (discussed in note 5, *supra*).
- 7 See, e.g., *Prince George's County v. Local Gov't Ins. Trust*, 879 A.2d 81, 93-94 fn. 9 (Md. 2005) (survey of case law concluded that 38 states and 2 territories had adopted a prejudice requirement and stating that the so-called majority rule cited in Cassinelli was now the minority rule).
- 8 Nevada law is consistent in its recognition that insurance policies are contracts of adhesion. See *Farmers Ins. Group v. Stonik*, 110 Nev. 64, 67, 867 P.2d 389, 391 (1994).
- 9 "First-party claimant" is defined as a person or any other legal entity asserting a right to payment under an insurance contract. See NAC 686A.625.



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