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***Atlantic Casualty Insurance Company v. Greytak; Adopting the
Notice-Prejudice Rule and Clarifying Misinterpretations***

Kristin Zadick

I. INTRODUCTION

Seeking to clarify past decisions and protect insureds' rights to insurance coverage, the Montana Supreme Court formally adopted the notice-prejudice rule in third party coverage disputes in *Atlantic Casualty Insurance Company v. Greytak*.¹ However, in doing so, the Court failed to fully reconcile the decision with prior case law regarding the notice-prejudice issue.

A. Factual and Procedural History

In March 2010, GTL brought suit in state court against Greytak for non-payment of construction work.² In April 2010, Greytak notified GTL of its grounds for counterclaims for construction defects, and in November Greytak filed the counterclaims against GTL.³ During the construction work, Atlantic Casualty Insurance Company ("Atlantic") insured GTL under a commercial general liability policy that required GTL to notify Atlantic as soon as practicable of any claim or suit brought against the insured or any offense that might result in a claim.⁴ GTL failed to notify Atlantic of the 2010 suit or the counterclaims brought by Greytak. In April 2011, GTL and Greytak entered a settlement agreement requiring GTL to notify Atlantic of Greytak's counterclaims.⁵ The agreement provided three courses of action: (1) GTL agreed if Atlantic did not defend the case or file an insurance coverage action to dispute coverage, GTL would allow judgment to be entered in favor of Greytak for \$624,685.14, plus costs; (2) if Atlantic assumed the defense, Greytak agreed to seek recovery only from Atlantic and ensure that GTL would not be responsible for any judgment; and (3) GTL and Greytak agreed if Atlantic filed a coverage action, Greytak would defend with the purpose of establishing coverage for GTL. GTL informed Atlantic of Greytak's counterclaims in May 2011, one year after Greytak notified GTL of its grounds for the counterclaims.⁶

In January 2012, Atlantic brought a declaratory action in federal district court, arguing it was not required to defend GTL because GTL

¹ 350 P.3d 63, 67 (Mont. 2015).

² *Id.* at 64.

³ *Id.*

⁴ *Id.* at 65.

⁵ *Id.* at 64.

⁶ *Id.*

violated the timely notice provision of the insurance policy. The federal district court granted Atlantic's motion for summary judgment.⁷ Relying on *Steadele v. Colony Insurance Company*,⁸ the court held an insurer need only demonstrate the insured failed to comply with the notice provision to avoid its duties to the insured, not that the insurer suffered prejudice from the untimely notice. Accordingly, the court found Atlantic did not have a duty to defend or indemnify GTL because Greytak's April 2010 notification to GTL of its grounds for counterclaims triggered the notice provision, and GTL's notice to Atlantic a year later violated the timely notice policy provision.⁹ Greytak appealed the decision to the Ninth Circuit Court of Appeals.¹⁰ Because both parties relied on *Steadele* for opposing arguments,¹¹ and because the Ninth Circuit Court of Appeals found no Montana decisions that resolved the issue of whether an insurer must show prejudice from untimely notice to avoid its duties, the Ninth Circuit Court of Appeals certified the notice-prejudice question to the Montana Supreme Court.¹²

B. The Majority Holding

In a unanimous decision, the Montana Supreme Court formally adopted the notice-prejudice rule in the context of third-party insurance coverage disputes.¹³ According to the rule, an insured's technical failure to comply with the timely-notice requirement of a policy does not automatically terminate coverage. Instead, the insurer must demonstrate it suffered prejudice from the untimely notice in order to avoid its duties to defend and indemnify the insured.¹⁴ The majority began its analysis with a review of cases that have considered the rule under Montana law, and detailed the policy considerations that arise when considering insured coverage disputes.¹⁵

⁷ *Greytak*, 350 P.3d at 65.

⁸ 260 P.3d 145, 150 (Mont. 2011).

⁹ *Greytak*, 350 P.3d at 65.

¹⁰ *Id.*

¹¹ *Atl. Cas. Ins. Co. v. Greytak*, 755 F.3d 1126, 1128 (9th Cir. 2014), certifying question to the Montana Supreme Court, 350 P.3d 63 (Mont. 2015) (Atlantic argued the Montana Supreme Court addressed timely notice provisions in *Steadele* and did not impose a prejudice requirement. Greytak responded that Montana law requires the insurer to demonstrate prejudice from the untimely notice, relying on the discussion of prejudice in *Steadele* as proof of the rule's prior application.).

¹² *Id.* at 1129.

¹³ *Greytak*, 350 P.3d at 68 (Although Justice Rice and Justice McKinnon wrote separate concurrences both arguing for an extension to the majority's holding, all the Justices agreed on the adoption of the notice prejudice rule).

¹⁴ *Id.* at 67.

¹⁵ *Id.* at 65–67 (citing *State Farm Ins. Co. v. Murnion*, 439 F.2d 945 (9th Cir. 1971); *Sorensen v. Farmers Ins. Exch.*, 927 P.2d 1002 (Mont. 1996); *Steadele v. Colony Ins. Co.*, 260 P.3d 145 (Mont. 2011)).

In its analysis, the majority explained the Court previously applied the notice-prejudice rule in *Steadele*, even though the analysis did not expressly mention the rule.¹⁶ In *Steadele*, the insurer did not receive notice of a lawsuit involving its insured until several months after a default judgment of \$1.8 million had been entered against the insured.¹⁷ The Court in *Steadele* reasoned that because the insurer did not receive timely notice of the claim, it suffered prejudice because it was deprived of the ability to investigate the claim and participate in the lawsuit.¹⁸ Although the *Steadele* Court held the insured's failure to provide timely notice to the insurer relieved the insurer of its obligations, the majority in *Greytak* argued *Steadele* is not a renunciation of the notice-prejudice rule. Rather, the Court analyzed the prejudice issue by considering how the late notice affected the insurer's ability to protect its interests. The *Steadele* Court considered the prejudice suffered by the insurer and applied the rule in favor of the insurer.¹⁹

To support its decision, the majority in *Greytak* addressed the policy considerations that support adoption of the notice-prejudice rule, namely the policies to extend insurance coverage when faced with disputes and to avoid automatic coverage loss by excusing technical policy breaches.²⁰ The Court held a failure to comply with a notice provision does not preclude coverage, reasoning the "public policy of Montana is to narrowly and strictly construe insurance exclusions because they are 'contrary to the fundamental protective purpose'" of insurance.²¹ Applying the notice-prejudice rule, the Court held an insurer must demonstrate it suffered prejudice from the insured's untimely notice before the insurer can deny coverage. Under the majority's rationale, an insurer must demonstrate it suffered prejudice even after the insured enters a settlement agreement contrary to the insurer's interests and without the insurer's knowledge.²²

C. Justice Rice and Justice McKinnon's Concurrences

While Justice Rice and Justice McKinnon agreed with the formal adoption of the notice-prejudice rule, both argued the majority should have extended its holding to declare Atlantic suffered prejudice from the untimely notice and was therefore relieved of its duties to defend and indemnify GTL.²³

¹⁶ *Id.* at 66.

¹⁷ *Steadele*, 260 P.3d at 147–148.

¹⁸ *Id.* at 151.

¹⁹ *Greytak*, 350 P.3d at 66.

²⁰ *Id.*

²¹ *Id.* at 67 (quoting *Steadele*, 260 P.3d at 149).

²² *Id.*

²³ *Id.* at 67 (Rice, J., concurring), 69 (McKinnon, J., concurring).

Reasoning the timely notice provision and the delay experienced by Atlantic were similar to those in *Steadele*, Justice Rice argued the majority should applied the notice-prejudice rule in favor of Atlantic, like the Court did in *Steadele*.²⁴ Much like the insured in *Steadele*, Greytak and GTL litigated the case without the involvement or knowledge of Atlantic and entered a settlement agreement that allowed for a judgment against GTL of over \$600,000.²⁵ Justice Rice argued the majority should have analyzed the prejudice suffered by Atlantic following the settlement agreement and held that GTL's failure to notify Atlantic resulted in a loss of coverage.²⁶ To support his argument, Justice Rice noted the purpose of the notice-prejudice rule is to protect insureds from the harsh effects of a technical breach, not to allow insureds to litigate claims and enter settlements without the knowledge or involvement of the insurer.²⁷

In her concurrence, Justice McKinnon agreed with Justice Rice's analysis that Atlantic suffered prejudice as a matter of law. However, as in *Estate of Gleason v. Central United Life Insurance Company*,²⁸ Justice McKinnon called for an exception to the notice-prejudice rule that presumes an insurer suffers prejudice when the insured fails to notify the insurer of a lawsuit until after judgment has been entered against the insured.²⁹ Justice McKinnon argued the entry of judgment prejudices the insurer because the the insurer is denied the ability to "investigate, defend, control, or settle the suit," and the majority's requirement that an insurer must demonstrate additional prejudice after the entry of judgment strays from the protective purpose of the notice-prejudice rule.³⁰ Specifically, the insured's delay in notification until after judgment has been entered is not a technical breach; the delay renders the timely notice provision ineffective by depriving the insurer of its rights to defend against the claim and participate in the suit.³¹

II. ANALYSIS IN SUPPORT OF THE MAJORITY HOLDING

As a threshold matter, the majority's decision to adopt the notice-prejudice rule is correct. The Court's extension of the notice-prejudice rule to third-party coverage is likely not subject to dispute, due to the unanimity of the Court's decision and the longstanding practice to

²⁴ *Id.* at 67–68 (Rice, J., concurring).

²⁵ *Id.* at 68.

²⁶ *Id.* at 67.

²⁷ *Id.* at 68.

²⁸ 350 P.3d 349, 370 (McKinnon, J., concurring in part and dissenting in part).

²⁹ *Greytak*, 350 P.3d at 69 (McKinnon, J., concurring).

³⁰ *Id.*

³¹ *Id.* at 69–70.

apply the principles of the notice-prejudice rule under Montana law.³² When confronted with insurance coverage disputes, courts must balance the interests of insurers and the rights of insureds. By formally adopting the notice-prejudice rule, the majority extended coverage to insureds, despite a procedural breach of the insurance policy, and reinforced the policy under Montana law to uphold an insured's right to coverage. The Court's formal adoption of the notice-prejudice rule clarified not only the status of the notice-prejudice rule, but also the rights and responsibilities of insureds and insurers. In its analysis, the Court relied on public policy considerations and contract law principles to extend the rule to its current status. Although *Greytak* corresponds with the tendency to extend coverage, the analyses used in *Steadele* and *Greytak* conflict, and although the majority clarified the status of the notice-prejudice rule, the majority failed to fully reconcile the two decisions.

A. Public policy considerations and anti-forfeiture principles support adoption of the notice-prejudice rule

Although insurance policy provisions that require the insured to notify the insurer of a claim as soon as possible are given effect under Montana law,³³ a provision that denies coverage for which the insured pays consideration violates public policy.³⁴ Motivated by the preference to uphold insureds' rights, *Greytak* gives effect to valid insurance policy provisions and extends insurance coverage when a breach of the policy causes no prejudice to the insurer. The majority conceded satisfaction of a notice requirement is a "condition precedent" to an insurer's liability, and failure to satisfy the condition may result in a loss of coverage.³⁵ However, to reconcile the competing interests of insurance carriers and consumers, Montana law excuses untimely notice under certain circumstances.³⁶ The *Greytak* decision relied on public policy considerations to adopt the notice-prejudice rule, reasoning the denial of coverage for a procedural breach that causes no prejudice to the insurer violates the "fundamental protective purpose" of insurance.³⁷ Allowing an insurer to escape its obligations to its insured contradicts the

³² See *Murnion*, 439 F.2d at 947 (upholding a district court ruling that under Montana law, an insured must demonstrate it suffered prejudice from the delay in notification); *Sorenson v. Farmers Ins. Exch.*, 927 P.2d 1002, 1005 (Mont. 1996) (holding that "absent some showing of material prejudice" to the insurer, coverage may not be precluded on a technicality); *XL Specialty Ins. Co. v. Patrol Helicopters, Inc.*, No. CV-08-73-BU-RFC-JCL, 2009 WL 4929261, at *1 (D. Mont.) (predicting the Montana Supreme Court would require the insurer to demonstrate prejudice before it could avoid liability based on the insurer's failure to provide timely notice of a claim).

³³ *Murnion*, 439 F.2d at 947.

³⁴ *Hardy v. Progressive Specialty Ins. Co.*, 67 P.3d 892, 899-900 (Mont. 2003).

³⁵ *Murnion*, 439 F.2d at 947.

³⁶ *Id.* ("delay in reporting is excusable when the accident is trivial, results in no apparent harm and furnishes no reasonable ground for the insured to believe that a claim might arise").

³⁷ *Swank Enters. Inc. v. All Purpose Servs., Ltd.*, 154 P.3d 52, 57 (Mont. 2007).

expectations of consumers and violates public policy considerations meant to protect consumers.

To reach a balance between the competing interests of insurers and insureds, the majority analogized the denial of coverage following untimely notice to the concept of forfeiture from contract law. Under Montana law, insurance policies are contracts subject to the principles of contract law,³⁸ and courts generally construe insurance policies in favor of the insured and in favor of extending coverage.³⁹ Although contract provisions requiring timely notice of claims are interpreted as conditions precedent to the insurer's duty to provide coverage,⁴⁰ contract law excuses the non-occurrence of a condition if the non-occurrence would result in a windfall to the insurer and an unjust loss of rights, or forfeiture, to the insured.⁴¹ The automatic loss of coverage following untimely notice can amount to an unjust forfeiture because the insured loses the insurance coverage for which he has paid consideration and the insurer is relieved of its obligations under the policy but suffers no harm from the untimely notice. Analogizing the loss of coverage to forfeiture, the notice-prejudice rule excuses untimely notice when the notice does not prejudice the insurer. The adoption of the notice-prejudice rule advances the protective purpose of insurance and conforms to the principles of forfeiture in contract law.

B. The Steadele Misinterpretation

Although adoption of the notice-prejudice is consistent with public policy considerations announced in prior decisions, the rule conflicts with the Court's treatment of untimely notice in *Steadele*. Despite the similarities between the timely notice requirements and the delays experienced by the insurers, the Court applied different standards to the notice-prejudice question in *Greytak* and *Steadele*. Although the *Greytak* decision recognized the confusion,⁴² the Court failed to fully address this inconsistency and reconcile the two decisions. While the *Greytak* majority argued *Steadele* applied the notice-prejudice rule in favor of the insurer,⁴³ the treatment of the untimely notice in *Steadele* paralleled an exception to the traditional rule called for by Justice McKinnon: notice to the insurer after judgment has been entered prejudices the insurer and relieves the insurer of its liability.⁴⁴ The Court

³⁸ Fisher ex rel. McCartney v. State Farm Mut. Auto. Ins. Co., 305 P.3d 861, 868 (Mont. 2013).

³⁹ *Steadele*, 260 P.3d at 149.

⁴⁰ *Murnion*, 439 F.2d at 947.

⁴¹ RESTATEMENT (SECOND) OF CONTRACTS § 229 (1979); see also MONT. CODE ANN. § 28-1-408 (2015) ("A condition involving a forfeiture must be strictly interpreted against the party for whose benefit it is created.").

⁴² *Id.* ("*Steadele* should not be read to renounce the notice-prejudice rule.").

⁴³ *Greytak*, 350 P.3d at 66.

⁴⁴ *Id.* at 69 (McKinnon, J., concurring).

in *Steadele* did not require the insurer to demonstrate it suffered prejudice. Rather, the Court noted that prejudice existed following the late notice and entry of judgment.⁴⁵ Although the traditional notice-prejudice rule requires the insurer to prove it suffered prejudice from the insured's untimely notice, the Court in *Steadele* reasoned the insured's timely notice was a condition precedent to coverage, and a failure to provide such notice barred the insured's recovery.⁴⁶ The *Steadele* decision held an insurer need only prove the insured provided notice after judgment has been entered, not that the insurer must demonstrate how the untimely notice prejudiced the insurer.⁴⁷ Although the Court used *Greytak* to clarify the status of the notice-prejudice rule, the Court does not clarify whether *Steadele* analyzed untimely notice under an exception to the rule. To reconcile the two decisions, the Court should have addressed the inconsistency, rather than assert *Steadele* does not stand for what it has been interpreted it to mean.⁴⁸ To resolve the inconsistency, the Court should have either recognized it presumed prejudice in *Steadele* under an exception to the notice-prejudice rule and adopted the exception that an insurer suffers prejudice as a matter of law when the insured gives late notice of a claim after judgment is entered, or the Court should have reconciled the conflicting analyses used in the two decisions by distinguishing *Greytak* from *Steadele*.

III. CONCLUSION

Although the Montana Supreme Court's adoption of the notice-prejudice rule in *Greytak* was the correct decision considering the history of the notice-prejudice requirement and the policy to protect insureds from coverage loss, the decision does not clarify the Court's treatment of untimely notice in *Steadele*. In the situation where an insured fails to notify the insurer of a claim and enters a settlement agreement contrary to the insurer's interests, it is unclear whether the insurer must make an additional showing of prejudice beyond that of the lost opportunity to participate in the defense and resolution of the claim. Going forward, late notice and forfeiture of policy benefits will continue to be analyzed from the perspective of prejudice. However, because the Court stopped short of announcing that prejudice will be presumed when notice comes

⁴⁵ *Steadele*, 250 P.3d at 151.

⁴⁶ *Id.* at 150.

⁴⁷ *Id.* at 151. ("[B]ecause Colony did not receive notice of the claim, Colony was prejudiced in that it was deprived of the ability to investigate, to locate witnesses, to appoint counsel, to engage in discovery, to negotiate a settlement, and to develop a trial strategy.").

⁴⁸ See Appellee's Answer Brief at 4, *Atl. Cas. Ins. Co. v. Greytak*, 350 P.3d 63 (Mont. 2015) (No. OP 14-0412) (arguing that under *Steadele*, an insurer is not required to show prejudice); *Atl. Cas. Ins. Co. v. GTL, Inc.*, 915 F.Supp.2d 1169, 1175 (D. Mont. 2013) (interpreting *Steadele* to mean an insured's failure to comply with a timely notice requirement in an insurance contract bars recovery under the policy).

after a settlement agreement or judgment has been entered, insurers bear the burden of proving prejudice on a case-by-case basis.