

INSURING YOUR INSURANCE WILL COVER YOU

Professional designers, contractors, material suppliers and even manufacturers, carry liability insurance as an important part of liability protection. One element of proper use of such insurance that each professional should constantly bear in mind is the requirement of giving timely notice of a claim or even of a potential claim. A recent case decided by the Wisconsin Court of Appeals, *Phoenix Contractors, Inc. v. Affiliated Capital Corporation* is an example of how an insured can lose the protection of the insurance by failing to timely report a claim to its insurance carrier.

In *Phoenix Contractors*, the trial court ruled that Phoenix, a roofing subcontractor to Affiliated Capital Corporation, failed to timely advise Phoenix's insurance carrier, Rural Mutual Insurance Company, of a claim against Phoenix. However, Phoenix began its liability odyssey when it went unpaid by Affiliated and commenced a small claims court action against Affiliated for \$1,518.12, the remaining amount due under the original contract between Phoenix and Affiliated. Affiliated filed a large counterclaim alleging that Phoenix's roofing work was defective. Phoenix then filed an amended complaint broadening its claim to include matters that had been the subject of previous arbitration between the parties and alleged additional damages. Affiliated responded to the amended complaint and repeated its previous counterclaim for defective work.

The dates of activity illustrate the problem that occurred regarding insurance coverage. On December 21, 2000, Phoenix commenced its small claims action against Affiliated. Not until December 5, 2001, did Affiliated file its large counterclaim alleging that Phoenix's roofing work was defective. On March 21, 2002, Phoenix filed its amended complaint to which Affiliated answered, repeating its previous counterclaim. On February 27, 2003, Phoenix tendered the

defense of Affiliated's counterclaim to Phoenix's insurance carrier, Rural Mutual. The tender stated that the case was scheduled for a three-day jury trial on March 18, 2003. Pre-trial discovery in the case had closed five months earlier in September of 2002.

When Rural Mutual got the tender, it filed a motion seeking to intervene, to stay the proceedings to allow it to file appropriate pleadings, to bifurcate the coverage issue from the liability issues, and to hear the coverage issue before any of the liability issues were resolved. In addition, Rural Mutual filed a counterclaim asserting that it did not provide coverage to Phoenix because, among other reasons, Phoenix had failed to provide Rural Mutual with timely notice of the claims asserted by Affiliated.

On April 15, 2003, Rural Mutual filed a motion for summary judgment arguing that Phoenix's 14-month delay in providing it with notice had deprived Rural Mutual of the opportunity to control the defense of Affiliated's lawsuit and to make a timely investigation of Affiliated's claims and to conduct necessary discovery. Rural Mutual contended that as a result it had been prejudiced. Phoenix responded by arguing that Rural Mutual had not been prejudiced by the delay.

After holding a hearing on the subject matter of the untimely notice, the court decided in favor of Rural Mutual and held that Phoenix's notice was untimely and that Rural Mutual had been deprived of the opportunity to engage in the defense of the action. The court further found that Phoenix had failed to offer sufficient evidence to rebut the presumption of prejudice that arose because of the late notice.

Under Section 631.81 of the Wisconsin Statutes entitled, "Notice and Proof of Loss", the statute reads in part:

"Provided notice or proof of loss is furnished as soon as reasonably possible and

within one year after the time it was required by the policy, failure to furnish such notice or proof within the time required by the policy does not invalidate or reduce a claim unless the insurer is prejudiced thereby and it was reasonably possible to meet the time limit.”

Section 632.26(2) of the Wisconsin Statutes states:

“Failure to give notice as required by the policy as modified by paragraph (1)(b) does not bar liability under the policy if the insurer was not prejudiced by the failure, but the risk of non-persuasion is upon the person claiming there was no prejudice.”

As you can see, the legislature has shifted the burden of proof as to whether the insurance carrier is prejudiced by late notice to the policyholder if the notice of a loss is not furnished to the carrier within one year after the time it was required by the policy. While insureds may doubt the significance of that, lawyers will tell you that who has the burden of proof may make the difference in the result.

In the Phoenix Contractors case, the Court of Appeals held that generally, whether an insurance carrier has been prejudiced by late notice may be a factual question. When the burden of proof shifts under the statute from the insurance carrier to the insured on the subject of prejudice caused by late notice, the evidence submitted by the insured who argues that the insurer was not prejudiced by late notice must be sufficient to rebut the presumption that there was prejudice. Where the insurance carrier has been deprived of the opportunity to timely conduct independent investigations and participate in pre-trial discovery by taking depositions and inspecting documentation, it will take strong proof by the insured to rebut the presumption of prejudice. In addition, proving the negative, i.e., that there was no prejudice, is much more difficult than proving prejudice.

In the Phoenix Contractors case, the court held that the mere fact that Phoenix had investigated the case and had conducted pre-trial discovery, all of which would be available to

Rural Mutual, was not sufficient to support Phoenix's argument that there had been no prejudice to Rural Mutual as a result of Phoenix's late notice. Rural Mutual did not concede at any point that it had not been prejudiced and continually asserted that the delay impaired its ability to defend. The Court of Appeals held that,

“Prejudice to the insurer is a serious impairment of the insurer's ability to investigate, evaluate, or settle a claim, determine coverage, or present an effective defense, resulting from the unexcused failure of the insured to provide timely notice.”

and further held,

“An insurer is prejudiced by late notice when...it has been denied the opportunity to have input into the manner of which the underlying claim is being defended.”

The Court of Appeals affirmed the trial court and held that Phoenix's evidence did not rebut the presumption that Rural Mutual's ability to make these defensive judgments and to take these defensive actions had not been seriously impaired, and held that Rural Mutual was relieved of its obligation to insure Phoenix in the case before the court.

To be told that your liability insurance carrier is released from its obligation to indemnify and defend a claim against you can cause significant, if not fatal, damage to the financial status of your professional or commercial firm. To avoid such a crisis, owners of engineering firms, construction companies, vendors and manufacturers should remain alert to the necessity of advising their insurance carrier of any claim, even while it is being handled by the firm's own attorney.