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Government Contractors Beware: Failing to Provide Notice to Your Insurer Before Settling May Doom Your Chance of Recovery

By Jocelyn Knoll, Katie Pfeifer, and Kathryn Johnson*

Many states have adopted a "notice-prejudice" rule, at least where the notice required is not a condition precedent to insurance coverage. While such rules may be helpful in overcoming potentially late notice of a claim, a recent Colorado Supreme Court decision signals that a settling party should not rely on the same rule in instances where it decides to settle a claim without first providing notice to the insurer. The authors of this article discuss the decision.

The Colorado Supreme Court recently issued a decision in *Travelers Prop. Cas. Co. v. Stresscon Co.*[1] *Stresscon*, a subcontracting concrete company, entered into a settlement agreement—without providing notice to its commercial general liability insurance carrier, Travelers—with Stresscon's general contractor, relating to a serious construction accident. Stresscon later sought indemnification from Travelers.

In a 4-3 decision, the court held that its earlier adoption of a "notice-prejudice" rule in *Friedland v. Travelers Indemnity Co.* did not overrule prior "no-voluntary-payments" jurisprudence, and declined to extend the reasoning in *Friedland* to Stresscon's voluntary settlement payment.

BACKGROUND

Colorado first adopted a "notice-prejudice" rule in uninsured motorist case in 2001.[2] Under the rule, if a preliminary determination shows that contractually-required notice of a claim by an insured to its insurer was untimely and the delay unreasonable, the insurer has the burden of demonstrating by a preponderance of the evidence that its significant interests were prejudiced by the delayed notice.

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[1] https://www.courts.state.co.us/userfiles/file/Court_Probation/Supreme_Court/Opinions/2013/13SC815.pdf.

[2] *See Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223 (Colo. 2001).

In 2005, the Colorado Supreme Court extended the "notice-prejudice" rule to liability policies.[3] *Friedland* also established that the insured's failure to give notice of a claim until after settlement is unreasonable as a matter of law, as it deprives the insurer of the opportunity to investigate a claim, present legitimate defenses, and participate in settlement negotiations, and the failure gives rise to a rebuttable presumption of prejudice. The court did not address, however, the effect of a voluntary payments clause on the analysis.

STRESSCON'S CLAIM AND THE APPEAL

In July 2007, one construction worker was killed and another seriously injured when a partially-erected building collapsed on them; the collapse was caused by Stresscon's subcontractor. The general contractor, Mortenson, asserted a claim against Stresscon for contract damages caused by project delays as a result of the accident.

Stresscon informed Travelers of the claim, and Travelers sent two reservation-of-rights letters to Stresscon. Travelers subsequently sent a letter to Mortenson, denying that Stresscon was liable for the delays. Stresscon and Mortenson then engaged in settlement negotiations and ultimately settled the dispute, without providing any notice to Travelers. Thirteen months later, Stresscon sued Travelers; this was the first notice Travelers had of the settlement.

At trial, the jury found that Travelers unreasonably denied Stresscon's claim and that Travelers had not been prejudiced by the settlement, awarding $546,899 in damages.

On appeal, Travelers asserted that the "notice-prejudice" rule does not apply to breaches of "no-voluntary-payments" clauses, and, alternatively, that insurers are prejudiced as a matter of law whenever an insured settles with a third party claimant before the third party has filed suit.

The Colorado Court of Appeals disagreed, holding that the "notice-prejudice rule" applies not only to "notice-of-claim" clauses, but also to "consent-to-settle" and "no-voluntary-payments" clauses. The court reasoned, among other things, that the policy considerations were similar to those at issue in *Clementi* and *Friedland* and that "forfeiting insurance benefits when the insurer has not suffered any prejudice would be a disproportionate penalty and provide the insurer a windfall based on a technical violation of the policy."

THE COLORADO SUPREME COURT'S DECISION

The Colorado Supreme Court reversed, holding that the "notice-prejudice" rule in *Friedland* did not overrule existing "no-voluntary-payments" jurispru-

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[3] *See Friedland v. Travelers Indem. Co.*, 105 P.3d 639 (Colo. 2005).

dence, and declining to extend the"notice-prejudice" reasoning to voluntary payments made in the face of a "no-voluntary-payments" clause. The court concluded that the "no-voluntary-payments" clause was a fundamental term defining the limits or extent of coverage. Unlike the notice requirements in *Clementi* and *Friedland*, the "no-voluntary-payments" clause does not impose a duty on the insured to do anything, nor does it impose a duty to refrain from doing something. Instead, it defines voluntary payments made without consent as uncovered expenses not borne by the insurer.

Moreover, the court reasoned that voluntarily making a payment, assuming an obligation, or incurring an expense requires affirmative and voluntary action on the part of the insured. The enforcement of such a provision cannot be characterized as an insurer reaping a windfall by invoking a technicality, and depriving an insurer of its choice to defend or settle a claim has practical implications for the risks that insurers take on and the premiums that insureds pay.

Finally, the court asserted that an insured has additional remedies under Colorado law if an insurer unreasonably delays or denies payment of a claim; however, those remedies do not include effectively expanding coverage beyond the express terms of an insurance policy by engaging in self-help. An insured may also protect itself under Colorado law by assigning to a third-party claimant any claim it may have against an insurer for breach of the duty of good faith and fair dealing.

The court ultimately concluded that extension of the "notice-prejudice" rule to "no-voluntary-payments" or "no-settlement" provisions would "deny insurers the ability to contract for the right to defend against third-party claims or negotiate settlements in the first instance. Public policy demands no such restriction on the right to contract."

DISCUSSION

Many states have adopted a "notice-prejudice" rule, at least where the notice required is not a condition precedent to coverage. While such rules may be helpful in overcoming potentially late notice *of a claim*, the Colorado Supreme Court's decision signals that a settling party should not rely on the same rule in instances where it decides to settle a claim without first providing notice to the insurer. In such instances it is better to ask first, rather than litigate later.