No. 99807

SUPREME COURT OF ILLINOIS

COUNTRY MUTUAL INSURANCE COMPANY,

Plaintiff-Appellee,

v.

LIVORSI MARINE, INC., an Illinois Corporation, and GAFFRIG PERFORMANCE INDUSTRIES, an Illinois Corporation,

Defendants-Appellants.

Appeal from the Appellate Court of Illinois, First Judicial District

on Appeal from the Circuit Court of Cook County, Illinois
Chancery Division, No. 01 CH 19671
The Honorable Steven A. Schiller

BRIEF OF *AMICUS CURIAE* UNITED POLICYHOLDERS IN SUPPORT OF DEFENDANTS-APPELLANTS

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

United Policyholders is a non-profit charitable organization founded in 1991 as a resource for buyers of all types of insurance products. The financial security insurance policies provide is an integral part of the fabric of our society and economy. Our organization exists to help enforce coverage promises that are made at the point of sale. Donations, grants and volunteer labor support United Policyholders' work. In addition to serving as a resource on insurance claims for disaster victims and commercial policyholders, United Policyholders provides pre and post loss claims education, files *amicus* briefs in cases involving coverage and claim disputes, and is an information clearinghouse on consumer issues related to commercial and personal lines insurance products.

In this brief, United Policyholders seeks to fulfill the "classic role of amicus curiae by assisting in a case of general public interest, supplementing the efforts of counsel, and drawing the court's attention to law that escaped consideration." *Miller-Wohl Co. v. Commissioner of Labor & Indus.*, 694 F.2d 203, 204 (9th Cir. 1982). This is an appropriate role for *amicus curiae*. As commentators have often stressed, an *amicus* is often in a superior position to "focus the court's attention on the broader implications of various possible rulings." R. Stern, E. Greggman & S. Shapiro, *Supreme Court Practice*, 570-71 (1986) (*quoting* B. Ennis, *Effective Amicus Briefs*, 33 Cath. U.L. Rev. 603, 608 (1984)).

United Policyholders has filed over one hundred and thirty five *amicus* briefs since it was founded. Most recently, our brief was considered and discussed by the California Supreme Court in *Julian v. Hartford Underwriters Ins. Co.*, 110 P.3d 903 (Cal. 2005). United Policyholders' *amicus* brief also was cited in the U.S. Supreme Court's opinion in *Humana Inc. et al v. Mary Forsyth*, 525 U.S. 299, 119 S.Ct. 710, 142 L.Ed.2d 753 (1999). We have been invited by several divisions of the California Court of Appeal, to participate in oral argument as

amicus curiae. Arguments from our *amicus curiae* brief were cited with approval by the California Supreme Court in *Vandenburg v. Superior Court*, 982 P.2d 229 (Cal. 1999) and contributed to *Watts Industries, Inc. v. Zurich American Ins. Co.*, 18 Cal.Rptr.3d 61 (Cal. App. 2004). United Policyholders was the only national consumer organization to submit an *amicus* brief in the landmark case of *State Farm Mut. Auto Ins. Co. v. Campbell*, 538 U.S. 408, 123 S.Ct. 1513, 155 L.Ed.2d 585 (2003).

SUMMARY OF ARGUMENT

The issue before the Court is whether insurance companies should be required to show that they have suffered prejudice from the timing of policyholders' notice before they can avoid coverage. The overwhelming majority of states have this requirement. The holdings of these courts are based on three fundamental principles of insurance law: (1) insurance contracts are not freely negotiated but are contracts of adhesion with terms that are largely imposed by insurers on policyholders; (2) the interpretation of policy language is informed by the public policy objective of protecting injured third parties; and (3) it is inequitable for insurers to receive a windfall and policyholders not to receive the benefits for which they paid due to a technicality. When the courts consider the purpose of insurance policy notice provisions in light of these principles, they hold that prejudice is required in order to fulfill that purpose and uphold the principles.

The courts of Illinois recognize and accept these three fundamental principles. Thus, Illinois already is in the majority in rejecting the traditional view of insurance and adopting the modern view which requires prejudice as a necessary component to insurers' coverage defense based on late notice. This Court has utilized these principles to excuse technical failures by policyholders to comply with policy provisions by allowing insurers' obligations to be triggered with "actual notice" of occurrences and lawsuits and by requiring prejudice before insurers can

avoid coverage for a breach of the cooperation clause in policies. Therefore, this Court should continue to follow the reasoning of this line of cases and fundamental insurance principles and hold that prejudice is required in order to avoid coverage based on late notice.

ARGUMENT

I. The Overwhelming Majority Of States Require Proof Of Prejudice Before An Insurer May Avoid Coverage On The Grounds Of Late Notice

A. The Insurers' Interpretation of Notice Provisions is Based on the Discredited and Rejected View of Insurance as a Freely Negotiated Private Contract

In the jurisprudence of the United States concerning insurance policies, the traditional view when interpreting policy terms was that courts should not interfere with the parties' presumed freedom to draft whatever agreement they desired, including provisions requiring policyholders to notify insurers of occurrences and lawsuits. *See Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 226-27 (Colo. 2001); *Cooperative Fire Ins. Ass'n of Vermont v. White Caps, Inc.*, 694 A.2d 34, 37 (Vt. 1997); *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193, 196 (Pa. 1977). Thus, many courts formerly held that notice provisions in insurance policies were conditions precedent with which policyholders had to comply strictly or forfeit all coverage under their policies. *See, e.g., Houran v. Preferred Accident Ins. Co.*, 195 A. 253, 259-60 (Vt. 1937). As a result, these courts held that insurers did not have to prove that they were prejudiced by the timing of policyholders' notice in order to avoid coverage. *See, e.g., Marez v. Dairyland Ins. Co.*, 638 P.2d 286, 290-91 (Colo. 1981) (discussing split between jurisdictions requiring prejudice and those that do not).

However, the vast majority of courts no longer adhere to the traditional view of insurance as a freely negotiated contract. *Clementi*, 16 P.3d at 228 ("Few courts today strictly adhere to the traditional approach which allowed for no consideration of insurer prejudice in determining whether benefits should be denied due to noncompliance with an insurance policy's notice

requirements"); *Alcazar v. Hayes*, 982 S.W.2d 845, 853 (Tenn. 1998). As explained by the Vermont Supreme Court in *Cooperative Fire*, in which the Court overruled its prior holdings and required insurers to prove prejudice before avoiding coverage on late notice grounds:

> Today it is widely recognized that an insurance contract is generally *not* a freely negotiated agreement; its terms and conditions are generally dictated by the insurer, and provisions such as the notice clause at issue here are standard terms on which the insured has no effective input.

694 A.2d at 37 (emphasis in original). Similarly, the Pennsylvania Supreme Court acknowledged the reality of insurance as a contract of adhesion in adopting the prejudice rule for late notice:

> We are of the opinion, however, that this argument, based on the view that insurance policies are private contracts in the traditional sense, is no longer persuasive. Such a position fails to recognize the true nature of the relationship between insurance companies and their insureds. An insurance contract is not a negotiated agreement; rather its conditions are by and large dictated by the insurance company to the insured. The only aspect of the contract over which the insured can 'bargain' is the monetary amount of coverage. And, as we have recognized, notice of accident provisions, such as that which we are concerned instantly, are uniformly found in liability insurance policies. . . . Thus, an insured is not able to choose among a variety of insurance policies materially different with respect to notice requirements, and a proper analysis requires this reality to be taken into account.

Brakeman, 371 A.2d at 196.

Courts also recognize that insurance implicates more than just the relationship between the insurer and the policyholder; the public has an interest in making sure that insurance is available to compensate injured third parties. *See Friedland v. Travelers Indem. Co.*, 105 P.3d 639, 646 (Colo. 2005); *Brakeman*, 371 A.2d at 198 n.8. For example, the Colorado Supreme Court recently adopted the prejudice rule for liability policies in reliance on this public policy of Colorado:

> [L]iability coverage is for the protection of the insured against liability to a third party and for the protection of the innocent tort victim who suffers personal injury or property damage for which the insured is liable. . . .
>
> In Colorado, there is a strong public policy in favor of protecting tort victims; this is a fundamental purpose of insurance coverage, whether or not the state makes the particular coverage mandatory to obtain.

Friedland, 105 P.3d at 646.

Finally, modern contractual jurisprudence disfavors forfeitures based on mere technical violations that result in windfalls to the insurer. *See Friedland*, 105 P.3d at 646; *Clementi*, 16 P.3d at 230; *Cooperative Fire*, 694 A.2d at 38; *Brakeman*, 371 A.2d at 198; *see also* Restatement (Second) of Contracts § 229 (1981) ("To the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange"). In other words, courts now hold that the penalty for failing to comply with a condition precedent should not overreach the purpose of the condition and the effect of the failure on the other party. *See Cooper v. Government Employees Ins. Co.*, 237 A.2d 870, 873-74 (N.J. 1968).

B. The Modern View of Insurance Requires Proof of Prejudice before Insurers May Avoid Coverage on the Grounds of Late Notice

Based on the modern view of insurance, courts have adjusted the standards for avoiding coverage on late notice grounds to ensure that the purpose of notice provisions in insurance policies is being fulfilled, rather than blindly allowing insurers to avoid coverage through a mechanical application of the language in such provisions. Courts balance the interests of policyholders and insurers in light of this purpose to arrive at the rule which requires prejudice to insurers before they can avoid coverage. As the Vermont Supreme Court explains:

> The purpose of a policy provision requiring notice of an accident, claim, or suit "is to allow the insurer to form an intelligent estimate of its rights and liabilities, to afford it an opportunity for investigation, and to prevent fraud and imposition

> upon it." [Citation omitted.] Prompt notice enables an insurance company to make a "seasonable investigation of the facts relating to liability," *Bayer & Mignolla Constr. Co. v. Deschenes*, 348 Mass. 594, 205 N.E.2d 208, 212 (1965), and thus
>
> "protects the insurance company from fraudulent claims, as well as invalid claims made in good faith, by allowing the insurance company to gain early control of the proceedings. . . .
>
> "[A] reasonable notice clause is designed to protect the insurance company from being placed in a substantially less favorable position than it would have been in had timely notice been provided. . . . In short, the function of a notice requirement is to protect the insurance company's interests from being *prejudiced*." *Brakeman*, 371 A.2d at 197 (emphasis added)."
>
> It follows that in cases where a late notice does not harm the insurer's interests, the reason for the notice clause has not been undermined. A strict forfeiture of coverage in these circumstances would thus "outreach[] the purposes of the provision" and constitute "an invidious . . . forfeiture . . . damaging to both an unwary insured and an innocent injured." [Citation omitted.] Properly understood and applied, the notice clause should not function as "a technical escape-hatch by which to deny coverage in the absence of prejudice," *Miller v. Marcantel*, 221 So.2d 557, 559 (La. Ct. App. 1969), but rather as an early warning mechanism to benefit both insurer and insured.
>
> We conclude, therefore, that the modern rule represents the better reasoned approach. The contract of insurance "not being a truly consensual arrangement," *Cooper*, 237 A.2d at 874, and the penalty being a matter of forfeiture, we think it appropriate to abandon the strict contract analysis of *Houran*. We hold, instead, that an insurer may not forfeit its insured's protection unless it demonstrates that the notice provision was breached, and that it "suffered substantial prejudice from the delay in notice." *Jones*, 821 S.W.2d at 803.

Cooperative Fire, 694 A.2d at 38; *see also Friedland*, 105 P.3d at 646-47; *Clementi*, 16 P.3d at 229-30; *Aetna Cas. & Sur. Co. v. Murphy*, 538 A.2d 219, 223 (Conn. 1988); *Brakeman*, 371 A.2d at 197-98; *Cooper*, 237 A.2d at 873-74.

Applying reasoning similar to that expressed by the Vermont Supreme Court in *Cooperative Fire*, at least 41 jurisdictions follow the modern rule and require proof that an insurer was prejudiced before it can avoid coverage on the grounds that notice was late. *See generally*, Annotation, *Modern Status of Rules Requiring Liability Insurer to Show Prejudice to*

Escape Liability Because of Insured's Failure or Delay in Giving Notice of Accident or Claim, or in Forwarding Suit Papers, 32 ALR 4th 141 (1984 and Supp. 2005); Barry R. Ostrager and Thomas R. Newman, Handbook on Insurance Coverage Disputes § 4.04 (12th ed. 2004). Moreover, in recent years the trend has continued in favor of the modern prejudice rule. Within the last eight years, both the Vermont and Colorado Supreme Courts have overruled their previous decisions and held that insurers must be held to a prejudice standard. *Friedland*, 105 P.3d at 646 (liability policies); *Clementi*, 16 P.3d at 230 (UIM coverage in automobile policies); *Cooperative Fire*, 694 A.2d at 38. Thus, the insurers' insistence that they can avoid coverage without proving prejudice is based on an ever-shrinking body of law that advocates an outdated and discredited interpretation of insurance policies generally, and notice provisions specifically.

II. Illinois Should Join The Majority And Require Insurers To Prove Prejudice In Order To Avoid Coverage On The Grounds Of Late Notice

A. Illinois Has Rejected the Traditional View of Insurance as a Freely Negotiated Private Contract

Illinois courts have not been consistent in their treatment of the role of prejudice in circumstances where the insurer has received late notice. In 1954 this Court held that, although the absence of prejudice alone cannot prevent insurers from avoiding coverage on the grounds of late notice, "lack of prejudice may be a factor in determining the question of whether a reasonable notice was given in a particular case." *Simmons v. Iowa Mut. Cas. Co.*, 3 Ill.2d 318, 322, 121 N.E.2d 509, 511 (1954). Since then, some appellate courts have followed *Simmons* and held that prejudice is a factor to consider in determining whether notice was reasonable. *See, e.g., Kerr v. Illinois Central R.R. Co.*, 283 Ill. App. 3d 574, 584, 670 N.E.2d 759, 767 (1st Dist. 1996); *Oliveri v. Coronet Ins. Co.*, 173 Ill. App. 3d 867, 871, 528 N.E.2d 986, 989 (1st Dist. 1987); *Kenworthy v. Bituminous Cas. Corp.*, 28 Ill. App. 3d 546, 549, 328 N.E.2d 588, 591 (4th

Dist. 1975). Others have refused to consider the lack of prejudice to an insurer at all, deeming it "immaterial" because notice is a condition precedent. *See, e.g., University of Ill. v. Continental Cas. Co.*, 234 Ill. App. 3d 340, 341, 599 N.E.2d 1338, 1355 (4th Dist. 1992); *INA Ins. Co. v. City of Chicago*, 62 Ill. App. 3d 80, 83, 379 N.E.2d 34, 37 (1st Dist. 1978). Still other courts hold that prejudice may be considered, but only where the policyholder "had a good excuse for the late notice or where the delay was relatively brief." *See, e.g., Fletcher v. Palos Community Consolidated School Dist. No. 118*, 164 Ill. App. 3d 921, 928, 518 N.E.2d 363, 368 (1st Dist. 1987). Recently, some courts have followed the majority rule and required insurers to prove prejudice, at least where the issue is the reasonableness of notice of a lawsuit. *See, e.g., Zurich Ins. Co. v. Walsh Constr. Co. of Illinois, Inc.*, 352 Ill. App. 3d 504, 511, 816 N.E.2d 801, 808 (1st Dist. 2004); *Montgomery Ward & Co., Inc. v. Home Ins. Co.*, 324 Ill. App. 3d 441, 449, 753 N.E.2d 999, 1005 (1st Dist. 2001); *Household Int'l, Inc. v. Liberty Mut. Ins. Co.*, 321 Ill. App. 3d 859, 869, 749 N.E.2d 1, 8 (1st Dist. 2001); *Illinois Founders Ins. Co. v. Barnett*, 304 Ill. App. 3d 602, 611-12, 710 N.E.2d 28, 35 (1st Dist. 1999); *Rice v. AAA Aerostar, Inc.*, 294 Ill. App. 3d 801, 808, 690 N.E.2d 1067, 1072 (4th Dist. 1998).

The confusion in Illinois regarding whether to consider prejudice, and if so what weight to assign it in determining whether insurers can avoid coverage for late notice, can be resolved by reference to fundamental principles of insurance law long accepted by Illinois courts. Illinois recognizes the same principles of insurance that the large majority of other jurisdictions have applied in reaching the conclusion that insurers cannot avoid their coverage obligations unless they prove they were prejudiced by the timing of notice.

Well before many other jurisdictions, this Court determined that insurance policies are not the result of bargaining between equals, but are unilateral contracts imposed by insurers on policyholders:

> [S]uch contracts are unipartite, or unilateral, being signed by the insurer only; and they are generally filled with conditions inserted by persons skilled in the learning of insurance law, and acting in the exclusive interest of the insurance company.

The Niagara Fire Ins. Co. v. Scammon, 100 Ill. 644 (1881); *see also Cincinnati Cos. v. West American Ins. Co.*, 183 Ill.2d 317, 328, 701 N.E.2d 499, 504-05 (1998) ("the insurer is usually in a better position than even a sophisticated insured to know the scope of the insurance contract and its duties under it"; noting the "frequent disparity in information and knowledge of insurance law" between an insurer and a policyholder); *Cramer v. Insurance Exchange Agency*, 174 Ill.2d 513, 531-32, 675 N.E.2d 897, 906 (1996) (Freeman, J., specially concurring) ("Insureds are often at a bargaining disadvantage with their insurers. . . . It is well established that an insurance contract is one of adhesion."); *Zubi v. Acceptance Indem. Ins. Co.*, 323 Ill. App. 3d 28, 37, 751 N.E.2d 69, 78 (1st Dist. 2001) ("[W]e recognize that insurance contracts are typically contracts of adhesion").

In common with most other states, Illinois public policy strongly favors the protection of innocent injured parties by construing insurance policies in favor of coverage. This Court noted in 1977 that:

> "[I]nsurance policies, in fact, are simply unlike traditional contracts. I.e., they are not purely private affairs but abound with public policy considerations, one of which is that the risk-spreading theory of such policies should operate to afford affected members of the public – frequently innocent third persons – the maximum protection possible consonant with fairness to the insurer. [Citation.] It is manifest that this public policy consideration would be diminished, discounted or denied if the insurer were relieved of its responsibilities although it is not prejudiced by the insured's actions or conduct in regard to its investigation or presentation and defense of the tort case."

M.F.A. Mut. Ins. Co. v. Cheek, 66 Ill.2d 492, 500, 363 N.E.2d 809, 813 (1977), quoting *Oregon Auto. Ins. Co. v. Salzberg*, 535 P.2d 816 (Wash. 1975); *see also Alberto-Culver Co. v. Aon Corp.*, 351 Ill. App. 3d 123, 132, 812 N.E.2d 369, 377 (1st Dist. 2004) (because the recovery of injured third-parties is involved, "public policy considerations dictate that a liberal construction in favor of coverage be applied"); *Rice*, 294 Ill. App. 3d at 807, 690 N.E.2d at 1071 ("Not every breach of a policy condition by the insured will allow the insurer to avoid payment under the policy. The law is also concerned with the rights of the public. . . .").

Finally, Illinois is in accord with the majority in holding that "insurance forfeitures are not favored as insurance serves important purposes in contemporary society". *A.D. Desmond Co. v. Jackson Nat. Life Ins. Co.*, 223 Ill. App. 3d 616, 620, 585 N.E.2d 1120, 1122 (2nd Dist. 1992). This Court affirmed this principle in *Cheek*, where this Court held that insurers cannot avoid coverage on the grounds of a breach of the cooperation clause in insurance policies without proving that they were prejudiced as a result of the breach. 66 Ill.2d at 500, 363 N.E.2d at 813. In rejecting the traditional approach of excusing an insurer without a showing of prejudice, this Court found that:

> "Such an approach places an undue emphasis on traditional, technical contract principles and their dubious application in cases of this nature. . . . Such relief, absent a showing a prejudice, would be tantamount to a questionable windfall for the insurer at the expense of the public."

Id., quoting *Salzberg*, 535 P.2d at 819.

B. The Modern View of Insurance as Adopted in Illinois Requires Proof of Prejudice before Insurers May Avoid Coverage on the Grounds of Late Notice

Because Illinois has the same modern view of insurance as the vast majority of jurisdictions that require proof of prejudice in order to defeat coverage on late notice grounds, this Court also should balance the interests of policyholders and insurers in light of the purpose

of notice provisions. As does the majority, Illinois understands that the purpose of notice provisions is to enable the insurer to conduct a timely and thorough investigation of the insured's claim to determine the extent of liability and to protect itself against unjustifiable claims. *Rice*, 294 Ill. App. 3d at 807, 690 N.E.2d at 1071; *University of Ill. v. Continental Cas. Co.*, 234 Ill. App. 3d 340, 364, 599 N.E.2d 1338, 1354 (4th Dist. 1992); *Rooney v. State Farm Mut. Auto. Ins. Co.*, 119 Ill. App. 3d 112, 116, 456 N.E.2d 160, 163 (1st Dist. 1983); *see also Commercial Underwriters Ins. Co. v. Aires Environmental Services, Ltd.*, 259 F.3d 792, 795 (7th Cir. 2001) (decided under Illinois law) ("Notice provisions such as the one at issue in this case are intended to ensure that the insurer ***will not be prejudiced*** in its ability to investigate and defend claims against its insureds." (emphasis added)). In cases where late notice does not harm the insurer's interest there is no reason to forfeit coverage, because the purpose of the notice provision has been fulfilled. To hold otherwise would "'outreach the purposes of the provision' and constitute 'an invidious . . . forfeiture . . . damaging to both an unwary insured and an innocent injured.'" *Cooperative Fire Ins. Ass'n of Vermont v. White Caps, Inc.*, 694 A.2d 34, 38 (Vt. 1997). Put another way, Illinois already has rejected the underlying rationale of the traditional rule where prejudice is not required to avoid coverage for late notice and has adopted the rationale of the modern view of insurance. Therefore, this Court should follow the path to its logical conclusion and require proof of prejudice to insurers as an element of the defense to coverage of late notice.

Indeed, this Court already has applied the rationale of the modern view of insurance to avoid forfeitures of coverage based on technical failures to comply with insurance policy provisions. For example, despite the fact that many policies require notice to be provided

specifically by the policyholder, as opposed to a third party,[1] this Court holds that "actual notice" from any source, including an injured third party, that allows the insurer to locate and defend a lawsuit is adequate notice to the insurer. *See Cincinnati Cos. v. West American Ins. Co.*, 183 Ill.2d 317, 329, 701 N.E.2d 499, 505 (1998). This Court based its decision on the modern view of insurance that takes into account the disparity in bargaining power between insurers and policyholders, the public policy in favor of preserving insurance for injured third parties, and the disfavor of technical forfeitures of coverage:

> We believe that the better rule is one which allows actual notice of a claim to trigger the insurer's duty to defend. . . . This rule is the result of a number of considerations. First, the insurer is usually in a better position than even a sophisticated insured to know the scope of the insurance contract and its duties under it. . . .
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> A second reason for allowing actual notice to trigger the duty to defend is to assure or protect the benefits of the insurance contract. The insurer, having received consideration for inclusion of the insured on its policy, should not be allowed to evade its responsibilities under the policy as a result of the insured's ignorance, particularly where the insurer has actual notice of a claim against its insured. [Citation omitted.]
>
> Finally, we note that the state has an interest in having an insured adequately represented in the underlying litigation. [Citations omitted.] A rule which requires only actual notice to trigger the duty to defend will protect that interest.

Cincinnati Cos., 183 Ill.2d at 329-30, 701 N.E.2d at 504-05. If these interests militate in favor of coverage in situations where the policyholder has not provided any notice to the insurer, they apply with equal if not greater force to trigger coverage under circumstances where the policyholder has provided delayed notice that has not harmed the interests of the insurer.

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[1] The policy issued by the Appellee, Country Mutual, to the Appellant Livorsi Marine, which is at issue in this case, contains a notice provision which states that "***You*** [*i.e.*, the policyholder] must see to it that we are notified as soon as practicable of an 'occurrence' or an offense which may result in a claim. . . . If a claim is made or 'suit' is brought against any insured, ***you*** must . . . Notify us as soon as practicable." (Emphasis added.)

Similarly, this Court holds that insurers must prove they were prejudiced before they can avoid coverage based on a breach of the cooperation clause in insurance policies. *See M.F.A. Mut. Ins. Co. v. Cheek*, 66 Ill.2d 492, 499, 363 N.E.2d 809, 813 (1977). As discussed above, this Court premised its holding on the same considerations that other courts have used to require prejudice to insurers before avoiding coverage based on a breach of the notice provision. *Cheek*, 66 Ill.2d at 499-500, 363 N.E.2d at 813.

It makes little sense to require insurers to prove "substantial prejudice" in order to avoid coverage for a breach of the cooperation clause, but not require prejudice in order to avoid coverage for a breach of the notice clause. In fact, several courts have treated the two clauses together and applied the same reasoning to hold that prejudice is required with respect to both provisions. *See, e.g., Oregon Auto. Ins. Co. v. Salzberg*, 535 P.2d 816, 818-19 (Wash. 1975); *Augat, Inc. v. Liberty Mut. Ins. Co.*, 571 N.E.2d 357, 361 (Mass. 1991). Therefore, in order to harmonize the standards applicable to insurance policies, which will enable both insurers and policyholders to more easily conform their conduct to these standards, this Court should adopt a rule that requires prejudice to insurers before they can avoid coverage for late notice.

One further point must be made. Currently in Illinois there is a line of cases that have adopted the prejudice rule where the issue is notice of a lawsuit. Illinois courts have not yet extended the prejudice rule to circumstances where notice of an occurrence or accident is at issue. However, as the above discussion makes clear, there is no basis for distinguishing between the two types of notice. States following the modern rule require prejudice for both the notice of occurrence and notice of suit defenses to coverage. *See generally*, Annotation, *Modern Status of Rules Requiring Liability Insurer to Show Prejudice to Escape Liability Because of Insured's Failure or Delay in Giving Notice of Accident or Claim, or in Forwarding Suit Papers*,

32 ALR 4th 141, 145 (1984 and Supp. 2005). This is because the rationales for requiring prejudice for notice of suit also apply to notice of occurrence.

Indeed, it often can be more difficult for a policyholder to determine whether to give notice of an occurrence as opposed to notice of a lawsuit, because the policyholder's potential liability and exposure in many cases are unclear in the aftermath of an occurrence. *See, e.g., Atlanta Int'l Ins. Co. v. Checker Taxi Co.*, 214 Ill. App. 3d 440, 445, 574 N.E.2d 22, 25-26 (1st Dist. 1992) (policyholder's two year delay in giving notice of accident to its excess insurers did not forfeit coverage, not only because policyholder's liability was in doubt but also "given the fact that neither excess insurer has asserted prejudice resulting from the delay"); *Commercial Underwriters Ins. Co. v. Aires Environmental Services, Ltd.*, 259 F.3d 792, 797-99 (7th Cir. 2001) (where policyholder promptly gave notice of lawsuit, but had not given notice of underlying accident that occurred two years before, policyholder's notice was reasonable because investigation of accident did not reveal likelihood of claim against policyholder). Requiring prejudice to insurers before avoiding coverage based on late notice of an occurrence would help to ensure that policyholders are not penalized for failing to give notice of occurrences during this period of uncertainty. Therefore, this Court should require prejudice to insurers for both notice of suits and notice of occurrences.

III. The Insurers' Objections To The Notice-Prejudice Rule Are Unjustified And Should Be Rejected

None of the insurance industry's arguments in opposition to the notice-prejudice rule withstand scrutiny. Insurance companies argue, in effect, that policyholders assume the risk of forfeiture, an argument that is inappropriate given the imbalance in the negotiating positions of policyholders and insurance companies. *See Cooperative Fire Ins. Ass'n of Vermont v. White Caps, Inc.*, 694 A.2d 34, 38 (Vt. 1997) ("The contract of insurance 'not being a truly consensual

arrangement,' [Citation omitted], and the penalty being a matter of forfeiture, we think it appropriate to abandon the strict contract analysis"). The contention that the notice-prejudice rule would eliminate policyholders' incentive to comply with policy terms fails as a matter of common sense. Policyholders would continue to have a substantial incentive to provide timely notice, because doing so would avoid inquiry into insurance company prejudice and eliminate the risk that coverage could be lost on this basis.

Almost all of the arguments advanced by insurance companies in objection to the notice-prejudice rule are red herrings, because the insurance industry is protected against its policy concerns by the prejudice component of the notice-prejudice rule. Insurance companies insist that prompt notice allows them to assess the strength of a claim and whether coverage exists; allows them to become involved in the defense of a claim at an early stage and explore early settlement opportunities; allows them to complete adequate investigations without stale evidence or missing witnesses; and allows them to investigate the possibility of fraud or collusion. To the extent an insurance company encounters actual problems in investigating, settling, or defending a claim because of the timing of notice, however, the insurance company can show that its investigation or settlement efforts were prejudiced and avoid coverage under the notice-prejudice rule.

The insurance industry's argument that a forfeiture rule is efficient fares no better. Any rule that operates to cut off rights is "efficient." Nevertheless, courts across the nation overwhelmingly have recognized that a forfeiture approach is gratuitously harsh and that the notice-prejudice rule does not unduly burden insurance companies. *See Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 230 (Colo. 2001) (observing that few courts still adhere strictly to the view that prejudice should not be considered). Further, under established principles of

Illinois law, efficiency must be balanced against the obligation of the insurance company to provide the protection for which the policyholder paid premiums, and against considerations of fairness generally. *See M.F.A. Mut. Ins. Co. v. Cheek*, 66 Ill.2d 492, 499-500, 363 N.E.2d 809, 813 (1977); *Bellmer by Bellmer v. Charter Sec. Life Ins. Co.*, 140 Ill. App. 3d 752, 755, 488 N.E.2d 1338, 1340 (4th Dist. 1986) (policy language "should be liberally construed in favor of coverage, toward the end that the insured is not deprived of the benefit of insurance for which was paid"); *Pierce v. Standard Acc. Ins. Co.*, 70 Ill. App. 2d 224, 232, 216 N.E.2d 818, 822 (2nd Dist. 1966) (insurance policies should be construed "so as not to defeat, without plain necessity, the insured's claim for indemnity which, in taking the insurance, it was his object to secure").

The insurance industry's contention that a notice-prejudice rule would leave insurance companies without "recourse" also misses the point of the notice-prejudice rule, which is precisely to provide insurance companies recourse, but only where it is necessary to protect insurance companies from actual prejudice. Nor can insurance companies object to the notice-prejudice rule on policy grounds by claiming that it would be difficult or impossible for them to establish prejudice. Where prejudice exists, insurance companies will be able to establish it. If insurance companies find it difficult or impossible to establish prejudice, it is in all likelihood because there was no material prejudice with respect to insurance company interests. Finally, it bears noting that the insurance industry has continued to function without dire consequences in the vast majority of Illinois' sister states despite their adoption of a rule requiring a showing of prejudice before a policyholder will forfeit its right to coverage. There is absolutely no reason to assume that insurance companies would not continue to carry on business as usual in this state in the event that this Court was to decide to adopt the modern approach of 41 other states.

CONCLUSION

The notice-prejudice rule is necessary to prevent serious and sometimes devastating harm to policyholders from the ability of insurance companies to void coverage based on technical grounds. Most jurisdictions now reject this result as offensive to the most basic notions of fairness. United Policyholders respectfully urges this Court to adopt the notice-prejudice rule for all liability policies in order to protect policyholders from the extreme penalty of forfeiture in cases where the insurance company has not been harmed by late notice of occurrence, claim or suit. This approach is fair, consistent with Illinois policy, and consistent with established principles of insurance and general contract law.

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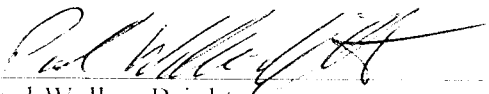
Respectfully submitted,



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CERTIFICATE OF SERVICE

The undersigned, an attorney, hereby certifies that he caused three copies of the Brief of *Amicus Curiae* United Policyholders in Support of Defendants-Appellants to be served on the following persons by placing true and correct copies in properly addressed envelopes, with proper pre-paid postage affixed thereto, and depositing the same in the United States mail, this 12th Day of July, 2005.

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