California Supreme Court Holds "Notice-Prejudice" Rule is "Fundamental Public Policy" of California, May Override Choice of Law Provisions in Policies

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On August 29, 2019, in *Pitzer College v. Indian Harbor Insurance Company*, 2019 Cal. LEXIS 6240, the California Supreme Court held that, in the insurance context, the common law "notice-prejudice" rule is a "fundamental public policy" of the State of California for purposes of choice of law analysis. Thus, even though the policy in *Pitzer* had a choice of law provision requiring application of New York law – which does not require an insurer to prove prejudice for late notice of claims under policies delivered outside of New York – that provision can be overridden by California's public policy of requiring insurers to prove prejudice after late notice of a claim. The Supreme Court in *Pitzer* also held that the notice-prejudice rule "generally applies to consent provisions in the context of first party liability policy coverage," but not to consent provisions in the third-party liability policy context.

The *Pitzer* case arose from a discovery of polluted soil at Pitzer College during a dormitory construction project. Facing pressure to finish the project by the start of the next school term, Pitzer officials took steps to remediate the polluted soil at a cost of $2 million. When Pitzer notified its insurer of the remediation, and made a claim for the attendant costs, the insurer "denied coverage based on Pitzer's failure to give notice as soon as practicable and its failure to obtain [the insurer's] consent before commencing the remediation process." The Supreme Court observed that Pitzer did not inform its insurer of the remediation until "three months after it completed remediation and six months after it discovered the darkened soils." In response to the denial of coverage, Pitzer sued the insurer in California state court, the insurer removed the action to federal court and the insurer moved for summary judgment "claiming that it had no obligation to indemnify Pitzer for remediation costs because Pitzer had violated the Policy's notice and consent provisions."

The insurance policy in *Pitzer* had three relevant provisions: (1) a notice provision requiring Pitzer to provide "notice of any pollution condition" with a "written report as soon as practicable;" (2) a consent provision requiring Pitzer to obtain the insurer's written consent "before incurring expenses, making payments, assuming obligations, and/or commencing remediation due to a pollution condition;" and (3) a choice of law provision stating that New York law governed all matters arising under the Policy. Based on the choice of law provision, the federal district court in *Pitzer* held that New York law applied to the policy. Under New York law, a policy delivered in New York is subject to the notice-prejudice rule; however, a policy delivered outside of New York was subject to a "strict no-prejudice rule" under New York common law, "which denies coverage where timely notice is not provided." Since the policy in *Pitzer* was delivered in California, the insurer did not need to prove prejudice from the College's late notice of its pollution claim.

The district court in *Pitzer* held that the insurer was entitled to summary judgment because Pitzer College's notice was not timely and the insurer did not need to show prejudice from that late notice. "[A]lthough a state's fundamental policy can override a choice of law provision," the district court observed, Pitzer "failed to establish that California's notice-prejudice rule is such a policy." Had it done so, Pitzer may have been able to avoid dismissal of its coverage claim due to its late notice of the pollution discovery and remediation work. Thus, Pitzer appealed to the Ninth Circuit Court of Appeals on the issue of whether the notice-prejudice rule was a fundamental public policy of California. The Ninth Circuit certified the question to the California Supreme Court.

The California Supreme Court in *Pitzer* held that the notice-prejudice rule was a fundamental public policy of California for several reasons, including that the rule "protects insureds against inequitable results that are generated by insurers' superior bargaining power." The notice-prejudice rule, the Supreme Court added, "is based on the rationale that the essential part of the contract is insurance coverage, not the procedure for determining liability, and that the notice requirement serves to protect insurers from prejudice, . . . not . . . to shield them from their contractual obligations through 'a technical escape-hatch.'" (internal citations and quotations omitted). The Supreme Court left it for the Ninth Circuit Court of Appeals to determine, based on its holding that the notice-prejudice rule is California's public policy, "whether California has a materially greater interest than New York in determining the coverage issue, such that the contract's choice of law would be unenforceable because it is contrary to our fundamental public policy."

Building on that holding, the Supreme Court also concluded that, with respect to the policy's consent provision, "failure to obtain consent in the first party context is not inherently prejudicial" to insurers, and "the usual logic of the notice-prejudice rule should control. . . ." The Supreme Court found "no reason to believe imposing this rule on first party insurers will prove so unmanageable for those suffering actual prejudice to justify a contrary conclusion." Thus, the court held, "California's notice-prejudice rule is applicable to a consent provision in a first party policy where coverage does not depend on the existence of a third party claim or potential claim." The California Supreme Court distinguished consent provisions in third-party liability policy context, "sometimes called 'no voluntary payment' provisions," which "are designed to ensure that responsible insurers that promptly accept a defense tendered by their insureds thereby gain control over the defense and settlement of the claim." In the third-party liability policy context, the Supreme Court observed, "the insurer's right to control the defense and settlement of claims is paramount," and California courts "generally refuse[ ] to find the notice-prejudice rule applicable to consent provisions in third-party policies."

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