

Parker Stanhagen

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**Reinsurer Says In 2nd Circuit That Judge's Evident Partiality Ruling Was Proper
Reinsured In N.Y. Federal Court Says Arbitration In Another Action Is Related**

INTERNATIONAL JURISDICTION

English Court Retains Jurisdiction Over Hurricane Rita Reinsurance Dispute

FOLLOW THE FORTUNES

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[Louisiana Safety Association of Timbermen – Self Insurers Fund v. Certain Underwriters at Lloyd's London, et al., No. 09-945, U.S. Sup.](#)

[Scandinavian Reinsurance Company Limited v. St. Paul Fire & Marine Insurance Company, et al., No. 10-0910, 2nd Cir.](#)

"[N]one of the alleged acts or omissions asserted in [the complaint] occurred in California. Rather nearly all of the alleged acts or omissions took place in Louisiana, and those which did not, took place outside of California," BAIG says. BAIG also says that none of the parties has a connection to California.

California

HFC notes that it is a risk retention group operating solely in California. HFC says that it "was created for California and does business solely in California."

HFC also says that BAIG was integral to its operations in California and BAIG's alleged wrongful conduct has harmed HFC's California policyholders.

HFC is represented by Marina Maniatis-Karvelas and Steven H. Weinstein of Barger and Wolen in Los Angeles. BAIG and Peter Myrtle are represented by Melissa Marie Thom of Younger & Associates in Rancho Cucamonga, Calif. The Aon companies are represented by Bryan C. Keane, Jill Alisa Hammerbeck and Timothy E. Branson of Dorsey & Whitney in Minneapolis. The reinsurers are represented by Andrew G. Wanger of Clyde & Co. in San Francisco.

(Additional document available. **Motion to dismiss.** Document #12-100917-004B.)

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Late Notice Defense — A Question Of Prejudice

By Steve Bazil and Parker Stanhagen

[Editor's Note: Steve Bazil is the founding partner of Bazil McNulty, a boutique law firm which for more than a decade has represented clients in the reinsurance industry. Recoveries by Mr. Bazil have involved clients and adversaries from more than 100 countries. Parker Stanhagen is an associate at Bazil McNulty specializing in commutations and claims defense throughout Latin America, Europe, and Asia. Despite the challenges associated with the reinsurance industry, Mr. Stanhagen has managed to successfully handle millions of dollars in commutations/collections for his clients. Copyright 2010 by Steve Bazil and Parker Stanhagen.]

Contracts in both the insurance and reinsurance industry customarily contain provisions indemnifying the insurer or reinsurer if they are not promptly notified of the filing of a claim. While the two industries are interconnected, courts have recently begun to acknowledge the differences in the fields and are now treating their respective late notice claims differently. This distinction by the courts may prove to be beneficial in the long run as the reinsurance practice will take another step away from its sometimes unjustified interconnectedness with the insurance industry. For the time being however, we are stuck in a state of limbo. The pace at which jurisdictions are willing to recognize the differences in the industries varies, and until definitive precedent is established in each jurisdiction we are left guessing as to how different States will distinguish between the insurance and reinsurance fields. Looking at the recent decisions can provide us with some clues as to how the trend is shaping up in the United States. These decisions can also give us a few definitive answers as to how certain States now distinguish between the insurance and reinsurance industry regarding late notice defense claims.

For years U.S. Courts have lumped insurance and reinsurance together, creating one precedent that tried to satisfy the nuances of two industries. Recognizing that this was creating unfair results in both industries, particularly the reinsurance field, courts have started to abandon associating the two industries and are now creating two different areas of law. The exact reason for this newfound awareness between the two industries may vary, but likely it is due to the fact that the United States has recently taken on a role as a serious participant in the reinsurance field. For years the U.S. remained in the backseat to many parts of Europe, particularly the U.K., in the industry. As such, U.S. courts remained inexperienced and

ignorant to many of the subtle differences between the two industries. With the expansion of the U.S. market in the reinsurance field, the number of cases litigated has grown. Faced with these new series of cases, courts have been forced to become better educated in the trade, which has allowed some of the prior misconceptions about the industry to fade. It is still important to remember that courts maintain the authority to examine the similarities between the two practices, but no longer does a decision made in the insurance field mean that a legal precedent has also been established in the reinsurance field.

Purpose Of Late Notice Provisions

As the courts have become more informed about the nuances of the reinsurance field they have been forced to deal with the myriad of issues that arise from late notice clauses. This much litigated topic has proven to be an area of uncertainty for those in the field and different jurisdictions have reached varying rulings on the matter. The divergence in how different jurisdictions handle late notice defense claims makes it important for anyone in the field to understand how different States treat this defense. Before understanding how various States handle these claims, it is important to have a solid understanding of late notice provisions and what causes such frequent litigation.

The primary purpose of a late notice provision in reinsurance agreements is to 1) reserve properly, 2) adjust premiums to reflect losses, and 3) determine whether to exercise the option of becoming associated with the ceding insurer in the defense and control of the underlying claim¹. Late notice provisions in reinsurance contracts are dependent upon the duty of utmost good faith at the center of all reinsurance relationships. Recognizing this, the Second Circuit stated:

[B]ecause information regarding risks lies with the ceding insurer, the reinsurance market depends upon a high level of good faith to ensure prompt and full disclosure. Absent such disclosure, reinsurers would have to duplicate actuarial and claims-handling efforts of ceding insurers, and reinsurance would become unavailable. Courts should thus adopt information-forcing default rules based on the good faith the reinsurance market demands.²

The Second Circuit is not alone in acknowledging the purpose of late notice provisions. In fact, most courts seem perfectly willing to recognize the purpose of late notice provisions however, they still continue to demonstrate a reluctance to fully enforce these provisions. The reasons for not enforcing the provisions vary, but often the court will focus on whether the lack of notice caused a quantifiable prejudice on the reinsurer. The insistence by the courts to prove prejudice reflects the courts newfound understanding of the differences in the insurance and reinsurance markets. Prejudice is often presumed to exist for late notice claims with the primary insurer because the insurer will have lost the ability to adequately defend itself on the claim. In the reinsurance field however, the recent realization by the courts that many reinsurers are responsible for only a very small portion of a claim has made them aware that late notice may not have actually caused any type of prejudice.³ This is because associating with the insurer on the defense of the claim may not have been financially practical or contractually permissible.⁴

Even as the new case law regarding late notice claims in the reinsurance field is beginning to develop, it is important to realize that courts will still rely on information that can be ascertained from late notice defense decisions within the insurance industry. One of the areas in which courts will still look to judicial decisions within the insurance industry for a reinsurance matter is to determine the proper interpretation of what constitutes "prompt notice". The late notice provisions we are discussing frequently have language requiring "prompt notice," notice "as soon as practicable," or "immediate notice."⁵ While the courts may vary on how to treat late notice defenses between the insurance and reinsurance field, there does not seem to be as large a delineation between what constitutes "prompt notice" in the two industries. Generally, courts have construed "prompt notice" to require notification within a 'reasonable' amount of time after a claim has arisen. The term 'reasonable' is an arbitrary term and courts have continued to struggle with when exactly the obligation to give notice arises.⁶ The standard is objective and seems to lie somewhere between mere speculation or rumor of an impending claim and total certainty of a claim. There is no hard and fast rule of when notice is "prompt,"⁷ as varying courts have found delays of five⁸, eight⁹, and twelve¹⁰ months to constitute late notice. This is another issue that needs to be grappled with on a jurisdiction-to-jurisdiction basis, but what does seem clear is that the courts will view a wide array of case law in making this decision, not simply relying on decisions that specifically center on the reinsurance field.

On the same note, courts will also refuse to allow a late notice claim in varying circumstances. Some states require a reinsurer to "promptly" object to late notice in order to avoid waiving the defense¹¹. In the absence of this objection, any claim based on late notice is lost.

Prejudice

Now that we understand the purpose of late notice provisions, it is easier to understand why many courts now require prejudice be shown in order for the defense to be raised. This is an area in which the courts new decisions within the reinsurance field are distancing themselves from traditional direct insurance law. Some courts have explained the distinction by saying that because a reinsurer has no obligation to defend, investigate, or settle a reinsurer's claims, the "failure to give the required prompt notice is of substantially less significance for a reinsurer than for a primary insurer."¹²

While most new decisions have begun to recognize that avoiding late notice can only be realized upon a showing of prejudice, the interpretation of prejudice varies from State to State. Some jurisdictions require "tangible economic injury" be shown to constitute prejudice¹³. On the other extreme, some States find that the loss of the right to "associate" with the cedent in the defense and control of the underlying claim or suit constitutes "prejudice."¹⁴ While others take a more middle-of-the-road approach, finding that "prejudice" is only present where the reinsurer can prove that it would have exercised its right to associate and that such association would have resulted in a more favorable result¹⁵. Variances such as these will always exist within separate jurisdictions. The pivotal issue those within the industry have to concern themselves with is how different States are currently handling late notice claims. While the trend is clearly moving in the direction of a need to show prejudice in order to succeed with the defense, this has not been established in every jurisdiction and the differences between how various States treat a late notice defense claim can have substantial effects on the outcome of the case.

States

The growth of the reinsurance industry within the United States has led the courts to a better understanding of the industry. This growth however, has been confined to a relatively minimal number of jurisdictions, which for one reason or another have been attractive to the reinsurance industry. As a result, the recent trend of decisions this article has focused on is confined to the States which handle reinsurance matters on a more frequent basis. This does not mean that courts which do not handle reinsurance related matters on a consistent basis will be unable to recognize the newfound distinction between the insurance and reinsurance industry that other U.S. Courts have made. In fact, it will be hard for any court to refuse to acknowledge the recent decisions and legal trend on this matter. Until there is a decision in every jurisdiction however, it will be hard to state with confidence how decisions will be made in jurisdictions facing reinsurance late notice claims as a matter of first impression. What we can know for certain are those decisions which have been recently made in various jurisdictions. As stated before, these decisions come from States which handle reinsurance matters within the U.S. more frequently and therefore are invaluable to those in the field. The lack of decisions in other States is unfortunate for those wanting to operate within a completely predictable industry; however as this is an impossibility at this time, we are forced to rely on the information available to us now. Fortunately, there is precedent which we can depend upon from a group of jurisdictions which handle reinsurance matters on a frequent basis:

New York: Courts have decided that a late notice defense claim requires proof of "tangible economic injury" unless notice was a condition precedent. In the event that notice is contractually included as a condition precedent then no prejudice needs to be shown.¹⁶

California: Courts have decided that any late notice defense claim must be accompanied with a showing that the reinsured was harmed through "actual and substantial prejudice".¹⁷

New Jersey: As early as 2002, Second Circuit courts did not require a showing of prejudice on late notice defense claims. In a change reflective of the recent trend, this decision was reversed and the Second Circuit has now decided that a showing of prejudice must be demonstrated to prevail on any late notice claim. The court reasoned that "ritualistic adherence to prompt notice clauses in reinsurance

contracts in the absence of prejudice" merely provides the reinsurer with an easy escape from its obligations under the reinsurance contract¹⁸.

Pennsylvania: Keeping with the recent trend of most courts, the Pennsylvania courts have ruled that even where the cedent admitted that notice was late, the reinsurer must prove it was "unduly prejudiced" by late notice to prevail¹⁹.

Illinois: A recent decision in Illinois found that a reinsurer did not have to show prejudice to escape its obligations when late notice was received in violation of a notice clause that was a condition precedent to coverage²⁰. This is similar to the New York ruling in which no prejudice must be shown so long as a requirement of prompt notice was contractually agreed upon as a condition precedent to coverage²¹. There is not a case on point showing how the court will rule on a late notice claim in which prompt notice is not a condition precedent. However, if the Illinois court continues to follow the decisions of the New York courts, then a showing a prejudice would need to be shown by the reinsurer for any claim in which notice is not a condition precedent. This remains as speculation however, until the court is faced with a case to resolve this outstanding issue.

Kansas: A reinsurer is required to show substantial prejudice to be relieved of its reinsurance obligations because of late notice.

New Hampshire: Focusing on the duty of good faith found in reinsurance contracts the New Hampshire Supreme Court differed from the recent trend and ruled that a ceding insurer's failure to provide prompt notice of a claim may relieve its reinsurer from indemnifying the ceding insurer without showing prejudice if the ceding insurer's late notice was due to gross negligence or recklessness amounting to a breach of the duty of utmost good faith.

Seventh Circuit: The Seventh Circuit has also strayed from the trend of most courts by ruling that late notice creates a "rebuttable presumption" of prejudice, rather than requiring that prejudice must be shown.²²

Conclusion

The distinction between direct insurance and reinsurance has a dramatic effect on how courts view the late notice defense. Recent decisions have demonstrated that courts are beginning to distinguish between the two fields and treating each independently. Conflicting legal conclusions on how to handle late notice claims have resulted from this distinction, but the trend in the reinsurance industry is to necessitate some showing of prejudice in order to prevail with a late notice defense. It is still evident, even with the trend moving in the direction that it is, that certain jurisdictions will depart from the trend and not require a showing of prejudice. The variances between the jurisdictions will never be completely removed, and it will be up to individual insurers and reinsurers to inform themselves of the laws of the State in which they operate. As time passes and more decisions are made, the fog in which those operating within the reinsurance industry now sit in will be lifted. As for now however, the uncertainty in many jurisdictions remains and only time will tell as to how the remaining jurisdictions will rule.

Endnotes

1. Christiania Gen. Ins. Corp. v. Great Am. Ins. Co., 979 F.2d 268, 274 Shepardize (2d Cir. 1992). See also Jess Ins. Co v. Fortress Re, Inc., 616 F. Supp. 874, 878 Shepardize (S.D.N.Y. 1984).
2. Unigard Security Insurance Co., Inc. v. North River Insurance Co., 4 F.3d 1066, 1069 Shepardize (2d Cir.1993).
3. Insurance Co. of State of Pennsylvania v. Associated Intern. Ins. Co. 922 F 2d 516 CA 9 Shepardize (Cal), 1990.
4. Keehn v Excess; Stuyvesant Ins. Co. v. United Public Ins. Co. 139 Ind.App. 533, 1966 Shepardize.

5. Nat'l Am. Ins. Co. v. Certain Underwriters at Lloyd's London, 93 F.3d 529 Shepardize (9th Cir. 1996).
6. Stonewall Ins. Co. v. Modern Exploration Inc., 757 S.W.2d 432 Shepardize (Tex. App. 1988).
7. Insurance Co. of Ireland, Ltd. v. Mead Reins. Corp., 1994 U.S. Dist. LEXIS 15690 Shepardize (S.D.N.Y. Nov 4, 1994).
8. Unigard Security Insurance Co., Inc. v. North River Insurance Co., 4 F.3d 1066, 1069 Shepardize (2d Cir.1993).
9. Stuyvesant Ins. Co. v. United Public Ins. Co., 221 N.E.2d 358 Shepardize (Ind. App. 1966).
10. Fortress Re, Inc. v. Jefferson Ins. Co., 465 F. Supp. 33, 338 Shepardize (E.D.N.C. 1978), aff'd, 628 F.2d 860 Shepardize (4th Cir. 1980).
11. Nat'l Am. Ins. Co. v. Certain Underwriters at Lloyd's London, 93 F.3d 529 Shepardize (9th Cir. 1996).
12. Unigard Security Insurance Co., Inc. v. North River Insurance Co., 4 F.3d 1066, 1069 Shepardize (2d Cir.1993).
13. Id. Shepardize
14. Keehn v. Excess Ins. Co. of Am., 129 F.2d 503, 505 Shepardize (7th Cir. 1942).
15. Fortress Re Inc v. Central National Insurance Company of Omaha, 766 F.2d 163 CA4 Shepardize (NC), 1985 (applying North Carolina law).
16. Constitution Reinsurance Corp. v. Stonewall Ins. Co., 980 F. Supp. 124 Shepardize (S.D.N.Y. 1997); aff'd 182 F.3d 899 Shepardize (2d Cir. 1999).
17. 17 Nat'l Am. Ins. Co. v. Certain Underwriters at Lloyd's London, 93 F.3d 529 Shepardize (9th Cir. 1996). (applying California law).
18. Unigard Sec. Ins. Co., Inc. v. North River Ins. Co., 79 N.Y.2d 576 Shepardize (2d. Cir. 1992) (interpreting New Jersey Law).
19. Life & Health Ins. Co. v. Federal Ins. Co., No. CIV A. 92-6736, 1993 U.S. Dist. LEXIS 12165, at *2 Shepardize (E.D. Pa. Aug. 25, 1993).
20. Casualty Ins. Co. v. Constitution Reins. Co., No. 91 L 14732 (Circuit Court of Cook County, Ill. Jan. 22, 1996), reprinted in Mealey's Litigation Reports: Reinsurance Vol. 6, No. 18 (Jan 31, 1996).
21. Constitution Reinsurance Corp. v. Stonewall Ins. Co., 980 F. Supp. 124 Shepardize (S.D.N.Y. 1997); aff'd 182 F.3d 899 Shepardize (2d Cir. 1999).
22. Central Nat'l Ins. Co. v. Prudential Reins. Co., 241 Cal. Rptr. 773, 787 Shepardize (1987).

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