

## Prejudice, Smejudice: Late Notice in the Face of a Condition Precedent

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### Introduction

Reinsurers know that raising the defense of late notice to a late-noticed claim from a reinsured is very difficult to sustain (*see* Expert Commentary June 2005 and September 2002). Most states' laws require the reinsurer to show actual prejudice to sustain the defense and avoid the late-noticed claim. Yet, the defense may be sustained based on the terms and conditions of the reinsurance contract. The language used in the notice provision of the reinsurance contract may impact how a court will interpret the clause. If the court interprets the notice clause as a condition precedent, a showing of prejudice by the reinsurer may not be required.

### Late Notice in Various States

In *Unigard Sec. Ins. Co. v. North River Ins. Co.*, the New York Court of Appeals was asked to answer a certified question posed by the Second Circuit Court of Appeals to resolve a split of authority in the federal courts. The question presented was “[m]ust a reinsurer prove prejudice before it can successfully invoke the defense of late notice of loss by the reinsured?” 79 N.Y.2d 576, 581 (1992). The court answered in the affirmative. The court reached its conclusion because the prompt notice terms of the reinsurance contract were held not to be read as an express condition precedent. *Id.* at 582.

The Second Circuit, accepting this view, held that “[f]or a reinsurer to be relieved from its indemnification obligations because of the reinsured’s failure to provide timely notice, absent an express provision in the contract making prompt notice a condition precedent, it must show prejudice resulted from the delay.” *Christiania Gen. Ins. Corp. v. Great Am. Ins. Co.*, 979 F.2d 268, 274 (2d Cir. 1992). The phrase, “absent an express provision making prompt notice a condition precedent,” opened the door for arguing that where there is an unambiguously written express condition precedent, the reinsurer would not need to show prejudice. Thus, where a notice provision is intended to serve as a condition precedent, a reinsurer need not show prejudice to raise the late notice defense. *Constitution Reinsurance Corp. v. Stonewall Ins. Co.*, 980 F. Supp.124 (S.D.N.Y. 1997).

Various other courts have adopted a similar view. *Keehn v. Excess Ins. Co. of Am.*, 129 F.2d 503, 504 (7th Cir. 1942); *Liberty Mutual Insurance Co. v. Gibbs*, 773 F.2d 15 (1st Cir.1985); *Ins. Co. of State of Pa. v. Assoc. Intern. Ins. Co.*, 922 F.2d 516 (9th Cir.1990); *Newcap Ins. Co. v. Employers Reinsurance Corp.*, 295 F. Supp.2d 1229, 1242 (D. Kan. 2003).

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## When Is a Notice Provision a Condition Precedent?

But whether a notice clause is a condition precedent is often in the eye of the beholder. In *Folksamerica Reinsurance Co. v. Republic Ins. Co.*, 03 Civ. 0402(HB), 2003 U.S. Dist. LEXIS 21162 (S.D.N.Y. Nov. 25, 2003), the court examined a notice provision almost identical to the one found in *Constitution Reinsurance*, yet held that the language should not be construed as an express condition. 2003 U.S. Dist. LEXIS 21162 at \*22. The court reasoned:

While the reinsurance Certificate there contained the identical notice provision, the issue of how to interpret the notice clause was never raised, nor did the Court discuss this issue in its Opinion....Therefore, *Constitution Reinsurance* lends no support to Folksamerica's argument that the notice clause is also a condition precedent.

*Id.* at \*23, n.12.

In discussing what an ideal condition precedent should contain, the court looked to Strain on Reinsurance and listed four identifiers that would establish an unambiguous condition precedent: The provision “(1) specifies to what the condition precedent refers; (2) sets out the number of days that suffice for prompt notice; (3) expressly states that the Reinsurer need not establish prejudice; and (4) clearly provides that the Reinsurer will be relieved of liability should prompt notice not be provided.” *Id.* at \*28-29. In other words, to merely include the statement “as a condition precedent” in the notice clause may not be good enough.

Thus, a notice provision that is ambiguous as to whether the parties intended to make it a condition precedent will not relieve a reinsurer of the requirement to show prejudice. But, when there is clearly an unambiguous express condition precedent in the notice provision, New York law will not require the reinsurer to prove prejudice. See *Folksamerica*, 2003 U.S. Dist. LEXIS 21162 at \*20, n.9 (citing to *Unigard* and *Christiana*).

In Illinois, however, a more flexible approach in interpreting whether a notice clause is a condition precedent appears to have prevailed. In *Keehn v. Excess Ins. Co. of Am.*, the court recognized that Illinois law provides that should a condition precedent be present in the reinsurance contract, no proof of prejudice would be required. 129 F.2d 503, 504 (7th Cir. 1942). Although the plaintiff contended that the provision should not be effective because the contract “failed to designate this provision as a condition precedent, nor did it contain a declaration of forfeiture for non-compliance,” the court still affirmed the district court's opinion that recovery by the insured is barred for failure to comply with the provision. *Id.*

In 2005, an Illinois federal court reinforced the *Keehn* holding regarding prompt notice provisions:

The law in Illinois, however, is clear that a notice requirement, such as the one contained in the Treaty, is a condition precedent to coverage.... Consequently, “when the insured fails to comply with

a prompt notice requirement, the insurer may deny liability, regardless of whether it has been prejudiced by the delay.”

*Allstate Ins. Co. v. Employers Reinsurance Corp.*, 441 F. Supp.2d 865, 875 (N.D. Ill. 2005) (citations omitted). The treaty in *Allstate* did not mention that the provision should be deemed a condition precedent, nor did it contain the model language suggested in Strain’s; yet the court found that it was indeed a condition precedent and that proof of prejudice would not be required. *Id.*

#### But Is Prejudice a Requisite Regardless of Condition Precedent?

Under California law, prejudice still seems to be required regardless of whether the notice provision is a condition precedent. In *Nat’l Am. Ins. Co. of Ca. v. Certain Underwriters at Lloyd’s London*, the court in interpreting California law explained: “[A] reinsurer may invoke the defense of late notice so long as it immediately objects to the late notice, and suffers ‘actual and substantial prejudice.’” 93 F.3d 529, 538 (9th Cir. 1996). The court emphasized that not only is a condition precedent subject to waiver under California law, but the notice provisions in the case were not considered conditions precedent “because they lack[ed] the requisite ‘clear and unambiguous expression by the parties . . . that they intended the notice provision to be a condition precedent . . . .’” *Id.* at 539 (citations omitted).

In *British Ins. Co. v. Safety Nat’l Cas. Corp.*, the court was asked to determine whether the New Jersey Supreme Court would hold that proof of prejudice is required by late notice of claims defenses in the reinsurance context. In coming to its decision, the Third Circuit relied heavily on New York law, and concluded that “under New Jersey law, a reinsurer must show the likelihood of appreciable prejudice in order to prevail on a late notice defense asserted against its reinsured.” 335 F.3d 205, 215 (3d Cir. 2003). The court in explaining why prejudice must be shown stated:

The New Jersey Supreme Court clearly frowns upon literal interpretation of notice provisions in situations where it results in the insured forfeiting coverage it has already paid for absent some countervailing consideration (such as prejudice) on the part of the insurer that has accepted premiums in return for offering coverage. We therefore conclude that the New Jersey Supreme Court would require the reinsurer to demonstrate prejudice where, as here, the reinsurer relies upon late notice as a defense against the otherwise legitimate claims of its reinsured.

*Id.* at 213. The court also quoted *Christiania* in holding that “[a] reinsurance contract is governed by the rules of construction applicable to contracts generally.” *Id.* at 212 (citations omitted). The court made it clear that the New Jersey Supreme Court “frowns upon literal interpretation of notice provisions in situations where it results in the insured forfeiting coverage,” and would perhaps read prompt notice provisions solely as a covenant.

Conclusion

A majority of courts recognize the difference between reinsurers and direct insurers regarding the notice-prejudice requirement. Because the failure to perform under a prompt notice provision is perceived as being less important to a reinsurer than a direct insurer, courts are comfortable in adding the prejudice requirement in the reinsurance context. But courts will carefully analyze whether a notice provision is indeed a condition precedent. Some courts have held that a notice provision will not sufficiently act as a condition precedent when the provision merely states that it is. If, however, the notice provision is found to be an unambiguous express condition precedent, the majority of courts will forgo the prejudice requirement and look solely to the failure of performing the prompt notice provision itself as the ground for the reinsurer's defense of late notice.

Careful attention should be paid when drafting notice provisions in reinsurance contracts to make clear whether prompt notice of a claim is intended to be a condition precedent to coverage under the reinsurance contract.

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