Remedies for Breach of Reinsurance Claims Provisions: From the Perspective of US and English Law

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In reinsurance law, subject to the reinsurance policy's provisions, the reinsured's liability forms the reinsurers liability. As the claim originally arises from the assured, the reinsurers usually have no opportunity to interfere with the reinsured's claims handling process. Claims provisions are used to overcome the severe consequences of such a situation and third party reinsurers may be entitled to be involved in the reinsured's claims handling. In England reinsurers tend to use the opportunity that is provided by their contractual terms; in the US, however, even though reinsurance contracts may provide such opportunity, claims co-operation and control clauses are called "discretionary" and in fact the reinsurers are concerned with the possibility that their interference might cause direct claims from the assureds. In the US, the law differs from State to State. In England, Aspen Insurance UK Ltd v Pectel Ltd[1] *indicates that the remedy for breach of claims provisions is settled. This paper aims to make a comparative analysis between the two systems with regard to the nature of claims provisions and remedies provided for their breach.*

In the absence of an express clause so requiring, the reinsured is under no obligation to notify the reinsurer with regard to the assured's claim and the reinsurers are not entitled to interfere with the settlement process or with the reinsured's defence of the assured's claim in arbitration or litigation[2]. However, claims provisions provide such opportunity to reinsurers. Claims co-operation clauses give the right to reinsurers to be involved in the investigation and settlement of the loss[3]. Claims co-operation clauses may be in the form of a notification provision which requires the reinsurers to be informed of circumstances that may give rise to claim, or may amount to a "consent" clause which requires the reinsured not to settle any claim without seeking the reinsurers' consent prior to any settlement. Claims control clauses may confer wider authority than claims co-operation clauses, to the effect that the reinsured may be obliged to pass to reinsurers the control of any negotiations with the direct assured.

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[1] [2008] EWHC 2804 (Comm).

[2] *Charman v Guardian Royal Exchange Assurance* [1992] 2 Lloyd's Rep 607, 614; Butler and Merkin, *Reinsurance Law*, Sweet & Maxwell, para C-0053; O'Neill and Woloniecki, *The Law of Insurance in England and Bermuda* London: Sweet & Maxwell 2004, para 5-105.

[3] Edelman, Burns, Craig and Nawbatt, *The Law of Reinsurance*, Oxford University Press 2005, para 5.07; Merkin, *Colinvaux Law of Insurance*, 8th Edition, London, Sweet & Maxwell 2006, para 17-24.

Claims provisions can be seen in US reinsurance policies as well, and claims control clauses entitle reinsurers to control claims against reinsureds[4]. For claims co-operation, however, the terminology differs and such provisions may also be called "right to associate"[5] clauses which give reinsurers the right "to consult with and advise the reinsured in its handling of the claim"[6]. There may also be a corresponding duty on the reinsured to make full and prompt disclosure of the information the reinsurer needs in order to decide whether to associate[7].

Notification Clauses

There is no single uniform form of notification clause. In the insurance context the forms of notice provisions may require the reinsured to give "immediate"[8] notifications of circumstances that "may" or "are likely" to give rise to claim, or notification of actual loss or the policy may specify the time of notification, or at least "as soon as reasonably practicable"[9]. In *AIG Europe (Ireland) Ltd v Faraday Capital Ltd*[10] the clause was a combination of the last two categories: "The Reinsured shall upon knowledge of any loss or losses which may give rise to a claim, advise the Reinsurers thereof as soon as is reasonably practicable and in any event within 30 days …". It was held that the obligation is not to notify as soon as practicable with 30 days as the maximum period, but that there is a single obligation to notify within 30 days. Circumstances that are "likely to give rise to a claim" are interpreted as referring event presenting at least a 50 per cent chance that a claim would ensue[11]. The fact that a later claim did arise was not of itself sufficient to establish that a claim had been likely[12]. Circumstances which "may" give rise to claim is more onerous on the assured, and has the effect of exposing reinsurers a larger number of claims during

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[4] Wollan, E, *Handbook of Reinsurance Law*, 2002, para 4.07; In order to oblige the reinsured to confer with and secure the agreement of the reinsurer to settle claims of certain types or amounts in order to be indemnified claims control clauses sometimes are worded "counsel and concurrence" or "concur and consent" clauses. New Appleman Insurance Law Practice Guide, LexisNexis, 2007, http://www.chadbourne.com/files/Publication/b3b45e9d-566d-4433-8198-68078ae54acf/Presentation/PublicationAttachment/441ebf2d-7946-4a56-958a-5d6ab2da6c9d/013-60099_60099-ch0040.pdf (last visited on 16 August 2009), para 40.11.

[4] Wollan, para 4.07.

[5] Wollan, para 4.07.

[6] *British Ins. Co. of Cayman v. Safety Nat. Cas.* 335 F 3d 205 CA3 (NJ), 2003.

[7] Wollan, para 4.07.

[8] *Aspen Insurance UK Ltd v Pectel Ltd* [2008] EWHC 2804 (Comm).

[9] *HLB Kidsons v Lloyd's Underwriters* [2009] 1 Lloyd's Rep. 8: "The Assured shall give to the Underwriters notice in writing as soon as practicable of any circumstance of which they shall become aware during the period specified in the Schedule which may give rise to a loss or claim against them. Such notice having been given any loss or claim to which that circumstance has given rise which is subsequently made after the expiration of the period specified in the Schedule shall be deemed for the purpose of this Insurance to have been made during the subsistence hereof".

[10] Morison J, [2007] Lloyd's Rep IR 267. The issues was not raised on appeal, the Court of Appeal reversed the judgment on other points.

[11] *Layher Ltd v Lowe* [2000] Lloyd's Rep IR 510; *Jacobs v Coster (t/a Newington Commercials Service Station)* [2000] Lloyd's Rep IR 506.

[12] *Jacobs v Coster (t/a Newington Commercials Service Station)* [2000] Lloyd's Rep IR 506.

the policy year[13]. The word "immediate" has been interpreted to mean "with all reasonable speed considering the circumstances of the case"[14].

The form of notification depends on the wording of the notification clause and exactly how specific the assured is required to be in the circumstances to make the notification meaningful[15].

In US reinsurance market the words "prompt notice" notice "as soon as practicable" "immediate notice" are interpreted as requiring notice within a reasonable time after the duty to give notice has arisen; the test of reasonableness is an objective one, based on the view that a prudent reinsured would take as to whether its policy may be involved[16]. Mere speculation, rumour, or a remote contingency is not enough to trigger the reasonable objectiveness test[17]. "Appears likely" or losses "which may give rise to claim" require a "reasonable possibility" that the information available will be required by the reinsurers. In *Liberty Mutual Ins. Co v Gibbs*[18] it was held that the reinsured should give notice as soon as possible after the assured's attorney started defending the claim; a notice that was given after the jury returned the verdict was held to be late according to the phrase requiring notice of "losses which 'may' give rise to a claim".

The Nature of Claims Provisions

The remedy for breach of claims provisions depends strictly on the nature of such clauses. Under English law if the clause is a condition precedent, the breach automatically discharges the reinsurers from liability from the claim tainted by the breach. If the provision is not a condition precedent, then it will be classified as innominate, the remedy for which will depend on the effect of the breach that if it is so serious that goes to the root of the contract, the reinsurers may choose to repudiate the insurance policy. It is inconceivable, however, that a breach would be a repudiation of the policy of reinsurance as a whole, as it will be very hard for reinsurers to prove that a claims provision will deprive them of the benefit that they expected to gain. Nevertheless, in *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp*[19] Waller LJ noted that "it is not impossible that it could in extreme circumstances of consistent breach over a number of claims". Otherwise, the reinsurers will only be entitled to claim damages, but this requires proof of loss

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[13] Butler and Merkin, para C-0543.
[14] *Coleman's Depositories Ltd and Life & Health Assurance Association's Arbitration, Re* [1907] 2 KB 798; *Aspen Insurance UK Ltd v Pectel Ltd* [2008] EWHC 2804 (Comm).
[15] Butler and Merkin, para C-0552. See *Merrill Lynch International Bank Ltd v Winterthur Swiss Insurance Co* [2007] Lloyd's Rep IR 532; *HLB Kidsons v Lloyd's Underwriters* [2009] 1 Lloyd's Rep. 8.
[16] *Christiania General Ins. Corp. of New York v. Great American Ins. Co.* 979 F 2d 268 CA2 (NY), 1992; *Travelers Ins. Co. v. Buffalo Reinsurance Co.* 735 F Supp 492 SDNY, 1990; *Zenith Ins. Co. v. Employers Ins. of Wausau* 141 F 3d 300 CA7 (Wis), 1998, (applying Wisconsin law); *Centaur Insurance Company v Safety National Casualty Corporation* 1993 WL 434056 (ND Ill).
[17] *Christiania General Ins. Corp. of New York v. Great American Ins. Co.* 979 F 2d 268 CA2 (NY), 1992.
[18] 773 F 2d 15 CA1 (Mass), 1985 (applying Massachusetts law).
[19] [2005] 2 Lloyd's Rep 517 para 42.

which again does not seem to be easy to prove. Prejudice is also irrelevant in England: if it is a condition precedent it is not required, and if it is not a condition precedent then insurers have to pay and prejudice is relevant only to any damages that the reinsured may wish to recover.

If the provision is a condition precedent, the reinsurers are discharged from liability from the claim to which the breach is related; it does not terminate the policy as a whole[20]. It should be noted that the possibility of repudiation of a claim for breach of a claims notification clause was discussed in *Alfred McAlpine v BAI (Run-Off) Ltd*[21], where it was suggested by Waller LJ that breach of claims notification clauses entitles the insurer to reject the claim even if the breach is not sufficiently serious to repudiate the policy. This interpretation was adopted in a number of subsequent decisions[22]. However in *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp*[23] the majority of the Court of Appeal, Waller LJ unsurprisingly dissenting, rejected the principle of repudiation of a claim and held that English law did not recognise the concept of partial repudiation. The solution that was offered by the *Friends Provident* case was that if there was a serious breach of contract then the entire policy was repudiated; if the breach was minor, then the only remedy was damages. Accordingly, given that claims conditions are to be construed as innominate terms only, and given that it is all but inconceivable that breach of a claims condition could ever amount to a repudiation of the policy as a whole, unless the term is drafted as condition precedent at the outset, the only remedy available to insurers is to claim damages[24].

This holding was approved recently by Teare J in *Aspen Insurance UK Ltd v Pectel Ltd*[25], a case involving a liability policy. In *Aspen* condition 4(a) provided that the assured shall give the insurer's agent "immediate written notice with full particulars of any occurrence which may give rise to indemnity under this insurance". Additionally, condition 13 provided that "The liability of Underwriters shall be conditional on (i) The Assured paying in full the premium demanded and observing the terms and conditions of this insurance." Holding that condition 4(a) was a condition precedent, the learned judge stated that condition 4(a) and 13 might literally be read as meaning that condition 13 has the effect that failure to comply with condition 4(a) deprives the reinsurer from all liability under the policy. Teare J felt that was not required by the objective purpose of the clause. The learned judge reworded the purposive construction of condition 13 as: "The liability of the underwriters to indemnify the assured in respect of a claim for an indemnity shall be conditional upon the assured observing the terms and conditions of the policy with regard to that claim"[26].

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[20] Whereas in English law breach of warranty terminates the risk as a whole from the date of breach of warranty.
[21] [2000] 1 Lloyd's Rep 437.
[22] *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] Lloyd's Rep IR 802 and *Glencore International AG v Ryan (The Beursgracht) (No.1),* [2002] Lloyd's Rep IR 335; *Bankers Insurance Co Ltd v South* [2004] Lloyd's Rep IR 1.
[23] [2005] 2 Lloyd's Rep 517.
[24] *Ronson International Ltd* v. *Patrick* [2006] Lloyd's Rep IR 194; *Limit (No 2) v Axa Versericherung AG* [2008] Lloyd's Rep IR 330.
[25] [2008] EWHC 2804 (Comm).
[26] [2008] EWHC 2804 (Comm) para 65.

Determining if the provision is a condition precedent

English Law

Determining the nature of claims provisions is a matter of construction. In *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd*[27] the reinsurance slip contained a claims co-operation clause which provided: "It is a condition precedent to liability under this insurance that all claims be notified immediately to the Underwriters subscribing to this policy and the Reassured hereby undertake in arriving at the settlement of any claim, that they will co-operate with the Reassured Underwriters and that no settlement shall be made without the approval of the Underwriters subscribing to this Policy." Leggatt J divided the clause into two and held that only the first part which related to notification of loss was a condition precedent[28]. The learned judge interpreted the rest of the clause as constituting a two-fold undertaking by the reassured in arriving at the settlement of the claim: first, that they will co-operate with the reinsurers; and secondly, that they will not make any settlement without the reinsurers' approval. The Court of Appeal agreed with this analysis and the reinsurer was held to be liable despite the breach of the claims co-operation clause, because the reinsured had proved its loss by being sued to judgment.

The clause in *Gan Insurance Co Ltd v Tai Ping Co Ltd (No.2&3)*[29] was worded differently from that of *Scor*. The parties agreed:

"Notwithstanding anything contained in the reinsurance agreement and/or policy wording to the contrary, it is a condition precedent to any liability under this policy that

a) The reinsured shall, upon knowledge of any circumstances which may give rise to a claim against them, advise the reinsurers immediately, and in any event not later than 30 day
b) The reinsured shall co-operate with reinsurers and/or their appointed representatives subscribing to this policy in the investigation and assessment of any loss and/or circumstances giving rise to a loss.
c) No settlement and/or compromise shall be made and liability admitted without the prior approval of reinsurers. All other terms and criticisms of this policy remain unchanged"[30].

Mance LJ found this clause more stringent than that in *Scor*, in that the draftsmen had separated out the three parts of the clause and had determined to make each into a condition precedent[31]. The result of this interpretation was that, while in *Scor* the breach of claims co-operation clause which was not a condition precedent left it open to the reinsured to prove actual liability against the assured, in *Gan* breach of claims

[27] [1985] 1 Lloyd's Rep. 312.
[28] No breach of notification clause was alleged in *Scor*.
[29] [2001] Lloyd's Rep IR 667.
[30] It was held that the reinsured would be in breach of the claims co-operation clause by settling, compromising the claim or admitting liability; in other words, a breach in any of these regards would entitle the reinsurers to reject the claim.
[31] [2001] Lloyd's Rep IR 667, 687.

provisions which was a condition precedent had the effect that the reinsured could not recover even by proving that he was in fact and in law liable to the assured[32].

Eagle Star Insurance Co Ltd v Cresswell[33] shows that the absence of the use of the words "condition precedent" is not conclusive to an interpretation of the clause having the same effect as a condition precedent[34]. In *Eagle Star* the clause provided:

a) To notify all claims or occurrences likely to involve the underwriters within seven days from the time that such claims or occurrences become known to them.
b) The underwriters hereon shall control the negotiations and settlements of any claims under this policy. In this event the underwriters hereon will not be liable to pay any claim not controlled as set out above.

Omission however by the company to notify any claim or occurrence which at the outset did not appear to be serious but which at a later date threatened to involve the company shall not prejudice their right of recovery hereunder"[35].

The reinsured argued that sub-paragraph (b) conferred an option on reinsurers whereby they could, if they wished, opt to control the negotiation and settlement of claims. That option was triggered by the reinsured giving notice of claims under sub-paragraph (a) which required the reinsured to notify all claims or occurrences likely to involve the reinsurers within seven days from the time that such claims or occurrences become known to them, but the reinsurers did not so opt, so sub-paragraph (b) had no application.

The Court of Appeal, however, rejected the argument and held that the clause was an allocation, not an option, so that the reinsurers were entitled to be informed when negotiations began so that the reinsurers could decide at that point how the negotiations should be conducted. The word "shall" did not impose any obligation on

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[32] [2001] Lloyd's Rep IR 667, 688.
[33] [2004] Lloyd's Rep IR 537. The policy also contained a typical full reinsurance clause.
[34] See also *Dornoch Ltd v Royal and Sun Alliance plc* 2005] Lloyd's Rep IR 544 where breach of claims co-operation clause was held not to deprive the reinsured of the right to make a claim against the reinsurers even though the clause expressly provided the words "condition precedent". Under the reinsurance policy the reinsured was required to give notice of any loss or losses which may give rise to claim under the policy within 72 hours upon knowledge of them. Longmore LJ stated that a breach of a condition precedent operated as an exemption to the reinsurers' liability but in this case the clause was not sufficiently clearly expressed as a condition precedent so as to exempt the reinsurers from liability in case of breach. Nevertheless, in *Anonymous Greek Co of General Insurances "The Ethniki" v AIG Europe (UK) & Ors.* [2000] Lloyd's Rep IR 343 the clause was stated to be a condition precedent and it was held that the breach of the clause deprived the reinsured of claiming indemnification from the reinsurers but the reason was not based on the "condition precedent" wording but the effect of the breach namely depriving the reinsurers of reducing or extinguishing the claim by making proper investigations in time. In this case the clause provided "…it is a condition precedent to any liability under this policy that: (A) the Reassured shall, upon any knowledge of loss or losses which may give rise to a claim under this policy, advise the Underwriters thereof by cable within 72 hours; (B) the Reassured shall furnish the Underwriters with all information available respecting such loss or losses, and the Underwriters shall have the right to appoint adjusters, assessors and/or surveyors and to control all negotiations, adjustments and settlements in connection with such loss or losses."
[35] The Court of Appeal commented that this clause was in the nature of a claims control clause; however nothing turned on that classification.

the reinsurers to control negotiations with the original assured but conferred upon them the right to do so.

The Court of Appeal stated that using the words "condition precedent" was not essential and that other clear words could be used to express the consequences of breach[36]: the expression "reinsurers will not be liable to pay any claim not controlled by them" were clear enough to create the equivalent remedy to a breach of a condition precedent. Additionally, the words "will not be liable to pay any claim" were found to be *strong words*[37], if not the language of condition precedent, at any rate the language of exclusion[38]. Furthermore, in the second sentence "in this event" dealt with the situation where there were negotiations in respect of a claim. Therefore the clause was held to mean that "whenever negotiations or settlement have taken place which have not been controlled by the reinsurers, reinsurers will not be liable to pay the relevant claim" unless some reason is shown for excusing the fact that the reinsurers did not control the negotiations or settlement of the assured's claim[39]. As a result their Lordships were convinced that the clause was to be construed as condition precedent.

In *Aspen Insurance UK Ltd v Pectel Ltd*[40] Teare J held that the consequence of the breach of clause 4(a) depended upon the true construction of clause 13 as applied to condition 4(a). Referring to *George Hunt Cranes v Scottish Boiler and General Insurance*[41] and *Eagle Star Insurance v Cresswell*[42] the learned judge confirmed that whilst the words "condition precedent" are often used in clauses to the effect that compliance with obligations in the policy is a condition precedent to the underwriters being liable in respect of a claim, other words can have the same effect so long as the clause is apt to make clear the intention of the parties. A conditional link between the assured's obligation to give notice and the underwriters' obligation to pay the claim was needed[43]. Reading condition 13 together with condition 4(a) Teare J found that the parties intended there to be a conditional link between the assured's obligation to comply with condition 4(a) and the underwriter's obligation to pay the claim in question. Moreover, the judge also noted that the commercial purpose of condition 4(a) was to enable the underwriters to investigate the potential claim at the earliest opportunity and this purpose justified compliance with condition 4(a) being regarded as a condition precedent to liability.

The burden of proof that the reinsured is in breach of claims provisions is borne by the reinsurer[44].

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[36] In its original form of the Claims Co-operation Clause in the Lloyd's and Companies Market Policies was expressed as a condition precedent to the liability of reinsurers.
[37] Emphasis added.
[38] [2004] Lloyd's Rep IR 537, 548.
[39] [2004] Lloyd's Rep IR 537, 549.
[40] [2008] EWHC 2804 (Comm).
[41] [2002] Lloyd's Reports 178.
[42] [2004] Lloyd's Reports IR 537.
[43] *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp* [2005] 2 Lloyd's Rep. 517.
[44] *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.3)* [2002] Lloyd's Rep IR 612.

US law

The position in the US different from English law. In the US, there are various opinions and, as will be seen in detail below, it is not easy to find a rule that is applicable to all cases. The law has developed from case by case basis and the law differs from State to State.

In some States, such as North Carolina[45] and Illinois[46], breach of notification clauses is held to bar recovery from reinsurers notwithstanding that the contract did not designate the provision requiring notice as a condition precedent or did not contain a declaration of forfeiture for non-compliance[47]. In *Travelers Ins. Co. v. Buffalo Reinsurance Co.*[48] the Southern New York District Court judge put emphasis on the effect of the reinsurers' contractual right to associate. Prompt notice was construed to be designed to afford an insurance company the opportunity to participate in the defence of a claim on which it may ultimately be liable. The fact that reinsurers rarely defend the claim in the same manner as original insurers does not make it less important for reinsurers. Therefore, as in the primary insurance context, notice from the primary insurer to its reinsurer was held to be a condition precedent to the reinsurer's liability.

However, some States require clear wording to hold that the clause is a condition precedent. In California, in *National American Ins. Co. of California v Certain Underwriters At Lloyd's London*[49] the clause "The Company upon knowledge of any occurrence likely to give rise to a claim hereunder shall give immediate written advice thereof to the person(s) or firm named for the purpose in the schedule" was held not to lay down a sufficiently clear expression. In *Security Mut. Cas. Co. v. Century Cas. Co.*[50] the nature of reinsurance and the particular wording of the whole policy were taken into consideration in the decision. The court found it important that the arbitration clause in the contract was expressly stated to be a condition precedent whereas such wording was omitted from the claims notification clause. Such an omission was held to be an indication that the parties did not intend to make the clause a condition precedent. The court also took into consideration that Colorado law did not favour construing ambiguous terms as conditions precedent and also that any ambiguity in a reinsurance contract was to be resolved against the reinsurer unless the contract was worded by the original insurer.

In *Security* it was emphasised that in reinsurance contracts, investigating the loss and defending the claim is usually left to reinsureds. The participation of the reinsurers in defending the assured's claim is not as essential as it is for primary insurers. The court found that the reinsured and reinsurer had the same concerns and benefits and loss from the claim, and that the reinsured had as much reason as the reinsurer to see that the claim was properly investigated and defended; therefore there

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[45] *Fortress Re, Inc. v. Jefferson Ins. Co. of New York* 628 F 2d 860, CA4 (NC), 1980.
[46] *Keehn v Excess Ins. Co of America* 129 F 2d 503 CA7 1942.
[47] See also *Highlands Ins. Co. v. Employers' Surplus Lines Ins. Co.* 497 F Supp 169 DC La, 1980.
[48] 735 F Supp 492 SDNY, 1990; the decision was vacated (739 F Supp 209 SDNY, 1990) but the condition precedent analysis of the notification provision was adhered to.
[49] 93 F 3d 529 CA9 (Cal), 1996.
[50] 531 F 2d 974 CA Colo 1976.

was little danger of fraud. If the reinsurers had proved any loss by the failure of the reinsured to notify a claim, then damages would have been an adequate remedy.

Prejudice

If a claims provision is interpreted as a condition precedent, it is usually the case that breach of such a clause will be a bar to recovery from reinsurers irrespective of proof of prejudice. In *Constitution Reinsurance Corp. v. Stonewall Ins. Co.*[51] the clause was expressly stated to be a condition precedent. The assured sued the reinsured after the latter denied coverage but then the reinsured paid $3.25 million in exchange for the assured dropping its suit. The reinsured became aware of the potential claim under the policy by 6 June 1990 but did not notify the reinsurer until 20 November 1992. The court held that the notice was not promptly given and that the condition operated as a complete bar against Stonewall recovering under the reinsurance policy, without the need for the reinsurer to prove prejudice. The same rule was applied in *Liberty Mut. Ins. Co. v. Gibbs*[52] where the court put emphasis on the fact that even though Liberty was an experienced underwriter, it did not notify Lloyd's of the accident until several weeks after the jury had returned a verdict[53].

By contrast, in North Carolina, prejudice is required even though the clause is a condition precedent. *Fortress Re, Inc. v. Central Nat. Ins. Co. of Omaha*[54] traces the development of the law in North Carolina. The Fourth Circuit stated that claims notification clauses had long been regarded as conditions precedent where prejudice was irrelevant and the bar to recovery was absolute. However, referring to *Great American Insurance Co v C.G. Tate Construction Co. (Tate I)*[55] where it was held that the failure to give timely notice to the insurer did not relieve the insurer of its obligations under the policy unless the delay materially prejudiced the insurer's ability to investigate and defend, the court stated that the rule in North Carolina has changed in a way so that the designation "condition precedent" no longer has this effect and that reinsurers have to prove either: (a) that they have suffered prejudice; or (b) that the reinsured acted in bad faith in failing to comply with the clause. The position is the same in California law: for example, in *Insurance Co. of State of Pennsylvania v. Associated Intern. Ins. Co.*[56] the Ninth Circuit confirmed that the purpose of a notice clause is to "protect the insurance company from being placed in a substantially less favourable position than it would have been if timely notice had been provided". Because primary insurers will usually provide a proper defence, the likelihood of prejudice from late notice is more remote[57].

Proof of prejudice is also required where a claims provision is not a condition precedent. For example, if the reinsurer suffers no prejudice from an unexcused delay in notice, the purpose of the notice clause has not been frustrated and there is no

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[51] 980 F Supp 124 SDNY, 1997.
[52] 773 F.2d 15 C.A.1 (Mass.), 1985.
[53] See also *Highlands Ins. Co. v. Employers' Surplus Lines Ins. Co.* 497 F Supp 169 DC La, 1980.
[54] 766 F 2d 163 CA4 (NC), 1985 (applying North Carolina law).
[55] 303 NC 387, 1981.
[56] 922 F 2d 516 CA 9 (Cal), 1990.
[57] *Pennsylvania v Associated* was applied in *National American Ins. Co. of California v Certain Underwriters At Lloyd's London* 93 F 3d 529 CA9 (Cal), 1996.

reason to relieve the reinsurer of its contractual obligation[58]. New York law states that, in the absence of an express provision in the reinsurance agreement making prompt notice a condition precedent to reinsurer's obligations under the contract, the reinsurer will not be relieved of its indemnification obligations because of the reinsured's failure to provide timely notice, unless it can show prejudice resulting from delay[59]. In *Life and Health Ins. Co. of America v. Federal Ins. Co.*[60] the reinsured was required to notify the reinsurers "as soon as practicably possible" in the event that a suit was initiated against the reinsured for which the reinsurers could ultimately be liable under the terms of the insurance policy. Without stating if the clause was or was not a condition precedent, the district court judge applied the settled rule in the insurance context in Pennsylvania to the reinsurance case before him, and held that an insurer cannot refuse to pay an otherwise valid claim solely because the insured's notice was out of time, or because the insured breached a notice provision of the insurance contract[61]. The reinsurers bear the burden of showing that the notice was late, and that they were unduly prejudiced by the lateness.

Proof of Prejudice

Proof of prejudice is a question of fact for the jury[62]. Prejudice to the reinsurer depends upon whether the reinsurer would have been in a more favourable position had it received earlier notice[63]. It was clarified in *Associated Intern. Ins. Co. v. Odyssey Reinsurance Corp.*[64] that the reinsurer will have to prove that "with timely notice, and notwithstanding a denial of coverage or reservation of rights, it would have settled the claim or taken steps that would have reduced or eliminated" the reinsured's liability. In *British Ins. Co. of Cayman v. Safety Nat. Cas.*[65] it was held that prejudice in a late notice defence is determined by examining: (1) whether substantial rights have been irretrievably lost; and (2) the likelihood of success of the insurer in defending against the victim's claim.

In California it is also accepted that[66] a mere possibility of prejudice will not suffice. Being deprived of the opportunity to join and control the underlying claim or being unable to take "evasive action" to protect the reinsurer against the loss is not enough to prove prejudice. The court accepted that being unable to claim a tax deduction is a prejudice but it was necessary to prove what prejudice had actually been caused. Similarly, in *Unigard Sec. Ins. Co., Inc. v. North River Ins. Co.*[67] the

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[58] *Central Nat. Ins. Co. of Omaha v. Prudential Reinsurance Co.* 241 Cal Rptr 773 1987. The Supreme Court ordered that the opinion be not officially published, and therefore it cannot be relied on as precedent. See In *California Joint Powers Ins. Authority v. Munich Reinsurance America, Inc*. 2008 WL 1885754 CD Cal.

[59] *Christiania General Ins. Corp. of New York v. Great American Ins. Co.* 979 F 2d 268 CA 2 (NY), 1992*; Unigard Sec. Ins. Co., Inc. v. North River Ins. Co.* 4 F 3d 1049 CA 2 (NY), 1993.

[60] 1993 WL 326404 ED Pa.

[61] The position is the same under New Jersey law: *British Ins. Co. of Cayman v. Safety Nat. Cas.* 335 F.3d 205 C.A.3 (N.J.),2003.

[62] *Life and Health Ins. Co. of America v. Federal Ins. Co.* 1993 WL 326404 ED Pa.

[63] *Life and Health Ins. Co. of America v. Federal Ins. Co.* 1993 WL 326404 ED Pa.

[64] Unpublished Disposition, 111 F 3d 137 CA9 (Cal), 1997.

[65] 335 F 3d 205 CA3 (NJ), 2003.

[66] *Insurance Co. of State of Pennsylvania v. Associated Intern. Ins. Co.* 922 F 2d 516 CA 9 (Cal), 1990.

[67] 4 F 3d 1049 CA2 (NY), 1993.

Second Circuit held that loss of contractual right to associate is not enough to prove prejudice without showing economic loss (tangible economic injury). However, in Illinois, if the reinsurance policy gives the reinsurer the right to associate it is likely that failure to give notice will deprive the reinsurer of the ability to use its contractual rights and opportunity to associate with the reinsured in defence of the third party claim against the assured, and this deprivation may be held to constitute prejudice without any actual proof that the results of the litigation would have been different[68].

It used to be the position under California law that, because both parties are experienced insurance companies who bargained at arm's length, and the reinsured acquired all of the claims information that the reinsurer lacked, it would be just and equitable to place the burden of proving compliance with the notice clause upon the reinsured[69]. If the reinsured was unsuccessful in meeting its burden, a rebuttable presumption of prejudice arose[70]. The reinsured could rebut the presumption by showing lack of prejudice to the reinsurer[71].

However, after the decision of *National American Ins. Co. of California v Certain Underwriters At Lloyd's London*[72] California law now requires proof of actual and substantial prejudice, ie, that it was likely that, with timely notice, and notwithstanding a denial of coverage or reservation of rights, it would have settled the claim for less or taken steps that would have reduced or eliminated the insured's liability.

Wisconsin law states that (Wis. Stat. § 631.81) "Provided notice or proof of loss is furnished as soon as reasonably possible and within one year after the time it was required by the policy, failure to furnish such notice or proof within the time required by the policy does not invalidate or reduce a claim unless the insurer is prejudiced thereby and it was reasonably possible to meet the time limit." The statute, however, does not address situations where notice is given more than one year after the time in which notice is required by the policy, which in fact was the issue in *Zenith Ins. Co. v. Employers Ins. of Wausau*[73]. The Seventh Circuit noted that, where notice is given more than one year after time required by policy, there is a rebuttable presumption of prejudice and the burden of proof shifts to the assured to prove that the insurer was not prejudiced by the late notice[74].

Exception to the prejudice rule: reinsured's bad faith

It has been ruled that, where a reinsurer cannot prove prejudice but has proved the reinsured's bad faith in failing to comply with the notification clause, the reinsurer would be discharged from liability[75]. Similarly to the proof of prejudice, whether or

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[68] *Keehn v Excess*; *Stuyvesant Ins. Co. v. United Public Ins. Co.* 139 Ind App. 533, 1966.
[69] *Central Nat. Ins. Co. of Omaha v. Prudential Reinsurance Co.* 241 Cal Rptr 773 1987.
[70] *Central Nat. Ins. Co. of Omaha v. Prudential Reinsurance Co.* 241 Cal Rptr 773 1987.
[71] *Central Nat. Ins. Co. of Omaha v. Prudential Reinsurance Co.* 241 Cal Rptr 773 1987.
[72] 93 F 3d 529 CA9 (Cal), 1996.
[73] 141 F 3d 300 CA 7 (Wis), 1998.
[74] *Gerrard Realty Corp. v. American States Ins. Co.* 89 Wis 2d 130, 1979.
[75] *Fortress Re, Inc. v. Central Nat. Ins. Co. of Omaha* 766 F 2d 163 CA4 (NC), 1985 (applying North Carolina law); *Unigard Sec. Ins. Co., Inc. v. North River Ins. Co.* 4 F 3d 1049 CA 2 (NY), 1993*; Christiania General Ins. Corp. of New York v. Great American Ins. Co.* 979 F 2d 268 CA 2 (NY), 1992*;*

not an insurance company has acted in bad faith is a question of fact[76]. The minimum standard for bad faith has been stated to be gross negligence or recklessness[77]. Accordingly, simple negligence in not disclosing a material fact will not be regarded as bad faith but a deliberate deception will be required[78].

Bad faith is not to be judged by reference to the conduct of a reasonable person; the test is a subjective one: "Anyone who knows that he may be at fault or that others have claimed he is at fault and who purposefully and knowingly fails to notify ought not to recover even if no prejudice results" [79].

It is noteworthy that in *Zenith Ins. Co. v. Employers Ins. of Wausau*[80] the district court also believed that prejudice did not matter if the insured acted in bad faith. On appeal however the Seventh Circuit noted that the district court referred to New York cases *Unigard* and *Christiania* but the Seventh Circuit did not find appropriate to apply New York law in Wisconsin as they found no analog to that New York rule in Wisconsin law and held that therefore, either Zenith must show prejudice or Wausau must show the lack of it, depending on how late Wausau's notice was.

These two New York cases were applied by the trial judge and affirmed by the Supreme Court of New Hampshire in *Certain Underwriters at Lloyd's London v. Home Ins. Co.* 146 NH 740, 783 A2d 238 NH, 2001.

[76] *Certain Underwriters at Lloyd's London v. Home Ins. Co.* 146 NH 740, 783 A2d 238 NH, 2001.

[77] *Unigard Sec. Ins. Co., Inc. v. North River Ins. Co.* 4 F 3d 1049 CA 2 (NY), 1993.

[78] *Unigard Sec. Ins. Co., Inc. v. North River Ins. Co.* 4 F 3d 1049 CA 2 (NY), 1993.

[79] *Fortress Re, Inc. v. Central Nat. Ins. Co. of Omaha* 766 F 2d 163 CA4 (NC), 1985.

[80] 141 F 3d 300 CA 7 (Wis), 1998.