New York Liberalizes Its Notice Rule in Reinsurance Cases: ‘Late Notice’ May Not Be Enough to Deny Coverage

by Irene C. Warshauer

The New York Court of Appeals recently adopted a liberal rule on notice to reinsurance companies. The case, Unigard Security Ins. Co. v. North River Ins. Co., should be helpful to policyholders seeking to settle claims with excess insurance companies that deny coverage for reasons of late notice (see Advisor June 1992).

The Court held that the reinsurance company, Unigard, had to “show prejudice” [i.e., that it was somehow injured] in order to deny coverage on the grounds of late notice to its policyholder, North River. This decision stands in stark contrast to New York’s draconian rule on notice to primary insurance companies, which states that timely notice is a condition precedent to coverage (see Security Mutual Inc. Co. v. Acker Fitzsimmons).

Issue of Prejudice Was the Key to the Decision

North River had provided primary insurance coverage to Owens-Coming Fiberglas for asbestos personal injury claims and had signed the so-called Wellington Agreement. On April 1, 1987, North River learned that the excess policies it had issued to Owens-Coming Fiberglas would be needed to cover claims and that there was a likelihood that the Unigard reinsurance policy would be involved.

North River sent notice to Unigard three months later, in August 1987. Unigard denied coverage. After a bench trial, the Federal District Court held that although North River’s obligation to send notice arose in April 1987, when it learned that Unigard would likely become involved, and that the notice would be considered late, the court nonetheless rejected Unigard’s late notice defense because:

- New York law required a reinsurer to demonstrate prejudice. Because there was no showing of prejudice, the Court rendered judgment in favor of North River.

- On appeal, the Second Circuit noted that there was a split of authority within the Southern District of New York and certified the following question to the New York Court of Appeals:

  Must a reinsurer prove prejudice before it can successfully invoke the defense of late notice of loss by the reinsured?

- The Court of Appeals answered yes.

Outlook for Policyholders With Excess Insurance

The notice language contained in the reinsurance policy is virtually identical to that contained in many excess liability policies. It states that the insurance company must give notice of “an occurrence or accident which appears likely to involve” the reinsurance policy. The court found that there is nothing in the North River notice clause or anywhere else in the North River policy that indicates the parties intended that notice should operate as a condition precedent. The court noted that rules of contract law would not ordinarily make notice a condition precedent. The court held that impairment of Unigard’s right to associate is not sufficiently grave to:

- warrant applying a presumption of prejudice and, accordingly, there is no sound reason to depart from the general contract law or principle that a breach will excuse performance only if it is material or demonstrably prejudicial.
In making its ruling, the Court of Appeals reiterated that under New York law the primary insurance company need not show prejudice for a late notice defense. According to the court, timely notice must be given to the primary insurance company so that it may have the opportunity to adequately investigate a claim and thereby exert “early control over the claim and [enhance] the possibility of a settlement.”

The court made a strong distinction however between a contract of primary insurance and a reinsurance contract. The court noted that a reinsurance company only has an obligation for indemnification, not for investigation or defense. Because the interests of the reinsurance company and its policyholder, the original insurance company, are usually similar, there is little danger of fraud.

Excess insurance companies are not actively involved in the defense of underlying litigation or in the investigation of claims. Policyholders can therefore argue that notice to excess insurance companies should be governed by the rationale of Unigard. Thus, this decision should be helpful to policyholders seeking coverage under excess policies.