No Harm, No Foul: Jury Rejects Reinsurer's Late-Notice Defense

By Tancred V. Schiavoni III and Vincent Weisband

Rarely, if ever, does a reinsurer's late-notice defense reach a jury; when one does, the lessons that flow from trial can be valuable. This is especially so when the jury rejects that defense—leaving the reinsurer on the hook for tens of millions of dollars—and a federal judge then denies the reinsurer's motion for a new trial. A New York federal court's recent decision offers an unusual, up-close glimpse of the bar that a late-notice defense may have to clear in a jury trial.

In *Utica Mutual Insurance Co. v. Fireman's Fund Insurance Co.*, No. 6:09-cv-853 (N.D.N.Y. Feb. 28, 2018), Utica sought reimbursement from its reinsurer, Fireman's Fund, for a 2007 settlement involving asbestos-related claims from the 1960s and 1970s. But Utica waited until mid-2008—more than a decade after it was aware of the asbestos claims—before notifying Fireman's Fund. Among the many points of contention in the long-running dispute, Fireman's Fund argued that Utica's claims were barred due to untimely notice. U.S. District Court Judge David Hurd ordered a jury trial, deeming late notice to be an issue of fact requiring a fact-finder to make credibility determinations.

So it was that for 2½ weeks last fall, a federal jury heard evidence on a defense that, in the reinsurance context, is rarely litigated. Four experts, a dozen fact witnesses, and three hours of deliberations later, the jury delivered a $64.1 million win for Utica. When Fireman's Fund moved for a new trial, Judge Hurd sustained the jury's verdict. His rationale was telling.

In analyzing the viability of Fireman's Fund's late-notice defense, Judge Hurd held that lateness alone is an insufficient basis for avoiding liability. Rather, the reinsurer must prove "both late notice and either material breach or demonstrable prejudice."[1] Judge Hurd concluded that a reasonable jury could have found that Fireman's Fund failed to satisfy either component of the second prong—demonstrable prejudice or material breach.

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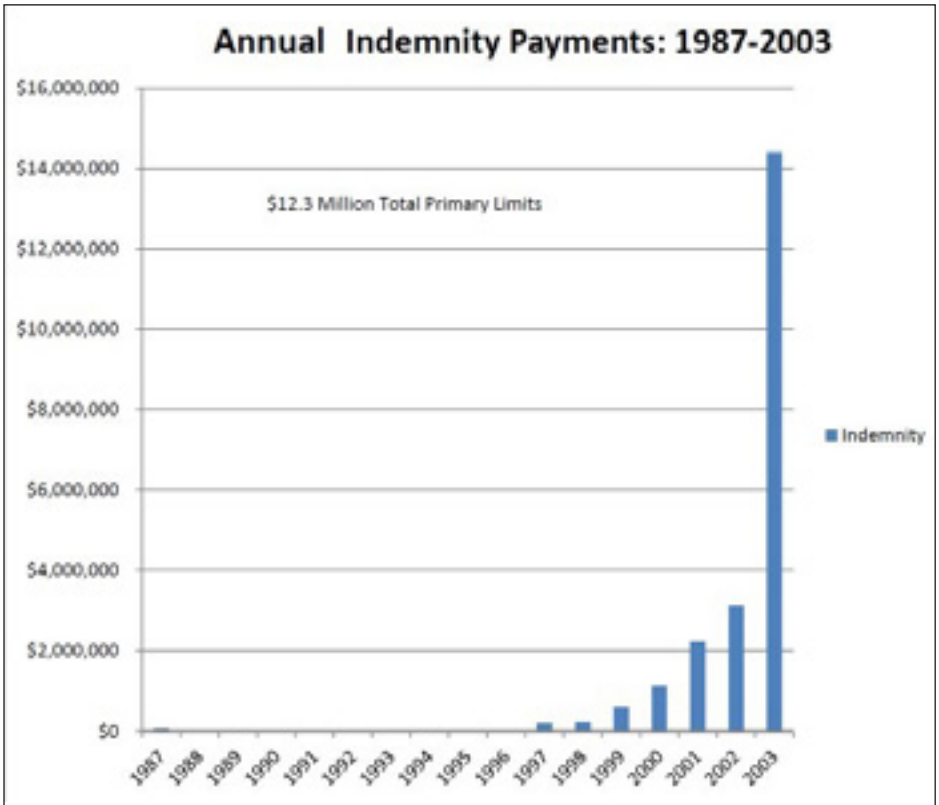
Demonstrable Prejudice

With respect to demonstrable prejudice, the court held that "[p]rejudice is tangible economic injury and demonstrable prejudice means that specific, tangible economic injury is shown to have resulted from the late notice, as opposed to a claim of speculative or hypothetical injury."[2] Fireman's Fund contended it was prejudiced by having entered into commutations with its own reinsurers prior to Utica's having given notice and, as a result, Fireman's Fund collected less money from them than it would have if Utica had given timely notice. Utica disputed that Fireman's Fund would have acted any differently or collected any more had it received earlier notice.

Fireman's Fund offered testimony from a finance employee to explain the commutations and why Fireman's Fund believes it received less than it would have had notice been given sooner. Utica challenged this testimony through cross-examination. No one involved in the commutation of Fireman's Fund's own reinsurance was called to testify, nor was anyone involved in the underwriting of Fireman's Fund's reinsurance to Utica called to testify. Both sides offered expert testimony on late notice.

Judge Hurd held that the jury did not act unreasonably in concluding that Fireman's Fund failed to satisfy the demonstrable prejudice standard, for several reasons. First, he found it noteworthy that Fireman's Fund "presented no witness involved in any of [its] actual negotiations with its commuting reinsurers."[3] The implication was that the evidence offered of prejudice was more speculative or hypothetical because no witness from the period in question testified.

Second, Judge Hurd found that a reasonable jury could have accorded little



Spending by cedent before notice.

to no weight to the Fireman's Fund fact witness on the basis that he did not take into account the following: (1) that even if Fireman's Fund had notice, it may have asserted an affirmative defense and refused to pay Utica; (2) any objections to payment that Fireman's Fund's retrocessionaires may have asserted; (3) that other reinsurers were insolvent at the time of their commutations; and (4) that when notice was allegedly due, the cedent had paid only about $100,000 over the previous 10 years. At the rate that Utica had incurred costs before giving notice, the court observed, "it would have taken over 10,000 years to reach Fireman's Fund's reinsurance layer."[4] On the other hand, Utica had paid indemnity in excess of the primary limits by 2003 and did not provide Fireman's Fund with notice until 2008.

Third, Judge Hurd observed that a reasonable jury could have rejected Fireman's Fund's position that it would have factored Utica's claims into its commutation negotiations since the reinsurer attributed zero dollars in liability for commutation of the $90 million in limits that Fireman's Fund had written as a direct insurer of the underlying policyholder. Judge Hurd thus concluded that a reasonable jury could have found no reason to believe Fireman's Fund would have treated the reinsurance claim differently than it did when it acted as a direct insurer.[5] And, even after Fireman's Fund received formal notice of Utica's claim, it did not take the claim into account in the two subsequent commutations.[6]

Material Breach

To show a material breach, Judge Hurd reasoned that the reinsurer needed to demonstrate that Utica was grossly negligent or reckless in providing no-

tice.[7] Thus, Fireman's Fund "had to show more than an inadvertent lapse in routine notification procedures or even mere negligence. Instead it had to show a failure to implement procedures such that Utica willfully disregarded the risk to reinsurers and is guilty of gross negligence."[8]

Fireman's Fund sought to satisfy this standard by contending that Utica had no written or oral procedures for providing notice, that it failed to conduct even a basic search for applicable reinsurance as the claim grew, and that it had shoddy document retention policies. Utica offered testimony from its former director of financial reporting, general counsel, and expert witnesses that Utica had policies and procedures in place for providing notice that met the then-industry standard.

Judge Hurd concluded a jury could have sided with Utica based on evidence showing that "Utica used a daily report and monthly report to inform a search for applicable reinsurance and to report such claims to reinsurers."[9] Judge Hurd cited the testimony of Utica employees on the supposed effectiveness and implementation of this policy.[10] Judge Hurd contrasted Utica's evidence with that of Fireman's Fund, which included criticism of Utica's document retention policy and its failure to locate the primary policies. Judge Hurd found Utica effectively rebutted this evidence by showing that an 11-year document retention policy was industry standard and that "missing or incomplete contract files from the 1960s and 1970s was not out of the ordinary for insurers dealing with these types of liability claims in the 1990s and 2000s."[11]

Utica also demonstrated that three of the five direct insurers to the policyholder lacked complete contract files when coverage was litigated, and that it provided early notice to over a dozen facultative reinsurers before notice was due. The court concluded: "This evidence, considered together, formed a sufficient basis for a jury to conclude that Utica had implemented routine practices and controls to ensure notification to reinsurers which worked in the majority of cases, and to the extent those practices did not work in the Fireman's Fund matter, such failure did not constitute bad faith, gross negligence, or recklessness."[12]

Lessons for Litigating Late Notice

The most compelling fact driving Fireman's Fund's late-notice defense was that the cedent had given it notice 10 years after notice was given to all other reinsurers. However, the cedent introduced evidence at trial that Fireman's Fund itself wrote insurance directly to the cedent's insured and, hence, was aware of the underlying asbestos claims as its direct insured. While Fireman's Fund argued that this was legally irrelevant to whether notice was late, the trial judge declined to give a curative instruction that Fireman's Fund sought. The trial judge also allowed the cedent to tout its ties to the local community and refer to Fireman's Fund as a "foreign" company due to its affiliation with German-based Allianz. No doubt, this will add grist to the appeal that Fireman's Fund has noticed.

Although it is impossible to know what ultimately caused the jury to reject Fireman's Fund's late-notice defense, Judge Hurd's post-trial opinion provides several guideposts for parties to consider when litigating the issue. With respect to demonstrable prejudice, the more concrete the harm, the more likely the reinsurer's success. Judge Hurd concluded a jury may have rejected Fireman's Fund's evidence as speculative because it offered no witness with direct knowledge of the commutations that formed the basis for its alleged prejudice. Furthermore, Judge Hurd concluded Fireman's Fund's fact witness failed to account for several variables, which rendered his conclusions speculative. As for material breach, Judge Hurd suggested a reinsurer must show a near-complete breakdown in the cedent's reporting procedures. Because Utica had a reporting process (however flawed), Judge Hurd was unwilling to disturb the jury's verdict.

Equally important was Judge Hurd's decision to allow Fireman's Fund's late-notice defense to go before a jury in the first place. It is impossible to know whether Judge Hurd would have sustained a verdict in Fireman's Fund's favor on late notice, but because Fireman's Fund in fact presented evidence that it suffered prejudice and that serious failures marred Utica's reporting procedures, there is reason to believe that he may have.

NOTES

1. *Utica Mutual Insurance Co. v. Fireman's Fund Insurance Co.*, No. 6:09-cv-853, Dkt. 452, at 10 (N.D.N.Y. Feb. 28, 2018).
2. *Id.* at 11.
3. *Id.*
4. *Id.*
5. *Id.* at 12.
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.* at 12–13.
11. *Id.* at 13.
12. *Id.*