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Notice Provisions in Insurance Contracts: Great American Insurance Co. v. C.G. Tate Construction Co.

Wanda Naylor

Notice Provisions in Insurance Contracts: *Great American Insurance Co. v. C.G. Tate Construction Co.*

In *Great American Insurance Co. v. C.G. Tate Construction Co.*,[1] the North Carolina Supreme court considered whether an insurer has to prove that it was prejudiced by the insured's failure to comply with a notice provision in an insurance policy before the insurer can deny its duty to defend and indemnify. In this declaratory judgment suit,[2] the Supreme Court held that an unexcused delay in giving notice of potential liability does not relieve the insurer of its obligations, unless the delay materially prejudices the insurer's ability to investigate.[3] Although many jurisdictions have adopted a similar rule, this decision overrules a long line of North Carolina cases holding that compliance with such notice provisions is a condition precedent to coverage and that failure to comply strictly with the condition precedent releases the insurer from its obligation under the insurance contract.[4]

An insurance contract usually includes a notice provision that requires the insured to notify of potential liability, during a specified period of time, to give the insurance company an opportunity to investigate and defend the claims. These provisions have been held to be reasonable, valid, and enforceable. Generally, such provisions require the insured to file written notice of a claim "as soon as practicable." In interpreting notice provisions, courts employ at least three major approaches.[5] Some jurisdictions require strict contractual compliance, treating notice provisions as conditions precedent, when they are so labeled in the contract.[6] Some courts have held that the require-

1. 303 N.C. 387, 279 S.E.2d 769 (1981).

2. Generally, these cases reach the court when an insured or an injured third party brings suit and the insurer refuses to defend and indemnify. In *Tate*, the insurer initiated the action. *See* Comment, *The Materiality of Prejudice to the Insurer as a Result of the Insured's Failure to Give Timely Notice*, 74 DICK. L. REV. 260 (1970).

3. 303 N.C. at 399, 279 S.E.2d at 771.

4. *E.g.*, Fleming v. Nationwide Mutual Ins. Co., 261 N.C. 303, 134 S.E.2d 614 (1964); Muncie v. Travelers Ins. Co., 253 N.C. 74, 116 S.E.2d 474 (1960); Peeler v. United States Cas. Co., 197 N.C. 286, 148 S.E. 261 (1929). A condition precedent is one that is to be performed before the agreement becomes effective, and which calls for the happening of some event or the performance of some act after the terms of the contract have been agreed on and before the contract shall be binding on the parties. 17 AM. JUR. 2D *Contracts* § 321 (1964).

5. Annot., 18 A.L.R. 2d 443 (1951).

6. *E.g.*, Liberty Mut. Ins. Co. v. Roberts, 357 So. 2d 968 (Ala. 1978); Preferred Acc. Ins. Co. v. Castellano, 148 F.2d 761 (2d Cir. 1945) (Conn.); Bituminous Cas. Corp. v. J.B. Forrest & Sons, 133 Ga. App. 864, 212 S.E.2d 497 (1975); Viani v. Aetna Ins. Co., 95 Idaho 22, 501 P.2d 706 (1972); INA Ins. Co. v. Chicago, 62 Ill. App. 3d 80, 379 N.E.2d 34 (1978); National Sur. Co. v. Dotson, 270 F.2d 460 (6th Cir. 1959) (Ky.); Security Ins. Group v. Emery, 272 A.2d 736 (Me.

ment of notice is "important" to the contract and results in an implied condition precedent, even when it is not labeled as a condition precedent. There is some conflict as to the effect to be given an implied condition precedent. In some cases, implied conditions are treated as if they were express, and the insurer can escape its obligations under the contract without showing prejudice.[7] In many other cases in which the provision is not labeled an express condition, courts use this opportunity to require the insurer to prove prejudice by the delay.[8]

Two other approaches use prejudice as an important concept in order to avoid the harsh results of the contractual theories. One line of cases provides that prejudice may be or should be considered in deciding whether the delay by the insured was reasonable.[9] These courts focus on the phrase "as soon as practicable," interpreting it to mean as soon as reasonably possible under the circumstances.[10] In determining this factual question juries must consider the length of delay by the insured, the reasons for the delay, and the prejudice to the insurer.[11] Another approach requires that the insurer show its ability to investigate and defend has been prejudiced by the failure of the insured to give notice, as required under the contract.[12]

1971); Rose v. Regan, — Mass. —, 181 N.E.2d 796 (1962); State Farm Mut. Ins. Co. v. Caccinnelli, — Nev. —, 216 P.2d 606 (1950); Gizzi v. State Farm Ma. Ins. Co., 56 App. Div. 2d 973, 393 N.Y.S.2d 107 (1977); Crumley v. Travelers Ins. Co., 225 Tenn. 667, 475 S.W.2d 654 (1970); Shelton v. Ray, 570 S.W.2d 419 (Tex. Civ. App. 1978); Zinman v. Employers Ins. Co., 493 F.2d 196 (2d Cir. 1974) (Vt.); Maryland Cas. Co. v. Wilkerson, 119 F. Supp. 383 (Va. 1954), *aff'd*, 210 F.2d 245 (4th Cir. 1954).

7. *E.g.*, Barfield v. Ins. Co. of N. Am., 59 Tenn. App. 631, 443 S.W.2d 482 (1968), *cert. denied*, (1969); Christensten v. Allstate Ins. Co., 29 Misc. 2d 671, 218 N.Y.S.2d 426 (Sup. Ct. 1961).

8. *E.g.*, Mass. Bonding & Ins. Co. v. Ariz. Concrete Co., 47 Ariz. 420, 56 P.2d 188 (1936).

9. These states support an intermediate standard by allowing prejudice to be a factor in determining the reasonableness of the delay. Lumbermans Mut. Cas. Co. v. Oliver, 115 N.H. 141, 335 A.2d 666 (1975); Bibb v. Dairyland Ins. Co., 205 N.W.2d 495 (Mich. App. 1973); St. Paul Fire and Marine Ins. Co. v. Wabash Fire & Cas. Ins. Co., 264 F. Supp. 637 (D. Minn. 1967).

10. *E.g.*, American Fidelity Co. v. Schemel, 103 N.H. 190, 193, 168 A.2d 478, 480 (1961).

11. Lumbermans Mut. Cas. Co. v. Oliver, 115 N.H. 141, 335 A.2d 666 (1975).

12. *E.g.*, Globe Indem. Co. v. Blomfield, 115 Ariz. 5, 562 P.2d 1372 (1977); Hope Spoke Co. v. Maryland Cas. Co., 102 Ark. 1, 143 S.W. 85 (1912); Campbell v. Allstate Ins. Co., 60 Cal. 2d 303, 384 P.2d 155 (1963); Barnes v. Waco Scaffolding & Equip. Co., — Colo. —, 589 P.2d 505 (1978); State Farm Mut. Ins. Co. v. Johnson, 320 A.2d 345 (Del. 1974); Torres v. Protective Nat'l Ins. Co., 358 So. 2d 109 (Fla. Dist. Ct. App. 1978); Ohio Cas. Ins. Co. v. Rynearson, 507 F.2d 573 (7th Cir. 1974) (Ind.); Henschel v. Hawkeye-Sec. Ins. Co., 178 N.W.2d 409 (Iowa 1970); O'Neal v. Southern Farm Bureau Ins. Co., 325 So. 2d 887 (La. Ct. App. 1976); Gov't Employees Ins. Co. v. Harvey, 278 Md. 548, 366 A.2d 13 (1976); Johnson Controls, Inc. v. Bowes, 1980 Mass. Adv. Sh. 1831, 409 N.E.2d 185 (1980); Wendel v. Swanberg, 384 Mich. 468, 185 N.W.2d 348 (1971); Sager v. St. Paul Fire & Marine Ins. Co., 461 S.W.2d 704 (Mo. 1971); Rampy v. State Farm Mut. Auto. Ins. Co., 278 So. 2d 428 (Miss. 1973); State Farm Mut. Auto. Ins. Co. v. Murnion, 439 F.2d 945 (9th Cir. 1971) (Mont.); Traush v. Knecht, 184 Neb. 134, 165 N.W.2d 738 (1969), *vacated on other grounds*, 184 Neb. 511, 169 N.W.2d 269 (1969); Cooper v. Government Employees Ins. Co., 51 N.J. 86, 237 A.2d 870 (1968); Mountainair Mun. Schools v. United States Fid. & Guar. Co., 80 N.M. 761, 461 P.2d 410 (1969); Automobile Club Ins. Co. v. Hoffert, 195 N.W.2d 542 (N.D. 1972);

C.G. Tate Construction Company (Tate) was insured by Great American Insurance Company (Great American). An accident occurred on April 6, 1978 on U.S. Highway 221 in South Carolina between an automobile driven by Norma Jean Pegg and a gasoline truck driven by Robert Allen Thomas and owned by Space Petroleum, Inc. At the time of the collision, Tate was engaged in a highway expansion project on U.S. 221.[13]

The cause of the accident, the path of the vehicles, and Great American's liability were strongly disputed. Both drivers and one other motorist who witnessed the accident claimed that Pegg was traveling south and Thomas was travelling north. Tate's front-end loader then backed out onto the highway causing the tanker to swerve left of the center line and collide head on with the automobile. Several of Tate's employees and one other eyewitness testified that both vehicles were traveling north, and that when the car driven by Pegg slowed or stopped, the tanker braked, jackknifed, and rolled over the car. These witnesses claimed that Tate's front-end loader was parked off the road approximately ten feet and was not involved in the accident. The local news media and the investigating officer accepted the drivers' version that Tate was responsible.[14]

Great American was not notified of the accident until twenty-seven days later when Thomas, the tanker driver, filed for workers' compensation through his employer. Great American was the workers' compensation carrier for Space Petroleum, Inc.[15] Tate's officers testified that they did not give notice to Great American because its employees who witnessed the accident stated Tate was not involved. Tate did not know of its potential involvement until it received the summons and complaint in this action from Great American.[16]

The trial court found that Tate "knew or in the exercise of ordinary and reasonable prudence should have known" that the accident might "result in a claim being made against it," and that the failure to give notice of the accident to the insured "as soon as practicable," required by the policy, was not justified or excusable.[17] The conclusions reached

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Zurich Ins. Co. v. Valley Steel Erectors, 13 Ohio App. 41, 233 N.E.2d 597 (1968); Lusch v. Aetna Cas. & Sur. Co., 272 Or. 593, 538 P.2d 902 (1975); Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977); Pickering v. American Employers Ins. Co., 109 R.I. 143, 282 A.2d 584 (1971); Whittington v. Ranger Ins. Co., 261 S.C. 582, 201 S.E.2d 620 (1973); Spangler v. Insurance Co. of N. Am., 17 Wash. App. 121, 562 P.2d 635 (1977); Dietz v. Hardware Dealers Mut. Fire Ins. Co., 88 Wis. 496, 276 N.W.2d 808 (1979); State Farm Mut. Auto. Ins. Co. v. Milam, 438 F. Supp. 227 (D.W.Va. 1977).

13. 303 N.C. at 388, 279 S.E.2d at 770.
14. *Id.*
15. *Id.*
16. *Id.* at 389, 279 S.W.2d at 771.
17. *Id.*

by the superior court in *Tate* were squarely based on prior North Carolina cases that held that a contract provision requiring written notice was a condition precedent to the insurer's obligation to defend and indemnify, even though the policy contained no forfeiture clause.[18]

When *Tate* reached the North Carolina Court of Appeals,[19] the court, despite precedent to the contrary, felt compelled by reasons of policy to require the insurer to prove how it had been prejudiced by the insured's delay in giving notice. The court of appeals held that before the insurance company can be relieved of its obligations under the contract, "the finder of the facts must determine: (1) Was notice given within a reasonable time considering all the facts and circumstances of the particular case and (2) if not, has the insurer suffered prejudice from the insured's delay in giving notice?"[20]

The North Carolina Supreme Court affirmed and modified the holding of the court of appeals and outlined a three step test:

> When faced with a claim that notice was not timely given, the trier of fact must first decide whether the notice was given as soon as practicable. If not, the trier of fact must decide whether the insured has shown that he acted in good faith, *e.g.*, that he had not actual knowledge that a claim might be filed against him. If the good faith test is met the burden then shifts to the insurer to show that is ability to investigate and defend was materially prejudiced by the delay.[21]

There are two major differences between these two tests. The supreme court requires the insured to demonstrate good faith in his delay as a prerequisite to reaching the issue of prejudice, an intermediate step not required by the lower court. Once the insured has demonstrated good faith, the insurer must prove *material* prejudice, a concept not found in the court of appeals' test.

The supreme court's rationale was similar to that of other courts ad-

18. Peeler v. United States Cas. Co., 197 N.C. 286, 148 S.E.2d 261 (1929). *See* Fleming v. Nationwide Mutual Ins. Co., 261 N.C. 303, 134 S.E.2d 614 (1964); Muncie v. Travelers Ins. Co., 253 N.C. 74, 116 S.E.2d 474 (1960). In *Peeler*, the plaintiff was a judgment creditor of an insured motorist whose insurance company denied liability because notice was not given until several months after the accident. The contract, in a paragraph designated "Condition C," required that written notice of any accident as soon as practicable. The court held that although the contract did not expressly provide for forfeiture, timely written notice was a condition precedent to the insured's right to recovery, and therefore plaintiff's action was barred. 197 N.C. at 289-90, 148 S.E. at 262-63. In *Muncie*, the contract required written notice as soon as practicable and, in another paragraph, stated that the insurance company would not be liable unless, as a condition precedent, the insured complied fully with all terms of the policy. The court held that notice given eight months after an accident, without any explanation or justification for the delay, was not given "as soon as practicable." The condition not having been met, the action could not be maintained. 253 N.C. at 82, 116 S.E.2d at 479.

19. Great American Ins. Co. v. Tate Construction Co., 46 N.C. App. 427, 265 S.E.2d 467 (1980).

20. *Id.* at 436, 265 S.E.2d at 473. A discussion of the court of appeals decision may be found at 17 WAKE FOREST L. REV. 141 (1981).

21. 303 N.C. at —, 279 S.E.2d at 776.

hering to the modern trend away from the application of the strict contract law.[22] Courts have traditionally honored the freedom to contract and have enforced insurance policies as written, when they were unambiguous. Recently, however, the trend has been to distinguish insurance contracts from other types of contracts because the monetary amount of coverage is frequently the only term negotiated by the parties. Typical of this trend is *Brakeman v. Potomac Insurance Co.*[23] Although the policy contained a notice provision designated as a condition precedent, the court required the insurance company to prove both a breach of the notice provision and prejudice.[24] The majority of the North Carolina court felt that the new rule would give effect to the real expectations of the parties, without affecting the risk assumed by the insurer or its ability to investigate claims.[25]

The court also reasoned that interpretation of the notice provision should be guided by its purpose, not by a conclusive term.[26] The supreme court agreed with the court of appeals that the purpose of the notice provision was to furnish the insurer with a timely opportunity to adequately investigate. If the insurer has not been materially prejudiced in its investigation, then the insurer should perform its obligation.[27]

The North Carolina court then turned to a New Jersey Supreme Court case[28] that concentrated on the public policy supporting this decision. The language of the contract may classify the notice provision as a condition precedent; however, what is involved is a forfeiture. The insured is denied what he paid for. Adoption of the modern trend promotes the social function of insurance because it maintains the reasonable expectations of the insured that the insurer will defend and indemnify. The insurer's expectations are not altered because its obligation is to the insured, unless materially prejudiced by the insured's delay in notification.[29] The broader aspect of public policy is that innocent victims of negligence will be compensated for their injuries, and the court should weigh these third party interests in determining whether to allow the forfeiture.[30]

22. The court relied primarily upon two decisions of other state supreme courts, Cooper v. Government Employees Ins. Co., 51 N.J. 86, 237 A.2d 870 (1968) and Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977).

23. 472 Pa. 66, 31 A.2d 193 (1977).

24. *Id.* at 72, 371 A.2d at 196.

25. 303 N.C. at 395-96, 279 S.E.2d at 774. Justice Meyer, in his dissent, disagreed with the majority on this point.

26. *Id.* at 397, 279 S.E.2d at 774.

27. *Id.* at 396, 279 S.E.2d at 774.

28. Cooper v. Government Employees Inc. Co., 51 N.J. 86, 237 A.2d 870 (1968).

29. 303 N.C. at 397, 279 S.E.2d at 774 (citing Cooper v. Government Employees Ins. Co., 51 N.J. 86, 93-94, 237 A.2d 870, 873-74 (1968)).

30. 303 N.C. at 398, 279 S.E.2d at 774.

While overruling the old law of strict interpretation of conditions in insurance contracts, the court retained the common law principle that each party to a contract must act in good faith. Expressly placing this burden on the insured, the court stated "we also now impose the requirement that any period of delay beyond the limits of timeliness be shown *by the insured* to have been in good faith.[31] In the three-step test propounded by the supreme court, the insured bears the burden of showing good faith before the burden of proving material prejudice shifts to the insurer. A bad faith delay by the insured releases the insurer from its obligations.[32]

If the insured meets the good faith test, there is a split of authority among jurisdictions as to who should bear the burden of proving prejudice. Some courts have placed the burden on the insured because he is seeking relief under the contract based on a variation of its terms.[33] Others place the burden on the party seeking to escape its contractual obligation.[34] Still others require the insured to overcome a presumption that the insurance company has been prejudiced.[35]

In *Tate*, the North Carolina Supreme Court chose what it labeled as the "sounder rule" and placed the burden on the insurer.[36] The court said that this rule would encourage prompt investigation by the insurer in order to protect its interests, and would, by implication, decrease the number of lawsuits. In addition, the insurer is in a better position to prove prejudice because it knows what factors will prejudice its position.[37]

Whether the insurer had been prejudiced is a question of fact.[38] The court of appeals listed factors to be considered by the trier of fact in determining this question, and the supreme court adopted this illustrative, non-exclusive list:

> [T]he availability of witnesses to the accident; the ability to discover other information regarding the conditions of the locale where the accident occurred; any physical changes in the location of the accident during the period of the delay; the existence of official reports concerning the occurrence; the preparation and preservation of demonstrative and illustrative evidence, such as the vehicles involved in the occurence, or

31. *Id.* at 399, 279 S.E.2d at 776.
32. *Id.*
33. *Id.* at 397, 279 S.E.2d at 775. E.g., Zurich Ins. Co. v. Valley Steel Erectors, 233 N.E.2d 597 (1968); Henderson v. Hawkeye-Sec. Ins. Co., 252 Iowa 97, 106 N.W.2d 86 (1960).
34. *See e.g.*, Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977); State Farm Mut. Auto. Ins. Co. v. Johnson, 320 A.2d 345 (Del. 1974); Cooper v. Government Employees Ins. Co., 51 N.J. 86, 237 A.2d 870 (1968).
35. *E.g.*, Laster v. United States Fid. Guar. Co., 293 So. 2d 83 (Fla. App. 1974); Dairyland Ins. Co. v. Cummingham, 360 F. Supp. 139 (D. Colo. 1973).
36. 303 N.C. at 398, 279 S.E.2d at 775.
37. *Id.* at 398, 279 S.E.2d at 775-76.
38. 46 N.C.App. 427, 265 S.E.2d 467, 473 (1980).

> photographs and diagrams of the scene; the ability of experts to reconstruct the scene and the occurence; and so on.[39]

The court was quick to point out that the insurer must prove not only one or more of the above factors, but that "changed circumstances materially impairs its ability to investigate the claim or defend and, thus, to prepare a viable defense."[40] Overall development in this area will be on a case-by-case basis and the outcome will be determined by the application of these factors to a particular fact situation.[41]

The full ramifications of the *Tate* decision will not be known for many years. *Tate* resolves the inconsistencies between the *Peeler-Muncie-Fleming*[42] line of cases, which adhered to the strict contractual theory, and the *Rhyne* and *Ball*[43] line of cases, which carved out exceptions to that rule by defining excusable or justifiable delay. From the perspective of the insured or an injured third party, the decision is a positive one. *Tate* alleviates the inequities of the old approach and allows a factual inquiry in all cases. Under *Tate* the insured will receive his benefit of the bargain more often than before. The North Carolina Supreme Court chose to overturn old law rather than to distinguish it. This decision clarifies prior inconsistencies and corrects the inequities by protecting and promoting the expectations of both parties.

The weight of authority is with the modern trend of requiring the insurer to defend and indemnify unless he has been materially prejudiced by the delay of the insured in giving notice.[44] Jurisdictions that have used this approach appear to find it both workable and satisfactory. North Carolina has deviated from the trend only by stating expressly a standard generally implied, that of good faith. Setting forth numerous reasons for the change in the law, the court appeared to focus on correcting the tilt of the unbalanced scale: "The rule we adopt today has the advantages of promoting social policy and fulfilling the reasonable expectations of the purchaser while fully protecting the ability of the insurer to protect its own interests."[45]

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39. 303 N.C. at 398, 279 S.E.2d at 776 (quoting 46 N.C. App. at 437, 265 S.E.2d at 473).
40. *Id.* at 398-99, 279 S.E.2d at 776.
41. *Id.* at 399, 279 S.E.2d at 776.
42. Peeler v. United States Cas. Co., 197 N.C. 286, 148 S.E.2d 261 (1929); Muncie v. Travelers Ins. Co., 253 N.C. 74, 116 S.E.2d 474 (1960); Fleming v. Nationwide Mut. Ins. Co., 261 N.C. 303, 134 S.E.2d 614 (1964).
43. Rhyne v. Jefferson Standard Life Ins. Co., 196 N.C. 717, 147 S.E. 6 (1929). Ball v. Employer's Assur. Corp., 206 N.C. 90, 172 S.E. 878 (1934).
44. 303 N.C. at 394, 279 S.E.2d at 773.
45. 303 N.C. at 395, 279 S.E.2d at 774.