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Commercial Law-Great American Insurance Co. v. C. G. Tate Construction Co.: Interpretation of Notice Provisions in Insurance Contracts

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Commercial Law—*Great American Insurance Co. v. C.G. Tate Construction Co.*: Interpretation of Notice Provisions in Insurance Contracts

Many insurance contracts require the insured to provide the insurance company with timely notice of events giving rise to a claim.[1] These contracts also usually require that the notice be given "immediately"[2] or "as soon as practicable"[3] after the claim arises. Often the terms of the contracts are explicit in making compliance with these provisions a condition precedent to recovery under the contract.[4] The traditional approach to cases involving a breach of this type of provision has been to read the contract literally and to deny recovery if the requirements of the provision have not been met.[5] North Carolina courts and those in many other jurisdictions have denied recovery based on this approach and upon the rule that when the terms of a contract are clear and unambiguous, the courts may not alter the contract.[6]

A trend has been developing, however, that abandons the strict reading of notice provisions in insurance contracts.[7] Courts are noting that these contracts are not freely negotiated agreements but are actually contracts of adhesion forced upon the insured by the insurer.[8] This trend is part of a general movement toward a view that insurance contracts should be interpreted consonant with the purposes and intentions of both parties, instead of being read strictly by the words of their provisions, which may be subject to more than one interpretation.[9] The purpose and intention of an insurance contract's notice provision is to enable the insurer to begin its investigation and to initiate other procedures as soon as possible after a claim arises, and to avoid any prejudice that might be caused by a delay in receiving notice.[10] Following this

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1. *See generally* 8 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4731, at 10 (1981); 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); Annot., 18 A.L.R.2d 443 (1951).

2. Annot., *supra* note 2, § 14, at 462-64.

3. *See, e.g.*, Fleming v. Nationwide Mut. 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).

4. 8 J. APPLEMAN, *supra* note 1, § 4732, at 10. Appleman notes that the result is often the same in cases which the policy does not make compliance an explicit condition precedent because courts often construe the notice provision as creating a condition precedent.

5. *Id.* at 10-13.

6. Fleming v. Nationwide Mut. Ins. Co., 261 N.C. 303, 134 S.E.2d (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).

7. Comment, *supra* note 1 at 261; Annot., *supra* note 1. *See, e.g.*, Cooper v. Government Employees Ins. Co., 51 N.J. 86, 237 A.2d 870 (1968); Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977).

8. *See, e.g.*, Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977). *See infra* notes 31-33 and accompanying text.

9. "As in other contracts, the objective of construction of terms in an insurance policy is to arrive at the insurance coverage intended by the parties when the policy was issued." Wachovia Bank & Trust Co. v. Westchester Fire Ins. Co., 276 N.C. 348, 354, 172 S.E.2d 518, 522 (1970) (construing a provision dealing with what types of accidents are covered).

10. 8 J. APPLEMAN, *supra* note 1, § 4731. *See, e.g.*, State Farm Mut. Auto. Ins. Co. v. Milam,

view, courts in numerous jurisdictions have held that even when the terms of a notice provision have not been met, coverage by the insurer may not be avoided unless the insurer shows prejudice from the delay.[11]

In *Great American Insurance Co. v. C.G. Tate Construction Co.*[12] the North Carolina courts joined the movement toward this more flexible approach. The supreme court in *Tate* explicitly overruled earlier precedent following the strict constructionist view.[13] The court held that an insurer may not deny coverage based on noncompliance with a notice provision unless the insurer can prove that it has been prejudiced by the delay in receiving notice.[14]

The dispute in *Tate* arose out of a collision between an automobile and a tanker truck that occurred near a construction site where the C.G. Tate Construction Company (Tate Construction) was working. The truck, driven by Robert Allen Thomas and owned by State Petroleum, Inc., collided with an automobile driven by Norma Jean Pegg. The law enforcement officer investigating the accident received conflicting reports from witnesses concerning the cause of the accident. Officials of Tate Construction testified that they did not believe the company was involved, and thus did not report the accident to the company's liability insurance carrier, Great American Insurance Co. It was not until twenty-seven days after the accident that Great American first learned of Tate Construction's potential liability. Subsequently, Great American initiated an action seeking a declaratory judgment relieving the insurance company of any obligation to defend or indemnify Tate Construction in an action arising out of the accident. The grounds for the action were Tate Construction's failure to comply with the notice provision in the comprehensive liability policy issued to Tate Construction by Great American, which required notification "as soon as practicable."[15] The trial court ruled that Great American was released from its duty under the policy because Tate Construction's failure to notify Great American "as soon as practicable" constituted a failure of a condition precedent to coverage under the contract.[16]

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438 F. Supp. 227 (S.D.W. Va. 1977); Peeler v. United States Cas. Co., 192 N.C. 286, 148 S.E. 261 (1929).

11. *See, e.g.*, Cooper v. Government Employees Ins. Co., 51 N.J. 86, 237 A.2d 870 (1968); Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977).

12. 303 N.C. 387, 279 S.E.2d 769 (1981).

13. The court explicitly overruled Fleming v. Nationwide Mut. Ins. Co., 261 N.C. 303, 134 S.E.2d 614 (1964), Munice v. Travelers Ins. Co., 253 N.C. 74, 116 S.E.2d 474 (1960), and Peeler v. United States Cas. Co., 197 N.C. 286, 148 S.E. 261 (1929). 303 N.C. at 396, 279 S.E.2d at 774.

14. 303 N.C. at 390, 279 S.E.2d at 771.

15. *Id.* at 387, 279 S.E.2d at 770. The actual wording of the notice provision in the policy issued to Tate Construction was:

> 4. Insured's duties in the event of occurrence, claim or suit:
>
> (a) In the event of an occurrence, written notice containing particulars sufficient to identify the insured and also reasonably obtainable information with respect to the time, place and circumstances thereof, and the names and addresses of the injured and of available witnesses, shall be given by or for the insured to the company or any of its authorized agents as soon as practicable.

Great American Ins. Co. v. C.G. Tate Constr. Co., 46 N.C. App. 427, 432, 265 S.E.2d 467, 470 (1980), *aff'd*, 303 N.C. 387, 279 S.E.2d 769 (1981).

16. 303 N.C. at 389-90, 279 S.E.2d at 771.

On appeal, the North Carolina Court of Appeals reversed and ruled that the insurance company must also show prejudice in order to deny recovery based on noncompliance with a notice provision.[17] The court of appeals distinguished the case from earlier precedent applying the strict constructionist view, noting that in *Tate* the insured party had given an excuse for not complying with the notice provision. The court went on to say that when an excuse is given, the question whether notice was given "as soon as practicable" becomes a quesiton of fact, and that the existence of prejudice to the insurer is the key factor to be considered in answering the question.[18] The case was remanded to the trial level for a finding on whether Great American had been prejudiced by the twenty-seven day delay.[19]

The supreme court, with one justice dissenting,[20] affirmed the appellate court's holding but modified the decision and based the ruling on a substantially different rationale. Since it possessed the authority to overrule its earlier precedent—a power the court of appeals lacked—the supreme court did not find it necessary to distinguish the *Tate* case based on the existence of an excuse.[21] The high court explicitly overruled prior cases that had followed the strict constructionist approach[22] and held that "failure of an insured to notify its insurer of an accident 'as soon as practicable' does not relieve the insurer of its obligations under the contract unless the delay operates materially to prejudice the ability of the insurer to investigate and defend."[23] The burden of proving prejudice is on the insurer once the insured is found to have acted in good faith.[24]

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17. 46 N.C. App. at 427, 265 S.E.2d at 467. For a more complete discussion of the opinion in the court of appeals, modified by the supreme court, *see* Note, *Insurance—A New Approach for the Interpretation of Insurance Contracts*, 17 WAKE FOREST L. REV. 141 (1981).

18. 46 N.C. App. at 434-35, 265 S.E.2d at 472.

19. *Id.* at 438, 265 S.E.2d at 474. The North Carolina Supreme Court initially denied Great American's petition for discretionary review, but eventually granted a reconsideration of this denial and granted review. 301 N.C. 401, 273 S.E.2d 446 (1980).

20. Justice Meyer dissented from the majority opinion in this case on almost all points. He argued strenuously for the strict constructionist view, noting his belief that this view is still held by the majority of jurisdictions. 303 N.C. at 401-02, 279 S.E. 2d at 777-78 (Meyer, J., dissenting). Justice Meyer's primary authority for this assertion is a 1970 comment from the DICKINSON LAW REVIEW, *see* Comment, *supra* note 1. A great number of jurisdictions have changed or at least modified their positions since 1970. *See* Annot., *supra* note 1. Appleman, on the other hand, indicates that the new approach adopted in *Tate* is still a minority view. 8 J. APPLEMAN, *supra* note 1, § 4732.

Justice Meyer also stated that even if he agreed with the result in *Tate*, he would not state the rule so broadly. He did not believe the burden of proving prejudice should be on the insurer, 303 N.C. at 404, 279 S.E.2d at 779, nor did he agree with the majority that the new rule protects the insurance company's interests. *Id.* at 405-06, 279 S.E.2d at 780. Justice Meyer argued that the case could be decided without overruling precedent by recognizing an exception when the insured does not believe he is liable for the accident. *Id.* at 406-07, 279 S.E.2d at 780-81. Finally, the dissenting justice did not believe that Tate's actions had been in "good faith," as required by the majority opinion. *Id.* at 407, 279 S.E.2d at 781.

21. The supreme court pointed out that an attempt to distinguish Tate on its facts did not square with the rationale of the earlier cases. These cases unwaveringly applied the strict constructionist approach and left no room for exceptions. *Id.* at 392-93, 279 S.E.2d at 772.

22. *See supra* note 13.

23. 303 N.C. at 396, 279 S.E.2d at 774.

24. *Id.* at 399, 279 S.E.2d at 776.

Prior to *Tate*, North Carolina traditionally had been in line with most other jurisdictions in applying a strict constructionist approach to the interpretation of insurance contracts.[25] Under this approach, the courts have held that insurance contracts must be enforced as written and have refused to "rewrite" contracts for the parties.[26] The basis for this rule is that although the intent of the parties is to be the guiding factor in interpreting insurance contracts, clear and unambiguous language, when present, must be the source used for finding this intent.[27] This position represents a straightforward application of general contract law principles to insurance policies.[28]

Courts have established various doctrines reflecting the recognition that insurance contracts are often not ordinary contracts, and thus should not always be governed by ordinary contract rules.[29] Courts have often noted that insurance contracts usually are not negotiated freely, but are presented by the insurance company on a "take-it-or-leave-it basis."[30] As such, policies are often contracts of adhesion, requiring the court to make special inquiries into their fairness and whether they represent the true intentions and expectations of both parties.[31] Further, since insurance contracts are prepared by the insurance company, all doubts and ambiguities must be construed in favor of the insured.[32]

In spite of this trend toward a more liberal construction of insurance contracts in general, North Carolina courts had, before *Tate*, applied the strict constructionist approach in cases dealing with notice provisions.[33] In cases involving a requirement that notice be given as soon as practicable or within a reasonable time, the courts had held that this determination must be made on the basis of the facts and surrounding circumstances.[34] If a determination were made that notice was not given in compliance with the terms of the policy, the old approach was to deny coverage to the insured based on the failure of a condition precedent to the contract.

A pioneering case in the movement toward the adoption of a more liberal view of notice provisions was the 1968 New Jersey Supreme Court's decision in

25. *See, e.g.*, Rose Hill Poultry Corp. v. American Mut. Ins. Co., 34 N.C. App. 224, 237 S.E.2d 564 (1977).

26. *See, e.g.*, York Indus. Center, Inc. v. Michigan Mut. Liab. Co., 271 N.C. 158, 155 S.E.2d 501 (1967); Richardson v. Liberty Life Ins. Co., 254 N.C. 711, 119 S.E.2d 871 (1961); Ford v. New York Life Ins. Co., 222 N.C. 154, 22 S.E.2d 235 (1942).

27. Duke v. Mutual Life Ins. Co., 286 N.C. 244, 210 S.E.2d 187 (1974).

28. 4 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §§ 601, 609, at 306-09, 402 (3d ed. 1961); 17 AM. JUR. 2D CONTRACTS § 242 (1964).

29. Comment, *supra* note 1, at 261.

30. *See, e.g.*, Cooper v. Government Employees Ins. Co., 51 N.J. 86, 237 A.2d 870 (1968). *See also* 7 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 900 (3d ed. 1973).

31. Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977).

32. Barker v. Iowa Mut. Ins. Co., 241 N.C. 397, 85 S.E.2d 305 (1955); Cherokee Ins. Co. v. Aetna Casualty & Sur. Co., 46 N.C. App. 242, 264 S.E.2d 913 (1980).

33. Fleming v. Nationwide Mut. 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).

34. *See, e.g.*, Harris v. Nationwide Mut. Ins. Co., 261 N.C. 499, 135 S.E.2d 209 (1964). *See also* 7 J. STRONG, N.C. INDEX INSURANCE § 96.1, at 511-12 (3d ed. 1976).

Cooper v. Government Employees Insurance Co.[35] In the face of a contract provision stating that notification of the insurer "as soon as practicable" was a "condition precedent" to coverage,[36] the court held that coverage could be avoided only by "a breach of the notice provision and a likelihood of appreciable prejudice."[37] Courts in numerous jurisdictions, and the legislature of at least one state,[38] followed the trend initiated in *Cooper*, often with slight variations as to the exact standard for denying coverage.[39] Despite these variations, almost all of the decisions have been based on the adhesion contract rationale. Noting that contracts of adhesion are to be read liberally with emphasis on the purposes and intention of the contract, these courts have found that the prevention of investigative and defense problems for insurance carriers is the principal purpose of notice provisions. Thus, these provisions should not be used to deny coverage unless the insurance company has been prejudiced in its ability to investigate and defend. Notwithstanding these arguments, however, the North Carolina courts had continued to follow the strict constructionist approach when dealing with notice provisions.[40]

The supreme court's decision in *Tate* represents a major shift in the North Carolina approach to notice provisions and relieves North Carolina tribunals from the necessity of distinguishing earlier precedent in order to avoid harsh results.[41] The court in *Tate* adopted a three-part test for determining whether the insurer is obligated under the policy:

> 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 no 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 its ability to investigate and defend was materially prejudiced by the delay.[42]

This three-step test, with its explicit inclusion of a good faith requirement, is stated in a form different from the standards in most jurisdictions adopting the

35. 51 N.J. 86, 237 A.2d 870 (1968).

36. *Id.* at 88-90, 237 A.2d at 871-72.

37. *Id.* at 94, 237 A.2d at 874.

38. MD. ANN. CODE art. 48A, § 482 (1979) provides:

> Where any insurer seeks to disclaim coverage on any policy of liability insurance issued by it, on the ground that the insured or anyone claiming the benefits of the policy through the insured has breached the policy by failing to cooperate with the insurer or by not giving requisite notice to the insurer, such disclaimer shall be effective only if the insurer establishes by a preponderance of affirmative evidence that such lack of cooperation or notice has resulted in actual prejudice to the insurer.

39. *See, e.g.*, State Farm Mut. Auto. Ins. Co. v. Milam, 438 F. Supp. 227 (S.D.W. Va. 1977); Globe Indem. Co. v. Blomfield, 115 Ariz. 5, 562 P.2d 1372 (1977); State Farm Mut. Auto. Ins. Co. v. Johnson, 320 A.2d 345 (Del. Super. Ct. 1974); Fakouri v. Insurance Co. of N. Am., 378 So. 2d 1083 (La. Ct. App. 1979); Johnson Controls, Inc. v. Bowes, 1980 Mass. Adv. Sh. 1831, 409 N.E.2d 185 (1980); Finstad v. Steiger Tractor, Inc., 301 N.W.2d 392 (N.D 1981); Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977) ; Dietz v. Hardware Dealers Mut. Fire Ins. Co., 88 Wis. 2d 496, 276 N.W.2d 808 (1979).

40. *See supra* note 31 and accompanying text.

41. *See supra* note 20-21 and accompanying text.

42. 303 N.C. at 399, 279 S.E.2d at 776.

new approach,[43] but its effect is probably similar. The North Carolina court relied heavily on the *Cooper* decision, which had adopted a two-step approach that required proof of both noncompliance with the notice provision and the likelihood of prejudice.[44] The *Cooper* court made it clear, however, that good faith was a significant factor in the determination of compliance with the notice provision.[45] Thus, it seems unlikely that the additional good faith requirement in the North Carolina analysis will significantly alter the doctrine from the way it has been applied in other states.

It might be argued that the good faith requirement is a return to the court of appeals' ruling that prejudice must be shown only in cases in which the insured has an excuse for the delay.[46] The court specifically rejected the court of appeals' analysis, however, and ruled that the existence or nonexistence of an explanation for the delayed notice is not controlling.[47] The court imposed the good faith requirement merely to ensure that the decision would not "be perceived as encouraging dilatory tactics in the notification of the insurer."[48] The good faith requirement does not necessitate any excuse for the delayed notification, only that the insured "had no actual knowledge that a claim would be filed against him."[49] It is significant that the court used the words "actual knowledge." This language makes it clear that if the insured merely *should* have known that a claim had been filed against him (in other words, he had no valid excuse for not notifying the insurer), but he had no actual knowledge of the claim, he still would be deemed to have acted in good faith.

Under the test adopted in *Tate*, the insurer carries the burden of proving prejudice once good faith and noncompliance with the notice provision have been established.[50] Although the North Carolina court correctly noted that the cases are split on this issue,[51] the *Tate* decision seems consistent with the trend in the more recent decisions in placing the burden on the insurer.[52]

The court offered persuasive reasons why the insurance company should

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43. The explicit inclusion of the good faith requirement is apparently unique; other jurisdictions imply that good faith of the insured is an important consideration. *See infra* note 47 and accompanying text. Other slight variations in language also exist. For example, North Carolina uses "material prejudice," while New Jersey uses "appreciable prejudice." These differences, however, seem insignificant since the cases are generally based on the same rationale. *See supra* note 39 & *infra* notes 70-72, and accompanying text.

44. 51 N.J. at 94, 237 A.2d at 874.

45. *Id.*

46. *See supra* note 18 and accompanying text.

47. 303 N.C. at 392, 279 S.E.2d at 772.

48. *Id.* at 399, 279 S.E.2d at 776.

49. *Id.*

50. *Id.*

51. *Id.* at 397, 279 S.E.2d at 775.

52. *See, e.g.*, Gladstone v. Fireman's Fund Ins. Co., 536 F.2d 1403 (2d Cir. 1976); State Farm Mut. Auto. Ins. Co. v. Milam; 438 F.Supp. 227 (S.D.W. Va. 1977); Globe Indem. Co. v. Blomfield, 115 Ariz. 5, 562 P.2d 1372 (1977); State Farm Mut. Auto. Ins. Co. v. Johnson, 320 A.2d 345 (Del. 1974); O'Neal v. Southern Farm Bureau Ins. Co., 325 So. 2d 887 (La. Ct. App. 1976); Johnson Controls, Inc. v. Bowes, 180 Mass. Adv. Sh. 1831, 409 N.E.2d 185 (1980); Cooper v. Government Employees Ins. Co., 51 N.J. 86, 237 A.2d 870 (1968); Finstad v. Steiger Tractor, Inc., 301 N.W.2d 392 (N.D. 1981); Brakeman v. Potomac Ins. Co., 472 Pa. 66, 371 A.2d 193 (1977); Sivaro v. Great Am. Ins. Co., 410 A.2d 116 (R.I. 1980).

carry the burden of proving prejudice. First, to do so will encourage the insurer to make a prompt investigation when it learns of the claim. Second, the insurer is in the best position to evaluate its ability to defend. Third, it would be difficult for the insured to prove a negative (lack of prejudice) if he is given the burden of proof.[53] The argument also has been made that the insurer should bear the burden of proof since it is trying to bring about a forfeiture of the very essence of the contract—protection of the insured.[54] On the other hand, some commentators and courts have argued that the insured should bear the burden of proof since he is the party trying to escape from the specific contract provision of notice.[55] Nevertheless, the practical considerations enumerated by North Carolina courts appear to have won out in most states.[56]

The major question left unanswered by the *Tate* holding is how the prejudice requirement will be interpreted and applied in future cases. Noncompliance with the notice provision will not relieve the insurance company's obligation unless the company proves that "the delay operates materially to prejudice the insurer's ability to investigate and defend,"[57] but it is unclear how much prejudice is "material." The existence of material prejudice will be based on the facts of each case, and thus the court conceded that it could not enunciate an exacting test.[58] Therefore, a major source for indications of how the prejudice standard will be applied in North Carolina may be the decisions of other jurisdictions that have adopted and interpreted similar rules.

Courts in other jurisdictions generally have been strict in requiring an affirmative showing of prejudice.[59] It is not enough for an insurance company to show an inability to follow its regular procedures for making an investiga-

53. 303 N.C. at 398, 279 S.E.2d at 775-76. The *Cooper* court noted, however, that the insured party is still under an obligation to produce any evidence within its possession that might impinge on the question of prejudice. 51 N.J. at 94 n.3, 237 A.2d at 874 n.3.

54. 303 N.C. at 39, 279 S.E.2d at 775.

55. This argument is made by Justice Meyer in his dissent. *Id.* at 404, 279 S.E.2d at 779 (Meyer, J., dissenting). *See also*, Dairyland Ins. Co. v. Cunningham, 360 F. Supp. 139 (D. Colo. 1973); Tiedke v. Fidelity & Casualty Co., 222 So. 2d 206 (Fla. 1969); 8 J. APPLEMAN, *supra* note 1 § 4732, at 26-30:

> Since it is often impossible for the insurer to know what witnesses it would have found or what facts it could have ascertained had immediate notice been given and a prompt investigation made, it is submitted that this test (placing burden on insurer to prove prejudice) is unworkable. The burden should be placed on the one seeking to recover.

56. *See supra* note 52 and accompanying text.

57. 303 N.C. at 390, 279 S.E.2d at 771.

58. *Id.* at 399, 279 S.E.2d at 776. The court did adopt the court of appeals' list of factors to be considered in determining whether the insurer has been prejudiced: the 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 vehicles involved in the occurrence, or photographs and diagrams of the scene; the ability of experts to reconstruct the scene and the occurrence. *Id.* at 398, 279 S.E.2d at 776 (citing 46 N.C. App. at 437, 265 S.E.2d at 473). The court, however, went on to say that this list is merely illustrative, and that "[a] more complete discussion of the prejudicial factors will have to await a case-by-case development." *Id.* at 399, 279 S.E.2d at 776.

59. It has often been said that the "mere speculation" or "mere possibility" of prejudice is not enough. *See, e.g.*, Moe v. Transamerica Title Ins. Co., 21 Cal. App. 289, 98 Cal. Rptr. 547 (1971); Falcon Steel Co. v. Maryland Casualty Co., 366 A.2d 512 (Del. Super. Ct. 1976).

tion.[60] The insurer must show affirmatively that it has lost an opportunity which would have made a difference in the settlement of the claim or in defense of the lawsuit.[61] Thus, courts have often stretched to avoid denying coverage under the proof of prejudice requirement. In *Colonial Gas Energy System v. Unigard Mutual Insurance Co.*[62] the owner of insured liquid natural gas tanks repaired the damaged tanks before filing a claim. The insurance company could no longer investigate due to the insured's actions, and prejudice was thus found. The court deferred judgment, however, because the insured stated that the insurer could now inspect the tanks, although this would cost the insurer $100,000 to $200,000 (the claim being for $3,257,035). The court found that this inspection might remove any prejudice suffered by the insurance company.[63] When significant and irreparable prejudice has clearly been shown, however, courts have held that the insurer has met its burden.[64]

The New Jersey courts, which pioneered the new approach with *Cooper*, elaborated on their test for proving prejudice in *Morales v. National Grange Mutual Insurance Co.*[65] In that decision two variables were identified as central to the resolution of the question of prejudice. The first is whether "substantial rights pertaining to a defense against the claim have been *irretrievably lost*."[66] The court pointed out that in some cases prejudice clearly will exist, but if the prejudicial effects of the delay can be removed, it would be unfair to deny coverage.[67]

The second variable identified in *Morales* is "the likelihood of success of the insurer in defending against the accident victim's claim."[68] The court noted that in cases in which the liability of the insured and proof of damages are clear, it would be unfair to deny coverage based on noncompliance with a notice requirement.[69] In such a case, prejudice to the insurer's ability to investigate and defend would not make any difference, since it is clear that the insured would be held liable in any event.

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60. Falcon Steel Co. v. Maryland Casualty Co., 366 A.2d 512 (Del. Super. Ct. 1976).

61. *Id.* at 518.

62. 441 F. Supp. 765 (N.D. Cal. 1977).

63. *Id.*

64. *See, e.g.*, Lumbermans Mut. Casualty Co. v. Oliver, 151 N.H. 141, 335 A.2d 666 (1975) (one year delay held prejudicial when it was impossible to locate any witnesses or ascertain cause of the accident). See also National Bank v. Winstead Excavating, 94 Ill. App. 3d 839, 419 N.E.2d 522 (1981).

65. 176 N.J. Super. 347, 423 A.2d 325 (Law Div. 1980).

66. *Id.* at 355, 423 A.2d at 329 (emphasis in original).

67. *Id.* at 355-56 , 423 A.2d at 329-30. *See also supra* text accompanying notes 62-63.

68. 176 N.J. Super. at 356, 423 A.2d at 330.

69. *Id.* The courts of Maryland, in applying that state's statute requiring proof of prejudice, *see supra* note 38, have ruled that the insurer must establish a "substantial likelihood that if the cooperation or notice clause had not been breached, the insured would not have been held liable." Harleysville Ins. Co. v. Rosenbaum, 30 Md. App. 74, ——, 351 A.2d 197, 202 (1976). The court went on to say that "a finding of actual prejudice inherently depends to some extent upon the closeness of the case." *Id. Accord* Northwestern Title Sec. Co. v. Flack, 6 Cal. App. 3d 134, 85 Cal. Rptr. 693 (1970).

Courts in most cases appear to hold that mere monetary prejudice to the insurer is not a sufficient reason for denying coverage.[70] This position is very much in line with the *Tate* test, which requires a showing of prejudice to "the insurer's ability to investigate and defend,"[71] not to the insurer's pocketbook.[72]

The courts of other states also have held that when an insurer has been prevented from making its own investigation, it will be required to accept the investigation of a third party if the insurer cannot show any reason why its own investigation would have been better.[73] Further, it has been almost universally held that where the insurer received *actual* notice of an accident within a reasonable time, it cannot claim prejudice simply because it did not receive notice *from the insured* until much later.[74] These cases are further evidence of the strong desire in jurisdictions following the more liberal approach to disfavor a forfeiture of coverage whenever possible.

With the *Tate* decision, the North Carolina Supreme Court has avoided the harsh results that often are caused by the inflexible application of strict legal principles. The court has shown a willingness to read insurance contracts more in line with the purposes of the contract, with less reliance on the technical language drafted by the party having most of the bargaining power. Some might argue that placing the burden on the insurance company to prove prejudice is an undue hardship, especially since the entire problem has been caused by the insured's delay. Nevertheless, the imposition of the good faith requirement by the North Carolina court is a reminder that the interests of the insurance company still must be balanced against those of the insured.[75] As the *Cooper* court noted, "This is not to belittle the need for notice of the accident, but rather to put the subject in perspective."[76] The *Tate* decision and the

70. *See, e.g.*, Reliance Ins. Co. v. St. Paul Ins. Cos., 307 Minn. 338, 239 N.W.2d 922 (1976) (no prejudice from showing that the delay merely caused a greater accumulation of interest); Abington Mut. Fire Ins. Co. v. Drew, 109 N.H. 464, 254 A.2d 829 (1969) (mere possibility that insurance company could have negotiated a cheaper settlement but for the delay does not require finding of prejudice).

71. 303 N.C. at 390, 279 S.E.2d at 771.

72. There are some cases from California, however, which at least hint that financial prejudice might be taken into consideration. *See, e.g.*, Northwestern Title Sec. Co. v. Flack, 6 Cal. App. 3d 134, 85 Cal. Rptr. 693 (may find prejudice if insurer can show it could have settled for smaller amount with proper notification). *See also* Billington v. Interinsurance Exch., 71 Cal. 2d 728, 456 P.2d 982, 79 Cal. Rptr. 326 (1969).

73. Saint Paul Fire & Marine Ins. Co. v. Petzold, 418 F.2d 303 (1st Cir. 1969); Allstate Ins. Co. v. Truck Ins. Exch., 63 Wis. 2d 148, 216 N.W.2d 205 (1974); Falcon Steel Co. v. Maryland Casualty Co., 366 A.2d 512 (Del. Super. Ct. 1976).

74. *See, e.g.*, Helay Tibbitts Constr. Co. v. Foremost Ins. Co., 482 F. Supp. 830 (N.D. Cal. 1979); Hood v. Fireman's Fund Ins. Co., 412 F. Supp. 846 (S.D. Miss. 1976); Arizona Title Ins. & Trust Co. v. Pace, 8 Ariz. App. 269, 445 P.2d 471 (1968); LaPointe v. Shelby Mut. Ins. Co., 361 Mass. 558, 281 N.E.2d 253 (1972); Kolbeck v. Rural Mut. Ins. Co., 70 Wis. 2d 655, 235 N.W.2d 466 (1975).

75. Justice Meyer argued vigorously in his dissent that the *Tate* rule does not adequately protect the interests of both parties. He argued that under the new rule only the expectations of the insured are adequately considered and that the insurer has not been protected from *"fraud and imposition."* 303 N.C. at 405-06, 279 S.E.2d at 780 (Meyer, J., dissenting) (emphasis in original).

76. 51 N.J. at 94, 237 A.2d at 873.

probable application of its doctrine appear to have struck a favorable balance between the interests of both parties in the resolution of this type of insurance contract dispute.[77]

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77. As the *Tate* court indicated, "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." 303 N.C. at 395, 279 S.E.2d at 774.