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Draconian Forfeitures of Insurance: Commonplace, Indefensible, and Unnecessary

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Cover Page Footnote

Eugene R. Anderson and Richard G. Tuttle are partners in the law firm of Anderson Kill & Olick, P.C. Susannah Crego is an attorney and is Communications Director at the firm. The firm has offices in NYC, Washington D.C., Newark, NJ, Philadelphia, PA, Phoenix, AZ, Tuscon, AZ and San Francisco, CA. The firm specializes in representing insurance policyholders in disputes with insurance companies.

ARTICLES

DRACONIAN FORFEITURES OF INSURANCE: COMMONPLACE, INDEFENSIBLE, AND UNNECESSARY

*Eugene R. Anderson, Richard G. Tuttle, and Susannah Crego**

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INTRODUCTION

FORFEITURE is a common law rarity and an insurance law ubiquity. Each year, millions, if not billions, of dollars of insurance are forfeited by policyholders who have not punctiliously complied with all of the "conditions" included in the fine print in their insurance policies.¹ Failure to give prompt notice of an accident, failure to file a timely proof of loss, or an innocent or minor misrepresentation in an insurance policy application—to cite only three common examples—may prompt an insurance company to deny coverage on a policyholder's otherwise valid claim. Worse, the courts may approve this forfeiture of insurance coverage even when the harm suffered by the insurance company from the policyholder's technical noncompliance is nil, or at any rate, is far less than the harm suffered by the policyholder who is denied much needed insurance coverage.²

The punishment does not fit the crime. Forfeiture is a draconian,³ anachronistic, archaic, and profoundly anti-consumer sanction. Outside insurance law, "hornbook" remedies for breach of contract no longer include forfeiture, if indeed they ever did.⁴ Forfeiture is mentioned in most contexts only in connection with a discussion of agreed contractual remedies, such as liquidated damages or specific performance, and even then it is often described as an unenforceable penalty.⁵ A homeowner can be late in making a mortgage payment

1. See *infra* part II.

2. Forfeiture may also result if a policyholder neglects to pay premiums. The argument in this article assumes, however, that premiums have been paid by the policyholder and accepted by the insurance company.

3. Draco was a 7th Century B.C. Athenian politician and law codifier. Concise Columbia Encyclopedia 232 (2d ed. 1989); Black's Law Dictionary 493 (6th ed. 1990). Draco's code prescribed the death penalty for even trivial offenses and the term "draconian" is synonymous with harsh penalties. Concise Columbia Encyclopedia 232 (2d ed. 1989).

4. Dan B. Dobbs, Law of Remedies § 12.1(1) (2d ed. 1993) (describing the main remedies available for breach of contract as damages, restitution, and specific performance); E. Allan Farnsworth, Contracts § 12.2 (1st ed. 1982) (same); see Restatement (Second) of Contracts § 345 (1981) (same); *infra* part III.C.

It can be argued that insurance should not be analyzed in the context of contract law. Much of the discussion in this article involves contract law principles and remedies only because most commentators and courts have viewed the insurance policy as a contract and the insurance relationship as a contractual relationship. The Delaware Supreme Court, however, is one court that has recognized that "[i]nsurance is different." *E.I. Dupont de Nemours & Co. v. Pressman*, No. 35, 1995, 1996 Del. LEXIS 179, at *36 (Del. May 2, 1996). The case involved employment law, and was not an insurance coverage dispute.

5. See *infra* part III.C. For example, it may be provided in a contract that a deposit of money will be forfeited in the event of a breach by the depositor. Dobbs, *supra* note 4, § 12.9(4). For a discussion of forfeiture as an unenforceable penalty, see William H. Loyd, *Penalties and Forfeitures*, 29 Harv. L. Rev. 117, 122 (1915).

but still keep his home.⁶ At common law, even a dog got one bite.⁷ There is no free bite, however, no opportunity to “kiss and make up,” for the insurance policyholder. When an insurance company can show the policyholder’s noncompliance with any condition in the insurance policy, the insurance claim may be denied, an action the courts frequently affirm.⁸

Forfeiture of insurance is a massive and disproportionate penalty in relation to the policyholder’s relatively harmless noncompliance with a condition in the insurance policy. A policyholder who purchases standard form liability insurance acquires five distinct services: (1) loss prevention and safety engineering services;⁹ (2) investigation of claims;¹⁰ (3) legal defense;¹¹ (4) loss mitigation (the policyholder’s expenses incurred to mitigate damages that would accrue if no remedial

6. See, e.g., Pa. Stat. Ann. tit. 41, § 404 (1992) (giving the homeowner the right to cure a default in mortgage payment).

7. The “one-bite” rule stated that the owner of a dog had to have reason to know of his animal’s vicious tendency, such as a previous bite, before he or she could be held liable for injury caused by the dog. *Gallick v. Barto*, 828 F. Supp. 1168, 1174 (M.D. Pa. 1993). At common law, the plaintiff must plead and prove that a dog owner either knew or was negligent not to know that his dog had a propensity to injure people. *Harris v. Walker*, 519 N.E.2d 917, 918 (Ill. 1988). Although an owner has a duty to prevent animals from injuring others, the owner must have had notice of an otherwise tame animal’s ill quality in order to hold him liable. Robert J. Kaczorowski, *The Common-Law Background of Nineteenth-Century Tort Law*, 51 Ohio St. L.J. 1127, 1174 n.308 (1990) (citing *Mason v. Keeling*, 88 Eng. Rep. 1359, 1361 (K.B. 1700)).

Jurisdictions have modified the “one-bite” rule by statute. See, e.g., Pa. Stat. Ann. tit. 3, §§ 459-502(a) (1995) (mandating that any dog “which bites or attacks a human being” shall be confined for a minimum of ten days at the owner’s expense); *Gallick*, 828 F. Supp. at 1174 (discussing a statute that expands the owner’s liability to cases where the owner lacks knowledge of the animal’s vicious tendencies).

8. See *infra* part II.

9. See *Pratt v. Liberty Mut. Ins. Co.*, 952 F.2d 667, 668 (2d Cir. 1992) (holding that an insurance company that conducted active loss-prevention program at the workplace could be sued in negligence for failure to exercise due care in performing safety inspections).

10. See *Carter v. Aetna Casualty & Sur. Co.*, 473 F.2d 1071, 1075 (8th Cir. 1973); *Daniels v. Horace Mann Mut. Ins. Co.*, 422 F.2d 87, 89 (4th Cir. 1970); *Roberts v. American Fire & Casualty Co.*, 89 F. Supp. 827, 832 (M.D. Tenn. 1950), *aff’d*, 186 F.2d 921 (6th Cir. 1951); Barry R. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* § 10.04[a] (8th ed. 1995) (“It is well-settled that [a policyholder] is entitled to a reasonable investigation as part of its defense.”).

An insurance company that does not make such an investigation is subject to liability for bad faith. See *Tibbs v. Great Am. Ins. Co.*, 755 F.2d 1370, 1375 (9th Cir. 1985) (holding that an insurance company’s failure to investigate adequately the policyholder’s claim before refusing to defend constituted bad faith, entitling the policyholder to punitive damages); *Industrial Indem. Co. v. Kallevig*, 792 P.2d 520, 526 (Wash. 1990) (stating that an insurance company’s failure to make a reasonable investigation constitutes bad faith because any resulting denial of a claim would be based on suspicion and conjecture).

11. The standard form comprehensive general liability insurance policy (“CGL”) provides that the insurance company has the “right and duty to defend” any “suit” seeking damages because of “bodily injury” or “property damage.” 1 Susan J. Miller & Philip Lefebvre, *Miller’s Standard Insurance Policies Annotated* 409 (4th ed. 1995).

action were taken);¹² and (5) indemnity.¹³ An unexpected forfeiture of the entire policy, as may happen when the policyholder has made an innocent misrepresentation in an application,¹⁴ may result in the loss of all of these services that are included with the insurance policy coverage. In sum, as one court accurately observed, "automatic forfeiture of [insurance] coverage due to a technical breach in an adhesion policy is inconsistent with any notion of fairness."¹⁵

It is curious, and unfortunate, that insurance should be the one area of law, outside the criminal and quasi-criminal context,¹⁶ in which forfeiture is alive and thriving. It is frequently noted that insurance policies are different from most contracts,¹⁷ primarily because insurance undeniably has an important social significance. Williston observes that an insurance policy differs from ordinary, negotiated contracts by the

increasing tendency of the public to look upon the insurance policy not as a contract but as a special form of chattel. The typical applicant buys "protection" much as he buys groceries. The protection is intangible, to be sure, but he is reassured by the words of the agent and by the fact that agent and company are regulated by the state and licensed to do business there. . . . [I]nsurance must still be considered a contract between insurer and insured, but it is a very special type of contract¹⁸

12. See *Slay Warehousing Co. v. Reliance Ins. Co.*, 471 F.2d 1364, 1367-68 (8th Cir. 1973) (finding that the CGL covers expenses incurred by a policyholder in taking steps, following collapse of warehouse wall, to prevent chemicals stored in policyholder's warehouse from damage due to exposure); *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253, 1280 (Cal. 1990) (holding that costs that are mitigative in character are "damages"); *Metex v. Federal Ins. Co.*, 675 A.2d 220, 228 (N.J. Super. Ct. App. Div. 1996); *Aronson Assocs., Inc. v. Pennsylvania Nat'l Mut. Casualty Ins. Co.*, 14 Pa. D. & C.3d 1, 6 (1977); see also *Leebov v. United States Fidelity & Guar. Co.*, 165 A.2d 82, 84 (Pa. 1960) (holding that coverage included the costs of arresting a landslide where "disastrous consequences might have befallen the adjoining and nearby properties"); Defendants-In-Intervention's Brief in Support of Motion for Summary Judgment or, in the Alternative, Partial Summary Judgment at 12-13, *Federal Ins. Co. v. Emery Mining Corp.*, No. 86C-0696-G (D. Utah Apr. 29, 1988) (on file with the *Fordham Law Review*) (arguing that "most, if not all, jurisdictions strongly favors [sic] a finding of insurance coverage of mitigation expenses incurred to prevent potential or increased property damage").

13. See Eugene R. Anderson et al., *Liability Insurance: A Primer for Corporate Counsel*, 49 Bus. Law. 259, 282 (1993) [hereinafter *Liability Insurance*]; see also Eugene R. Anderson et al., *What Every Corporate Lawyer Should Know About Insurance Coverage*, Corp. Analyst, Feb. 1996, at 2-3.

14. See *infra* part II.D.

15. *Yannitsadis v. Mission Nat'l Ins. Co.*, No. 84-4025, slip. op. at *4 (D.N.J. Feb. 6, 1986).

16. For a discussion of the civil forfeiture debate, see Barbara A. Mack, *Double Jeopardy—Civil Forfeitures and Criminal Punishment: Who Determines What Punishment Fits the Crime*, 19 Seattle U.L. Rev. 217 (1996).

17. See Robert E. Keeton, *Basic Text on Insurance Law* ch. 6 (1971).

18. 7 Williston on Contracts § 900, at 34, 36 (1963) (footnote omitted). Professor (now Judge) Keeton has counseled that "because of the public interests at stake, courts should decline to legitimate the development of labyrinthian policy provisions

Ironically, insurance companies agree. One text used to train insurance company personnel emphasizes:

Notwithstanding the often stated opinion that the insurance contract is a contract affected with a public interest, insurers often view their policies as simple contractual obligations between parties. While an insurance policy does represent a contractual commitment, the attitudes of the general public, the legislatures, and the courts make clear that the insurance agreement is viewed as having broader ramifications than a mere contract. The public has a definite interest in the reliability of the insurance product. Insurance involves an obligation that affects the public interest as well as the policyholder and therefore is necessarily subject to certain restrictions.¹⁹

Insurance companies understand that insurance protects against losses individual policyholders would not be able to withstand otherwise.²⁰

Moreover, beyond the welfare of the individual policyholder, insurance is affected with a public interest.²¹ Insurance protects not only policyholders, but also injured parties, neighbors, the community, creditors, and employees.²² Dean Roscoe Pound wrote:

the reconciliation of which requires inordinately complex analysis and occasions wasteful litigation." Keeton, *supra* note 17, at 172.

Much of the discussion in this article involves contract law principles and remedies only because many commentators and courts view the insurance policy as a contract. Insurance is not a contract but is a product. In fact, the President of the Insurance Services Office ("ISO"), Inc., Fred R. Marcon, referred to ISO's insurance policy forms as products, stating "[o]ne look at ISO's Products Catalog will convince you that we're providing this industry with an ever-widening array of products and services." Fred R. Marcon, President's Remarks at the Twenty-First Annual Meeting of Insurance Services Office 21 (Jan. 14, 1992); see Joanne Wesolowski Wuefing, *Balanced Research Vital to Product Development*, Best's Rev., June 1996, at 78; Joseph H. Golant, *Patenting Coverages*, Best's Rev., Apr. 1993, at 24 ("The insurance and finance industries issue a variety of products, with the possibilities limited only by the imagination.").

In 1981, Carole J. Banfield of ISO stated that "[b]ecause of its unique position in the property/liability insurance industry, ISO is careful to observe the restrictions and limitations that govern its products and services." Carole J. Banfield, *The Role of Insurance Service Associations in the Property/Casualty Business*, Address at Insurance Services Office 1981 Annual Conference, in *The Interpreter*, Dec. 1981, at 31.

For an extensive discussion of insurance industry advertising that refers to insurance as "products," see Tom Baker, *Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages*, 72 Tex. L. Rev. 1395 (1994).

19. James J. Lorimer et al., *The Legal Environment of Insurance* 38 (3d ed. 1987).

20. Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 U. Mich. J.L. Ref. 1, 10-11 (1992).

21. *O'Gorman & Young, Inc. v. Hartford Fire Ins. Co.*, 282 U.S. 251, 257 (1931); *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389, 413 (1914).

22. Charles A. McAlear, *The Emperor's Old Clothes*, Best's Rev., Feb. 1989, at 22-

23. The insurance industry has characterized itself as the "banker of the tort system." Brief of the American Insurance Association, the National Association of Independent Insurers, Farmers Insurance Exchange, Fire Insurance Exchange, the State Farm

[W]e have taken the law of insurance practically out of the category of contract, and we have established that the duties of public service companies are not contractual, as the nineteenth century sought to make them, but are instead relational; they do not flow from agreements which the public servant may make as he chooses, they flow from the calling in which he has engaged and his consequent relation to the public.²³

The "public interest" nature of insurance is confirmed by the myriad of state laws governing insurance. For example, states regulate automobile insurance coverage²⁴ and workers' compensation insurance coverage.²⁵ Moreover, a text that is used to train those preparing to become Certified Property and Casualty Underwriters notes that statutes concerning the conduct of insurance companies "have been enacted by state legislatures in order to control the activities of the insurance companies and their relationships with policyholders."²⁶

The purpose of insurance is to insure.²⁷ When insurance coverage is forfeited, policyholders will not receive the primary benefit that they intended to purchase, peace of mind.²⁸ Despite the widespread con-

Insurance Companies, and Truck Insurance Exchange as Amici Curiae in Support of Appellant at 2-3 n.1, *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813 (1996) (No. 84-1601).

23. Bradford J. Harris, Comment, *Extracontractual Insurance Damages: Pennsylvania Insureds Demand a "Piece of the Rock,"* 85 Dick. L. Rev. 321, 322 (1981) (quoting Roscoe Pound, *The Spirit of the Common Law* 29 (1929)).

24. See, e.g., N.Y. Veh. & Traf. Law §§ 310-321 (McKinney 1995) (setting forth the requirements for auto insurance in New York state).

25. See 3 Arthur Larson, *Workmen's Compensation for Occupational Injuries and Death* § 92.11 (1995).

26. James J. Markham et al., *The Claims Environment* 347 (1993).

27. See *Bollinger v. National Fire Ins. Co.*, 154 P.2d 399, 403 (Cal. 1994); *Queen City Farms, Inc. v. Central Nat'l Ins. Co.*, 827 P.2d 1024, 1033 (Wash. Ct. App. 1992), *aff'd in part, remanded in part*, 882 P.2d 703 (Wash. 1994); 13 John Alan Appleman & Jean Appleman, *Insurance Law & Practice* § 7403 (1976).

Even insurance companies agree. One insurance company lawyer has said "[a]n insurance contract is, of course, meant to 'insure.' This is 'the first and great commandment.'" Alfred E. Reichenberger, *The General Liability Insurance Policies—Analysis of 1973 Revisions, in General Liability Insurance—1973 Revisions* 5, 5-6 (Fred L. Bardenwerter & Donald J. Hirsch eds., Def. Res. Inst. 1974).

28. See *Berg v. First State Ins. Co.*, 915 F.2d 460, 464 (9th Cir. 1990) (stating that an insurance contract's value is the peace of mind it gives the insured); *Armada de la Republica v. Yorkington, L.P.*, C.A. No. 92-0285 (RCL), 1995 U.S. Dist. LEXIS 1317, at *50 (D.D.C. Jan. 27, 1995) ("The peace of mind that comes with the assurance that one's insurance company will assume responsibility for defending lawsuits arising under one's policy can be an integral component of a liability insurance contract."); *Pitcher v. Principal Mut. Life Ins. Co.*, 870 F. Supp. 903, 916 (S.D. Ind. 1994) ("People buy insurance for peace of mind . . ."); *Crisci v. Security Ins. Co.*, 426 P.2d 173, 177-78 (Cal. 1967) (en banc) (holding that insurance company had a duty to consider a settlement offer that was within the range of the policyholder's contract); *McCorkle v. Great Atl. Ins. Co.*, 637 P.2d 583, 588 (Okla. 1981) (finding that the insurance was purchased to protect against accidental loss and mental stress); *Christian v. American Home Assurance Co.*, 577 P.2d 899, 905 (Okla. 1977) (finding that insurance company had duty to act in good faith in handling the policyholder's claim); *D'Ambrosio v. Pennsylvania Nat'l Mut. Casualty Ins. Co.*, 431 A.2d 966, 972 (Pa. 1981) (Larsen, J., dissenting) ("[I]nsurance is purchased to provide *peace of mind*.")

sensus about this fact, forfeiture persists as a remedy for insurance companies against policyholders for minor insurance policy infractions. This Article argues that forfeiture is a needlessly harsh and inequitable remedy for relatively innocuous noncompliance with conditions in insurance contracts. This Article considers the problems that arise from a policyholder's failure to comply fully with the conditions in the policy,²⁹ the assertions by insurance companies in disputes with their reinsurers that forfeiture is an inequitable remedy,³⁰ and the remedies, other than forfeiture, that are available to insurance companies and courts in breach of contract cases.³¹ Part I discusses the typical conditions contained in an insurance policy. Part II considers a variety of judicial decisions where the courts have imposed forfeiture on policyholders for relatively harmless and technical violations of their insurance policies. Part III, drawing upon general principles of contract law and the arguments of insurance companies, argues that forfeiture is an unnecessary and inequitably harsh remedy. Part IV argues that courts, as an alternative remedy to forfeiture, should award an insurance company the actual damages it suffered from the policyholder's breach. This Article concludes that, because insurance companies suffer relatively minor harm from a policyholder's breach of a policy condition, forfeiture is an improper remedy.

I. THE TYPICAL CONDITIONS FOUND IN INSURANCE POLICIES

This part discusses the conditions and requirements that are typically included in insurance policies. Specifically, this part focuses on four issues: (1) the notice of occurrence or claim condition; (2) the proof of loss condition; (3) the examination under oath condition; and (4) misrepresentations in insurance applications.

A. Conditions Generally

An insurance policy may contain conditions.³² The *Restatement (Second) of Contracts* defines a condition as "an event, not certain to

This loss of peace of mind is particularly burdensome when the product purchased was life and health insurance. Long delays in payment of health insurance claims can cause severe hardship for purchasers of health insurance. See Esther B. Fein & Elisabeth Rosenthal, *Delays by H.M.O. Leaving Patients Haunted by Bills*, N.Y. Times, Apr. 1, 1996, at A1.

29. See *infra* part II.

30. See *infra* part III.B.

31. See *infra* part IV.

32. See *infra* part II.B. Insurance policy provisions are regulated by state insurance departments and some are mandated by statute. See, e.g., 12 Appleman & Appleman, *supra* note 27, § 7043 (describing the controlling effect of statutes on particular insurance provisions and requirements). Unfortunately, state insurance departments are no longer consumer protection agencies. See *Riordan v. Nationwide Mut. Fire Ins. Co.*, 977 F.2d 47, 50 (2d Cir. 1992) (observing that the response of the New York Superintendent of Insurance to policyholder's complaint was to advise the policyholder to "retain an attorney and sue."); see also Walter L. Updegrave, *Stacking*

occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due."³³ The *Restatement's* definition describes what is traditionally referred to as a "condition precedent,"³⁴ which is an event that must occur before *performance* is due. There are also "conditions subsequent," by which a duty that has already arisen may be discharged by the occurrence of a specified event.³⁵ A better, and simpler, definition includes both notions: "[A] condition is an act or event, other than a lapse of time, which, unless the condition is excused, must occur before a duty to perform a promise in the agreement arises . . . or which discharges a duty of performance that has already arisen"³⁶

Arguments to defeat insurance coverage based upon the policyholder's noncompliance with policy conditions are as old as insurance.³⁷ These arguments are typified by the following statement in 1894 by the United States Supreme Court:

Contracts of insurance are contracts of indemnity upon the terms and conditions specified in the policy or policies, embodying the agreement of the parties. For a comparatively small consideration the insurer undertakes to guarantee the insured against loss or damage, upon the terms and conditions agreed upon, and upon no other, and when called upon to pay, in case of loss, the insurer, therefore, may justly insist upon the fulfillment of these terms. . . . The compliance of the assured with the terms of the contract is a condition precedent to the right of recovery. . . . It is immaterial to consider the reasons for the conditions or provisions on which the

the Deck, Money, Aug. 1996, at 50 (finding that the insurance industry writes its own laws because insurance regulators are closely tied to the industry). State insurance departments are almost exclusively concerned with insurance company solvency. See *In re Plan of Restructuring of INA Financial Corp.*, No. MS95-10-056 (Pa. Ins. Comm. Feb. 7, 1996), reprinted in 10 Mealey's Litigation Reports: Insurance, at A-1 (Feb. 14, 1996).

33. Restatement (Second) of Contracts § 224 (1981); see 3A Corbin on Contracts § 627 (West 1960); Farnsworth, *supra* note 4, § 8.2 (1982).

34. John D. Calamari & Joseph M. Perillo, *The Law of Contracts* § 11-2 (3d ed. 1987); Farnsworth, *supra* note 4, § 8.2 (1982).

35. Calamari & Perillo, *supra* note 34, § 11-7.

36. *Id.* § 11-2.

37. At early common law, policies of insurance and regular contracts were treated similarly by the courts. Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 U. Mich. J.L. Ref. 1, 5 (1992). In fact, before 1786, warranties in insurance policies were treated the same as warranties in general. *Id.* at 5 n.19. A warranty in an insurance policy was a policyholder's statement promising "the existence of certain facts, . . . the literal truth of which is essential to the validity of the contract." 7 George J. Couch, *Cyclopedia of Insurance Law* § 35.2 (Ronald A. Anderson ed., 2d ed. 1985). Warranties were required to be accurate, but an immaterial breach, which was not connected to the loss, would not work a forfeiture. Henderson, *supra*, at 5 n.19. Lord Mansfield, Chief Justice of the Court of Kings' Bench, changed this rule. In *De Hahn v. Hartley*, 99 Eng. Rep. 1130 (K.B. 1786), the court held that even an immaterial breach of warranty would permit an insurance company to avoid the insurance policy. See Robert E. Keeton, *Basic Text on Insurance Law* § 5.6 (1971).

contract is made to terminate, or any other provision of the policy which has been accepted and agreed upon. It is enough that the parties have made certain terms, conditions on which their contract shall continue or terminate. The courts may not make a contract for the parties.³⁸

Although strict forfeiture rules in insurance cases have been mitigated occasionally since 1894,³⁹ they have not been eliminated.

B. Common Insurance Policy Conditions

Most liability and property insurance policies contain a section titled "Conditions."⁴⁰ A number of the provisions in the "Conditions" section impose duties upon the policyholder that arise in the event of a loss. Three of these post-loss conditions are: (1) notice conditions requiring the policyholder to give notice "as soon as practicable" of an occurrence or a claim or suit;⁴¹ (2) conditions requiring policyholders

38. *Imperial Fire Ins. Co. v. Coos County*, 151 U.S. 452, 462 (1894). The Court's emphasis on the "comparatively small consideration" paid by the policyholder is telling. The discussion antedates wide acceptance of insurance as an important component of the tort recovery system and therefore gives little recognition to the fact that premiums, in gross, normally exceed claims paid. Moreover, most modern large companies incur enormous costs for insurance premiums, exceeding over time their aggregate recovery upon claims.

39. Within seven years of its decision in *Coos County*, the Supreme Court, like many other courts, began to soften its view about policy "conditions," recognizing that the policyholder needed some protection from the insurance company's skills at drafting policy language:

A literal interpretation of the contracts of insurance might sustain a contrary view, but the law does not require such an interpretation. In so holding the court does not make for the parties a contract which they did not make for themselves. It only interprets the contract so as to do no violence to the words used and yet to meet the ends of justice.

Liverpool London & Globe Ins. Co. v. Kearney, 180 U.S. 132, 138 (1901) (holding that a requirement that documents be stored in a "fireproof safe" was not violated by policyholder's decision to remove documents from the safe during a fire and apparently misplacing an inventory in the process).

40. See *Liability Insurance*, *supra* note 13, at 280.

41. For example, the standard commercial general liability ("CGL") form promulgated by the Insurance Services Office, Inc., provides:

2. Duties in the Event of Occurrence, Offense, Claim or Suit.
 - a. You must see to it that we are notified as soon as practicable of an "occurrence" or offense which may result in a claim. . . .
 - b. If a claim is made or "suit" is brought against any insured, you must:
 - (1) Immediately record the specifics of the claim or "suit" and the date received; and
 - (2) Notify us as soon as practicable. You must see to it that we receive written notice of the claim or "suit" as soon as practicable.
 - c. You and any other involved insured must:
 - (1) Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the claim or "suit."

Susan J. Miller & Philip Lefebvre, *Miller's Standard Insurance Policies Annotated* 415-16 (4th ed. 1995). The standard homeowners' form provides that in case of a loss to covered property the policyholder must:

- a. Give prompt notice to us or our agent;

with property insurance coverage to send to the insurance company, within sixty days after the insurance company's request, a signed, sworn, proof of loss;⁴² and (3) conditions that a property insurance policyholder submit to an examination under oath.⁴³

1. Notice of Claim

Notice of occurrence or claim clauses are intended to enable insurance companies to investigate occurrences,⁴⁴ claims, and suits while the facts of a claim are still readily available, and enable the insurance company to make an informed decision as to whether or not insurance coverage exists.⁴⁵ In addition, prompt notice, it has been contended, "allow[s] the insurance company to make an investigation of the accident in order to prepare a defense, . . . to afford the insurance com-

b. Notify the police in case of loss by theft;

. . .

d. Protect the property from further damage . . . ;

e. Prepare an inventory of damaged personal property showing the quantity, description, actual cash value and amount of loss.

Id. at 210.

42. *Id.* at 456 (describing homeowners' insurance and standard commercial all-risk property insurance).

A "proof of loss" includes a formal statement of the claim and other information. A document or form may be furnished to the policyholder for this purpose, but, normally, the proof may be made in any manner as long as it contains adequate information. 2 Stephen A. Cozen, *Insuring Real Property* § 21.02, at 21-5 (1996).

43. 1 Miller & Lefebvre, *supra* note 41, at 210, 456.1 (describing homeowners' insurance and standard commercial all-risk property insurance).

Some insurance policies contain conditions which explicitly state that failure to comply with the condition will cause the policy to be void. For example, one Hartford Accident & Indemnity Company policy provided:

Concealment, Fraud

This entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein or in the case of any fraud or false swearing by the insured relating thereto.

Brief in Opposition to Plaintiff's Motion for Partial Summary Judgment and in Support of Defendant's Cross-Motion for Summary Judgment at 50, *Biddle Sawyer Corp. v. Fireman's Fund Ins. Co.*, No. MON-L-5219-91 (N.J. Super. Ct. Nov. 15, 1995) (on file with the *Fordham Law Review*) (arguing that because policyholder did not comply with the condition, coverage for policyholder's claim was precluded).

44. See Arthur Paul Berg, "Occurrence": *An Elusive Description*, in "Occurrence" and Other Coverage Issues 2 (Donald J. Hirsch & Eva M. Soeka eds., Def. Res. Inst. 1982).

45. See *United States Fidelity & Guar. Co. v. Maren Eng'g Corp.*, 403 N.E.2d 508, 511 (Ill. App. Ct. 1980); 8 Appleman & Appleman, *supra* note 27, § 4731 (stating that the purpose of the provision requiring prompt notice is to give the insurance company an opportunity to make a timely and adequate investigation).

pany the opportunity to control the litigation,"⁴⁶ and to determine whether or not the claim is fraudulent.⁴⁷

2. Proof of Loss

In addition to requiring the policyholder to send notice of a claim to the insurance company, property insurance policies also require the policyholder to submit a sworn proof of loss as specified in the insurance policy or at the insurance company's request.⁴⁸ The proof of loss is normally a single-page form on which the policyholder makes the request for payment and states the amount sought with a sworn, notarized signature at the bottom.⁴⁹ Insurance companies require a proof of loss to enable them to determine if the claim comes within the terms of the policy, to make an investigation, and to prevent fraud.⁵⁰

3. Examination Under Oath

Property insurance policies also contain a provision that requires a policyholder to submit to an examination under oath.⁵¹ This examination enables the insurance company to gather all available knowledge and information relating to the loss and to evaluate its rights and obligations to protect itself against false claims.⁵² Insurance companies contend that the policyholder's noncompliance with this provision deprives the insurance company of a valuable right for which it contracted.⁵³

46. *Sears, Roebuck & Co. v. Hartford Accident & Indem. Co.*, 313 P.2d 347, 352 (Wash. 1957); *see Ostrager & Newman, supra* note 10, § 4.02[a], at 91-92.

47. *Duggan v. Travelers Indem. Co.*, 383 F.2d 871, 873-74 (1st Cir. 1967); *Young v. Travelers Ins. Co.*, 119 F.2d 877, 880 (5th Cir. 1941); *General Fin. Co. v. Pennsylvania Threshermen & Farmers' Mut. Casualty Ins. Co.*, 35 A.2d 409, 410 (Pa. 1944).

48. *See supra* note 42.

49. 1 *Miller & Lefebvre, supra* note 41, at 456.1. In practice, the policyholder requests payment from the insurance company, the agent, the broker, or the insurance adjuster before the proof of loss is submitted. The form is merely a sworn version of the request. If insurance is denied and the policyholder sues, the policyholder must make a sworn statement or give sworn testimony before the court that the claim is legitimate and insurance proceeds are due. Thus, the proof of loss serves little purpose except as a "hoop" through which the policyholder must jump (or stumble over) to obtain the insurance benefits for which premiums have already been paid and accepted. A misstatement in the sworn proof of loss may subject the policyholder to forfeitures for false swearing and criminal prosecution for perjury.

50. *Hawkeye Sec. Ins. Co. v. Apodaca*, 524 P.2d 874, 877 (Wyo. 1974); *see Allan D. Windt, Insurance Claims and Disputes* § 3.03 (2d ed. 1988).

51. *See supra* note 43.

52. *See Claffin v. Commonwealth Ins. Co.*, 110 U.S. 81, 97 (1884).

53. *5A Appleman & Appleman, supra* note 27, § 3549, at 549-50; *see American Reliance Ins. Co. v. Riggins*, 604 So. 2d 535, 535-36 (Fla. Dist. Ct. App. 1992).

4. Representations in Applications

A policyholder may lose insurance coverage when a material misstatement appears in the application.⁵⁴ The general rules are clear and widely accepted:

If a material misrepresentation is made concerning the matter at risk, it may constitute such a breach as will relieve the insurer of liability A misrepresentation may invalidate the policy regardless of whether the concealment was intentional or unintentional Under the common law, an insurer has no duty to investigate and confirm material representations. The insurer can therefore cancel the policy after a claim has been made.⁵⁵

Forfeiture may be imposed even though the misstatement was made innocently.⁵⁶

II. FAILURE TO COMPLY WITH INSURANCE CONDITIONS MAY RESULT IN FORFEITURE OF COVERAGE

This part discusses a variety of decisions in which courts have imposed forfeiture of coverage on policyholders who have not complied with policy conditions. This part focuses on court decisions where courts have imposed forfeiture of coverage because the policyholder: (1) failed to notify the insurance company of its claim; (2) failed to file a proof of loss; (3) failed to submit to an examination under oath; or (4) made misrepresentations in an insurance application.

A. Notice of Claim

Policyholders and insurance brokers often wait until the extent of a loss or liability is clearer before they notify their insurance companies. Any delay, however, is unwise. In many states, a delay in giving notice will result in automatic forfeiture of insurance coverage.⁵⁷ One court described the rationale and operation of the rule requiring forfeiture for late notice as follows:

The purpose of a notice requirement . . . is to enable the insurer to make a timely and thorough investigation of the injury claim Such provisions are not considered technical requirements, but rather are valid prerequisites to coverage Therefore, when the insured fails to comply with a prompt notice requirement, the in-

54. See *infra* part II.D.

55. 6B Appleman & Appleman, *supra* note 27, § 4252, at 9-15 (footnotes omitted).

56. A common statement is that "[i]nnocent material misrepresentations will have the same affect [sic] as fraud in rendering the policy voidable." *Fireman's Fund Ins. Co. v. Knutsen*, 324 A.2d 223, 230 (Vt. 1974).

57. See *infra* Appendix (noting that Alabama, Colorado, the District of Columbia, Illinois, Louisiana, New York, South Dakota, Tennessee, and Virginia require automatic forfeiture for noncompliance with notice conditions). Other states, such as Arkansas, Idaho, and Mississippi impose forfeiture if the condition is found to be a "condition precedent." *Id.*

surer may deny liability, regardless of whether it has been prejudiced by the delay.⁵⁸

Delays of as little as ten days,⁵⁹ thirteen days,⁶⁰ twenty-two days,⁶¹ forty days,⁶² forty-six days,⁶³ and fifty-three days⁶⁴ have resulted in forfeiture of insurance coverage.

For example, under New York law, compliance with the notice provisions in an insurance policy is a condition precedent to all of the insurance company's duties under the policy, including the duty to defend.⁶⁵ If the policyholder fails to give adequate, timely notice, the insurance company need not show prejudice; there is simply no insurance coverage.⁶⁶ Courts have found that relatively short, unexcused periods of delay in giving notice were "unreasonable as a matter of law."⁶⁷

An examination of the fact patterns of these cases reveals the enormous inequity of these holdings. For example, in *Deso v. London & Lancashire Indemnity Co. of America*,⁶⁸ the court held that written notice to the insurance company five months after an accident resulted in forfeiture of insurance coverage.⁶⁹ In that case, the policyholder was a landlord whose tenant fell on the landlord's steps. At

58. *INA Ins. Co. v. City of Chicago*, 379 N.E.2d 34, 36-37 (Ill. App. Ct. 1978) (citations omitted).

59. *Haas Tobacco Co. v. American Fidelity Co.*, 123 N.E. 755, 755 (N.Y. 1919).

60. *Gullo v. Commercial Casualty Ins. Co.*, 235 N.Y.S. 584, 588 (App. Div. 1929).

61. *Rooney v. Maryland Casualty Co.*, 67 N.E. 882, 883 (Mass. 1903); *Rushing v. Commercial Casualty Ins. Co.*, 167 N.E. 450, 451 (N.Y. 1929).

62. *Brackman v. American Employers' Ins. Co.*, 208 N.E.2d 225, 225 (Mass. 1965).

63. *Edwards v. Ranger Ins. Co.*, 456 S.W.2d 419, 421 (Tex. Ct. App. 1970).

64. *Power Auth. v. Westinghouse Elec. Corp.*, 502 N.Y.S.2d 420, 423 (App. Div. 1986).

65. *Security Mut. Ins. Co. v. Acker-Fitzsimons Corp.*, 293 N.E.2d 76, 78 (N.Y. 1972) (holding that absent a valid excuse, failure to satisfy the notice requirement of the policy vitiates insurance coverage); *Town of Smithtown v. National Union Fire Ins. Co.*, 594 N.Y.S.2d 318, 319 (App. Div. 1993); see *White v. City of New York*, 598 N.Y.S.2d 759, 760 (N.Y. 1993). The hardships created by the failure of an insurance company to defend its policyholder because of allegedly late notice are detailed in Rhonda D. Orin, *The Wrong War, the Wrong Time, the Wrong Enemy: Insurers' Allegations of Late Notice Are Untimely when Underlying Actions Are Pending*, 31 *Tort & Ins. L.J.* 711 (1996).

66. *Security Mut. Ins. Co.*, 293 N.E.2d at 78.

67. *Deso v. London & Lancashire Indem. Co. of Am.*, 143 N.E.2d 889, 891 (N.Y. 1957); *Winstead v. Uniondale Union Free Sch. Dist.*, 608 N.Y.S.2d 487, 489 (App. Div. 1994); *Pandora Indus., Inc. v. St. Paul Surplus Lines Ins. Co.*, 590 N.Y.S.2d 471, 471 (App. Div. 1992); *Schiebel v. Nationwide Mut. Ins. Co.*, 560 N.Y.S.2d 801, 801 (App. Div. 1990); *Republic N.Y. Corp. v. American Home Assurance Co.*, 509 N.Y.S.2d 339, 339-40 (App. Div. 1986); *Power Auth.*, 502 N.Y.S.2d at 423; *Gold Fields Am. Corp. v. Aetna Casualty & Sur. Co.*, No. 19879/89, slip op. at 44 (N.Y. Sup. Ct. Mar. 28, 1996); see *American Home Assurance Co. v. Republic Ins. Co.* 984 F.2d 76, 78-79 (2d Cir.), cert. denied, 508 U.S. 973 (1993) (applying New York law); *American Motorists Ins. Co. v. General Host Corp.*, 919 F. Supp. 1506, 1511 (D. Kan. 1996) (applying New York law).

68. 143 N.E.2d 889 (N.Y. 1957).

69. *Id.* at 891.

the time of the accident, the tenant told the policyholder, "It's all right."⁷⁰ Three and one-half months after the fall, the tenant's doctor told him that his sore back was the result of the fall, and the tenant reported the diagnosis to the policyholder.⁷¹ The policyholder, who was not fluent in English and who was unfamiliar with insurance, testified that he sent the policy to the insurance company within a month and a half of learning about the connection between the accident and the injury.⁷² Five months and one week after the accident, and less than two months after the policyholder learned of the facts, the policyholder notified the insurance company of the accident on a form supplied by the insurance company. The insurance company investigated the premises, interviewed the policyholder, took photographs, and obtained a physical examination of the injured tenant. After the physical examination, the insurance company disclaimed insurance coverage based on the failure to comply strictly with the notice provision. The New York Court of Appeals ruled that the written notice, given five months after the accident and two months after the policyholder acquired knowledge, was untimely as a matter of law, and that the policyholder had forfeited his insurance.⁷³

More recently, in *Steelcase, Inc. v. American Motorists Insurance Co.*,⁷⁴ a policyholder waited two years before notifying the insurance company about a spill of hazardous material.⁷⁵ The policyholder waited⁷⁶ because it believed the cleanup expenses would be minimal.⁷⁷ When the problem grew, the policyholder and the broker gave no-

70. *Id.* at 890.

71. *See id.*

72. *Id.* at 892 (Desmond, J., dissenting).

73. *Id.* at 891. New York's common law is more favorable to insurance companies than to policyholders. James A. McGuire & Kristin Dodge McMahon, *Issues for Excess Insurer Counsel in Bad Faith and Excess Liability Cases*, 62 Def. Couns. J. 337, 338-39 (1995); James A. McGuire & Kristin Dodge McMahon, *Bad Faith, Excess Liability and Extracontractual Damages: Counsel for the Excess Carrier Looks at the Issues*, 72 U. Det. Mercy L. Rev. 49, 52 (1994). New York law is the law of choice for insurance companies as evidenced by offshore insurance policies that regularly contain a New York choice of law provision. Eugene R. Anderson & Paul Liben, *The Perfect Insurance or the Perfect Crime*, Metropolitan Corp. Couns., Jan. 1995, at 51.

Curiously, New York law is more policyholder friendly when the policyholder is an insurance company. In the reinsurance context, the New York Court of Appeals requires the reinsurer who disclaims coverage for an insurance company to prove prejudice. *Uniguard Sec. Ins. Co. v. North River Ins. Co.*, 594 N.E.2d 571, 575 (N.Y. 1992). In a recent decision, a New York court ruled that an excess insurance company, like a reinsurance company, must plead and show prejudice from the late notice. *American Home Assurance Co. v. International Ins. Co.*, 641 N.Y.S.2d 241, 242 (App. Div. 1996).

74. No. G87-553 CA1, 1989 WL 253892 (W.D. Mich. Feb. 24, 1989), *aff'd*, 907 F.2d 151 (6th Cir. 1990).

75. *See id.* at *1-2.

76. The policyholder advised its broker of the loss, but not the insurance company directly.

77. 1989 WL 253892, at *1.

tice.⁷⁸ The insurance company denied coverage based solely upon late notice.⁷⁹ The policyholder sued the insurance company and lost. The court held that insurance coverage was forfeited by reason of late notice.⁸⁰ The policyholder's uninsured loss totaled almost \$1 million.⁸¹

Insurance companies frequently contend that forfeiture is necessary to permit insurance companies to establish adequate reserves to cover potential liability and to calculate future premiums.⁸² In effect they argue that "the actuaries made us do it."⁸³ The insurance company in *Jones v. Bituminous Casualty Corp.*⁸⁴ argued that the policyholder's failure to provide the insurance company with notice of an occurrence for six and one-half months required forfeiture of coverage, and that prejudice from the delay need not be proved.⁸⁵ As support for its arguments, the insurance company referred to its calculations of premiums. It maintained that strict compliance by the policyholder with notice clauses was essential for the insurance company to price its insurance according to the risk.⁸⁶ The Supreme Court of Kentucky disagreed:

The insurance carrier has argued that [notice] clauses are essential from an actuarial standpoint in order to price the insurance according to the risk. Whereas this argument is valid with reference to imposing on the insurer risks which are unreasonable and unforeseeable, such is *not* the case with *this* clause in *this* policy. Where there has been no prejudice to the insurer from the delay in notice, there has been no increase in the risk. On the contrary, in the absence of prejudice a strict forfeiture clause simply provides the insurance company with a windfall.⁸⁷

The court realized that when strict application of a notice condition in the absence of prejudice results in forfeiture, the insurance company receives a windfall.⁸⁸ Although this windfall might be returned to

78. *Id.* at *2.

79. *See id.* at *2-3.

80. *Id.* at *12.

81. *Id.* at *2.

82. Ostrager & Newman, *supra* note 10, § 4.02[a].

83. Although insurance companies contend that forfeiture is necessary because they find it difficult to forecast future liability, insurance companies know that courts are concerned with the inadequacy of information in insurance policies. As one commentator has stated:

That [the inequality of information] being understood, the terms of mass-marketed insurance are prepared with sensitivity to what has been called the "juridical risk." To that extent the insurance industry itself discounts the value of the stock of underwriting information that is available to it: the claims-adjustment function overrides that of risk-classification.

W.F. Young, *Is Insurance a Niche Business? Reflections on Information as an Insurance Product*, 1 Conn. Ins. L.J. 1, 15 (1995) (footnote omitted).

84. 821 S.W.2d 798 (Ky. 1991).

85. *See id.* at 800.

86. *See id.* at 802.

87. *Id.*

88. *See id.* at 802-03.

other policyholders in the form of lower rates, as insurance companies will argue, it need not be. If the insurance company is having a difficult year, non-payment of a \$5 million claim to a policyholder might mean the difference between a profit or loss for the year. The premiums of other policyholders may not be lowered at all.

The majority of jurisdictions now require that the insurance company show that it has been prejudiced by late notice.⁸⁹ A careful opinion from the Tenth Circuit summarized the various views regarding forfeiture and late notice:

Our research indicates that there are three different approaches to this question which is concerned with the degree of prejudice which results from the failure of the insured to notify the insurer of an accident. The oldest of these viewpoints takes the position that prejudice to the insurer is not an important element; that it is immaterial. In jurisdictions which hold to this view, the failure to give timely notice results in violation of a valid covenant of the policy which in turn results in loss of coverage.

A second view is that an unreasonably late notice raises a presumption of prejudice to the insurer. The presence of the presumption places the burden of showing lack of prejudice on the insured party.

A third view of late notice is that no presumption of prejudice results. It is up to the insurer to demonstrate substantial prejudice growing out of the late notice before it is relieved of liability under the policy.⁹⁰

Other states permit the policyholder to prove the lack of prejudice to the insurance company.⁹¹

89. See *infra* Appendix (noting that Alaska, Arizona, California, Delaware, Hawaii, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, New Jersey, New Mexico, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, Washington, and West Virginia require the insurance company to prove prejudice); Ostrager & Newman, *supra* note 10, § 4.02[b][5].

90. *Jennings v. Horace Mann Mut. Ins. Co.*, 549 F.2d 1364, 1367-68 (10th Cir. 1977) (citations omitted).

91. See *infra* Appendix (noting that Connecticut and Florida follow this approach); *Niesz v. Albright*, 217 So. 2d 606, 608 (Fla. Dist. Ct. App. 1969); *Fireman's Fund Ins. Co. v. ACC Chem. Co.*, 538 N.W.2d 259, 265 (Iowa 1995); *Henschel v. Hawkeye-Sec. Ins. Co.*, 178 N.W.2d 409, 419-20 (Iowa 1970).

Other courts have disagreed with this result. As the Supreme Court of Kentucky in *Jones v. Bituminous Casualty Corp.* observed:

There are two reasons for imposing the burden on the insurance carrier to prove prejudice, rather than imposing on the claimant the burden to prove no prejudice resulted. The first is the obvious one: it is virtually impossible to prove a negative, so it would be difficult if not impossible for the claimant to prove the insurance carrier suffered no prejudice. Secondly, the insurance carrier is in a far superior position to be knowledgeable about the facts which establish whether prejudice exists.

821 S.W.2d at 803.

Courts that require the insurance company to show prejudice to avoid insurance coverage have explained their holdings in terms of public policy. As the New Jersey Supreme Court noted in its decision adopting a prejudice approach:

The insurance contract not being a truly consensual arrangement and being available only on a take-it-or-leave-it basis and the subject being in essence a matter of forfeiture, we think it appropriate to hold that [insurance coverage is not forfeited] unless there are both a breach of the notice provision and a likelihood of appreciable prejudice. The burden of persuasion is the carrier's.⁹²

Similarly, in *New England Reinsurance Corp. v. National Union Fire Insurance Co.*, the United States Court of Appeals for the Ninth Circuit held:

The underlying public policy requiring a showing of insurer prejudice to avoid coverage liability does not change depending on whether an unambiguous notice provision is described as a condition precedent to liability or a coverage covenant For an insurer to circumvent California's public policy underlying the notice prejudice rule by the simple expedient of categorizing the notice clause as a coverage requirement would be a triumph of form over substance.⁹³

The court concluded that forfeiture was an inequitable solution.⁹⁴

There has also been opposition to forfeitures among state legislatures, and even among some insurance companies. Some state legislatures have followed the lead of the courts and have enacted statutes that limit forfeitures.⁹⁵ In Maryland, insurance coverage cannot be forfeited because of late notice unless the insurance company proves "actual prejudice."⁹⁶

At least one insurance company has also recognized the unfairness of forfeiture. The Aetna Technical Claim Manual affords its low-level claims handlers great discretion in waiving alleged late notice, advising that "[i]f there is six months to a year delay, use your discretion relative to acceptance if there is no prejudice."⁹⁷ Relying on insur-

92. *Cooper v. Government Employees Ins. Co.*, 237 A.2d 870, 874 (N.J. 1968) (footnote omitted); see also *Peskin v. Liberty Mut. Ins. Co.*, 530 A.2d 822, 823 (N.J. Super. Ct. App. Div. 1987) (holding that an eleven-year delay in providing notice of an occurrence did not constitute prejudice to the insurance company as a matter of law).

93. No. 86-6432, slip op. at 6 (9th Cir. July 21, 1987) (footnote omitted), *vacated pursuant to stipulation between parties*, 829 F.2d 840 (9th Cir. 1987).

94. *Id.* at 3.

95. See, e.g., Md. Ann. Code art. 48A, § 482 (1994) (limiting forfeiture to circumstances when the insurance company can establish non-cooperation by a preponderance of the evidence); Mass. Ann. Laws ch. 175, § 112 (Law. Co-op. 1987) (regulating the liability of the insurance company under a motor vehicle liability policy).

96. Md. Ann. Code art. 48A, § 482 (1994); see *Harleysville Ins. Co. v. Rosenbaum*, 351 A.2d 197, 202-03 (Md. Ct. Spec. App. 1976).

97. Aetna Technical Claim Manual B-5-1 (Oct. 1977).

ance companies to "do the right thing," however, puts the policyholder at the mercy of a rule of men and not a rule of law.

In sum, placing the burden on the insurance company to prove prejudice is obviously more favorable to the policyholder than requiring the policyholder to prove an absence of prejudice.⁹⁸ Furthermore, both of these rules are preferable to an automatic imposition of forfeiture.⁹⁹ The differences, however, are still merely ones of degree. Forfeiture remains a possibility under any of the three approaches. Once prejudice to the insurance company has been established, either by way of the insurance company's proof, or the policyholder's failure of proof, insurance benefits are denied entirely, even when the prejudice suffered by the insurance company is minimal in relation to the harm that forfeiture will inflict upon the policyholder. In other words, the principal unfairness inherent in a prejudice analysis is that it continues to permit forfeitures that are disproportionately harsh in comparison to the damage suffered by the insurance company from the policyholder's noncompliance. The prejudice approach is like a slide rule in a world filled with pocket calculators. The results of the analysis are approximated, and include an unnecessary level of error, at least when compared with the results achievable through use of an available, more accurate, and efficient tool.¹⁰⁰

B. *Proof of Loss*

The notion that insurance companies need special assistance with respect to claims investigation is specious. Insurance companies tout their special expertise in claims handling and loss investigation. Nearly every insurance company has a special unit to ferret out false claims and the insurance industry has a plethora of industry-wide organizations to combat insurance fraud.¹⁰¹

98. See *supra* note 89 and accompanying text.

99. See *supra* note 57 and accompanying text.

100. The measuring tool that the authors propose is the ordinary measure of recoupment or damages used in breach of contract cases. See *infra* part IV.

101. The insurance industry is well aware of the "problem" of fraud and takes steps to educate itself and its counsel about the issue. See Defense Research Institute, Insurance Fraud and Suspicious Claims Seminar (No. 9519) (Oct. 1995). At that two-day seminar, over 15 attorneys who represent insurance companies discussed topics such as "Fraud Indicators—What to Look For—Red Flags."

Many groups and special units have been charged with the task of fighting insurance fraud. For example, a coalition of insurance companies, government agencies, and consumer groups was formed in 1993 to advocate federal and state anti-fraud legislation and regulation. Paul Dykewicz, *New Coalition Urges Rules to Combat Insurance Fraud*, J. Com., June 4, 1993, at 8A. And, in 1992, the National Insurance Crime Bureau was formed to fight workers' compensation fraud. George Griffith, *NICB Working with Insurers to Fight WC Fraud*, Nat'l Underwriter, Apr. 19, 1993, at 12. In fact, insurance companies have even turned to private investigators to ferret-out fraud. One owner of a chain of detective agencies in Lexington, Kentucky reported that "[o]ur biggest percentage of business is workers compensation and insur-

Nonetheless, failure to submit a timely and proper proof of loss may result in forfeiture of insurance coverage. In *Scott v. Exchange Mutual Insurance Co.*,¹⁰² an illiterate policyholder promptly provided her insurance company with notice of fire damage to personal property, and the insurance company's adjuster visited the fire scene within four days of the fire. An attorney representing the policyholder lost the proof of loss form and requested another.¹⁰³ The policyholder changed her attorney thereafter, and the proof of loss form was not submitted until 180 days after the fire.¹⁰⁴ The court held that the policyholder's insurance for personal property loss was entirely forfeited because the proof of loss form was not submitted within sixty days as required by the terms of the policy.¹⁰⁵

Similarly, in *Whitehead v. Lumbermens Mutual Casualty Co.*,¹⁰⁶ the policyholder, a store owner, sent notice of a burglary to his insurance company the day after the burglary.¹⁰⁷ The notice included a detailed schedule of merchandise stolen, prepared by the policyholder's accountant, with a listed value of \$19,180.30.¹⁰⁸ The policyholder did not file a sworn proof of loss form within the sixty days required by the policy or at any time before suit was filed.¹⁰⁹ The policyholder did, however, permit the insurance company to review his books, and he submitted a sworn affidavit about the facts of the case to the court. The court granted summary judgment in favor of the insurance company because the policyholder failed to submit a sworn proof of loss.¹¹⁰ The court's decision was rendered less than eight months after the burglary. Thus, even though the policyholder was prepared to submit to a sworn examination in court about very recent events, and had provided an inventory and access to his records, the court ordered his insurance forfeited for failure to submit the precise piece of paper described in the policy within the prescribed period of time.¹¹¹

In *Aryeh v. Westchester Fire Insurance Co.*,¹¹² the policyholder submitted an unsworn statement of her loss, but failed to submit a sworn proof of loss within sixty days of the insurance company's request, as

ance fraud." Philip Campbell, *Insurance Companies Turn to Detectives for Answers*, J. Com., May 4, 1994, at 11A.

102. No. 86-45-II, 1986 WL 6276 (Tenn. Ct. App. June 4, 1986).

103. *Id.* at *2.

104. *Id.*

105. *Id.* at *10.

106. 543 F. Supp. 967 (N.D. Ga. 1982), *aff'd*, 703 F.2d 580 (11th Cir. 1983).

107. *Id.* at 968.

108. *Id.*

109. *Id.* at 970.

110. *Id.* at 970-71.

111. After the expiration of the 60-day period, the insurance company first suggested to the policyholder that he submit a proof-of-loss form. *Id.* at 970. The court noted that "[f]or reasons that are not apparent from the record, [the policyholder] chose not to do so." *Id.*

112. 525 N.Y.S.2d 628, 629 (App. Div. 1988).

required by the policy. As a result, the court found that there was no insurance coverage for a burglary loss.¹¹³

As with the notice requirement, however, some states will not automatically impose forfeiture for failure to submit a proper proof of loss.¹¹⁴ In those states, coverage will be lost only if the insurance company can prove that it was prejudiced by the policyholder's failure to submit a timely proof of loss.¹¹⁵

C. Examination Under Oath

Noncompliance with a condition requiring examination under oath can also result in forfeiture. In a recent case, *Goldman v. State Farm Fire General Insurance Co.*,¹¹⁶ a court determined that the failure to submit to an examination under oath was a willful and material breach of the insurance policy which precluded recovery.¹¹⁷ The court characterized the condition requiring examination under oath as a condition precedent,¹¹⁸ and held that there was no requirement that the insurance company show prejudice.¹¹⁹ The court imposed forfeiture despite the fact that an examination under oath, in the form of a deposition, was available to an insurance company during coverage litigation. Forfeiture was nevertheless imposed when the policyholder had refused to submit to the examination under oath before litigation.

In addition to the failure to submit to an examination under oath, the failure to answer specific questions and to turn over financial and other documents requested by the insurance company has also resulted in loss of insurance coverage. In *Powell v. United States Fidelity & Guaranty Co.*,¹²⁰ the United States Court of Appeals for the Fourth

113. *Id.*

114. *See, e.g.*, N.C. Gen. Stat. § 58-44-50 (1994) (allowing the jury to decide the question of forfeiture under some circumstances); Wis. Stat. Ann. § 631.81 (West 1995) (allowing a policyholder to file a claim within one year after the time required by the policy).

115. N.C. Gen. Stat. § 58-44-50 (1994) (requiring the insurance company to show prejudice); Wis. Stat. Ann. § 631.81 (West 1995) (same).

116. 660 So. 2d 300 (Fla. Dist. Ct. App. 1995).

117. *Id.* at 303 (citing *Southern Home Ins. Co. v. Putnal*, 49 So. 922, 932 (Fla. 1909); *Stringer v. Fireman's Fund Ins. Co.*, 622 So. 2d 145 (Fla. Dist. Ct. App. 1993); *see also Pervis v. State Farm Fire & Casualty Co.*, 901 F.2d 944 (11th Cir.) (holding that the Fifth Amendment privilege does not excuse the policyholder from submitting to a sworn examination before filing an action to recover insurance policy proceeds), *cert. denied*, 498 U.S. 899 (1990); *Watson v. National Sur. Corp.*, 468 N.W.2d 448, 451 (Iowa 1991) (holding that submission to an examination under oath was a condition precedent to recovery under the insurance policy); *Fineberg v. State Farm Fire & Casualty Co.*, 438 S.E.2d 754, 755 (N.C. Ct. App.) (declining to create a good cause exception to the requirement that the policyholder submit to an examination under oath).

118. *Goldman*, 660 So. 2d at 303.

119. *Id.* at 303-04 (citing *Bolivar County Bd. of Supervisors v. Forum Ins. Co.*, 779 F.2d 1081 (5th Cir. 1986) and *DeFerrari v. Government Employees Ins. Co.*, 613 So. 2d 101, 103 (Fla. Dist. Ct. App. 1993).

120. 88 F.3d 271 (4th Cir. 1996).

Circuit held that a homeowners' insurance company was not obligated to pay the fire loss claim of its policyholders when the policyholders refused to answer some questions and refused to turn over certain financial records in connection with an examination under oath. The policyholders had argued that the examination-under-oath clause was limited in scope, but the court, after examining the law in other jurisdictions,¹²¹ disagreed and held that the examination-under-oath clause was broad enough to cover financial information, including tax returns and income-source information.

D. Misrepresentations in Applications

The gulf between the dramatic harm suffered by the policyholder from forfeiture and the harm to the insurance company from the policyholder's noncompliance is perhaps widest in cases when misrepresentation in connection with the purchase of insurance is asserted as a defense to payment. Although states generally require that life and disability insurance policies contain incontestability clauses,¹²² most other policyholders cannot rely on such clauses.

Incontestability clauses have long been recognized as a means to protect the public against untimely denials of insurance coverage. By the early twentieth century, states had passed statutes mandating that certain insurance policies be incontestable.¹²³ Despite this development, however, the New Jersey Supreme Court has held that a statute that precluded an insurance company's defense based on a pre-existing disability¹²⁴ did not preclude an insurance company from denying a claim when the policyholder intentionally concealed a disabling disease in the insurance application.¹²⁵

121. *Id.* at 273 (citing *Pisa v. Underwriters at Lloyd's, London*, 787 F. Supp. 283, 285-86 (D.R.I.), *aff'd*, 966 F.2d 1440 (1st Cir. 1992); *Kisting v. Westchester Fire Ins. Co.*, 290 F. Supp. 141, 145-48 (W.D. Wis. 1968), *aff'd*, 416 F.2d 967 (7th Cir. 1969)).

122. Incontestability clauses in life insurance policies protect a policyholder from a contest as to the validity of the policy. 43 Am. Jur. 2d *Insurance* §§ 761, 762 (1982 & Supp. 1996). Ordinarily the clause provides that the policy shall be incontestable after the period designated (usually one or two years) except for certain noted reasons. *Id.*

Similarly, incontestability clauses are required in disability policies. *See, e.g.*, *Oglesby v. Penn Mut. Life Ins. Co.*, 889 F. Supp. 770, 775 (D. Del. 1995) (quoting Del. Code Ann. tit. 18, § 3306 (a)(2) (1989)).

123. *Paul Revere Life Ins. Co. v. Haas*, 644 A.2d 1098, 1102 (N.J. 1994) (citing 7 Williston on Contracts § 912, at 395 (3d ed. 1963)); *see* *Wischmeyer v. Paul Revere Life Ins. Co.*, 725 F. Supp. 995, 1000 (S.D. Ind. 1989).

As one commentator has stated, incontestability clauses exist because of widespread "charges of corruption, fraud and dishonesty" in the insurance industry. *Id.* at 1109 (O'Hearn, J., concurring in part and dissenting in part) (quoting Eric K. Fosaaen, Note, *AIDS and the Incontestability Clause*, 66 N.D. L. Rev. 267, 269 (1990)).

124. For example, N.J. Stat. Ann. § 17B:26-5 (West 1985 & Supp. 1996) requires an incontestability provision in all health insurance policies.

125. *Paul Revere Life Ins. Co.*, 644 A.2d at 1108-09; *see* *Ledley v. William Penn Life Ins. Co.*, 651 A.2d 92, 99 (N.J. 1995); *see also* *Fioretti v. Massachusetts Gen. Life Ins. Co.*, 53 F.3d 1228, 1237 (11th Cir. 1995) (applying New Jersey law).

Claims often arise, of course, before the date of incontestability, or under policies that do not contain an incontestability clause. In such cases courts have frequently held that actual reliance upon, or prejudice to, the insurance company is unnecessary to permit avoidance of the policy by the insurance company, as long as the statement is material to the risk.¹²⁶ In some jurisdictions, proof of a fraudulent misstatement by the policyholder will be sufficient to avoid coverage even when the misstatement was not material.¹²⁷

The rules about misrepresentation achieve perhaps their highest level of abstraction (indeed, absurdity) in the principle that a material misrepresentation will defeat coverage even when the fact misrepresented was entirely unrelated to the risk from which the loss ultimately resulted. Thus, for example, a court has held that a failure to disclose a poor driving record justified a denial of coverage notwithstanding that the policyholder was not driving when the accident happened.¹²⁸ A court has also held that a misstatement about prior insurance coverage was sufficient to defeat a recovery on a claim for theft of a trailer.¹²⁹ A misrepresentation by an applicant about his health history was the basis for a denial of life insurance coverage even when the policyholder died from a cause unrelated to the condition misrepresented.¹³⁰ As illogical as it is, the notion that an insurance company may disclaim coverage on the basis of misrepresentation, even in the absence of a causal link between the misrepresentation and the loss, is probably the majority view.¹³¹

126. See, e.g., *Perry v. State Farm Fire & Casualty Co.*, 734 F.2d 1441, 1443 (11th Cir. 1984) (holding that a material misrepresentation will void an insurance policy even when the insurance company neither relied on the misrepresentation nor suffered any prejudice).

127. See, e.g., *Upton v. Western Life Ins. Co.*, 492 F.2d 148, 149 (6th Cir. 1974) (holding that a showing of materiality is unnecessary when a fraudulent misrepresentation is made). Under general contract and tort law, of course, a misrepresentation must be material before the law will afford relief. *Calamari & Perillo*, *supra* note 34, § 9-14, at 357. Only under insurance law, in some states, is misrepresentation punished purely on moral grounds without regard to its effect upon the complaining party.

In an even more sweeping argument, at least one insurance company has asserted that misrepresentations and/or omissions of material fact that were not made in connection with the insurance application should entitle the insurance company to rescind the policy. Reply Brief to Plaintiff's Opposition to Hartford Accident & Indemnity Company's Cross-Motion for Summary Judgment on the Issue of Bad Faith at 70-82, *Biddle Sawyer Corp. v. Fireman's Fund Ins. Co.*, No. MON-L-5219-91 (N.J. Super. Ct. Nov. 15, 1995) (on file with the *Fordham Law Review*).

128. *Countryside Casualty Co. v. Orr*, 523 F.2d 870, 872-74 (8th Cir. 1975).

129. *Bagwell v. Canal Ins. Co.*, 663 F.2d 710, 711-712 (6th Cir. 1981).

130. *Montgomery v. Reserve Life Ins. Co.*, 585 S.W.2d 620, 621-22 (Tenn. Ct. App. 1979).

131. See *Wickersham v. John Hancock Mut. Life Ins. Co.*, 318 N.W.2d 456, 460 (Mich. 1982).

III. FORFEITURE IS AN IMPROPER AND UNDULY HARSH REMEDY

Courts have improperly imposed forfeitures on policyholders for minor and technical violations of an insurance policy. This part argues that forfeiture is an improper remedy, given three important considerations: (1) a policyholder's lack of notice that forfeiture will result from a minor breach of the insurance contract; (2) the arguments of insurance companies themselves against forfeitures asserted in their disputes with reinsurers; and (3) general principles of contract law that disfavor forfeiture.

A. *Lack of Notice to Policyholders*

Standardized insurance policies do not inform the policyholder that failure to comply with the enumerated conditions will result in forfeiture of coverage. For example, in a standard form liability insurance policy (a commercial general liability or "CGL" policy), the Insuring Agreement recites that the insurance company will pay those sums that the insured becomes legally obligated to pay "as damages," and contains a long list of exclusions to coverage.¹³² The policy explains in detail who the persons insured will be, and sets forth the limits of insurance. Section IV, the "Commercial General Liability Conditions," however, is a different animal. Condition Two, "Duties in the Event of Occurrence, Claim or Suit," informs the policyholder that it must provide notice of an occurrence or of a suit brought against it "as soon as practicable."¹³³ It does not say, "if you do not, coverage will be forfeited."¹³⁴ Commentators have agreed that insurance policies are "inferior sources of information."¹³⁵

The threat of forfeiture is likewise conspicuously absent from the relevant portion of the standard 165-line fire insurance policy.¹³⁶ That standard policy, at lines 28-37, begins (in boldface print) with "Conditions Suspending or Restricting Insurance," and provides, for example, that the insurance company "shall not be liable for loss occurring" while the property is vacant.¹³⁷ But later in the policy, at lines 97-122, the conditions requiring that the policyholder submit to an examina-

132. 1 Miller & Lefebvre, *supra* note 41, at 409-12.

133. *Id.* at 415.

134. Interpreting a notice provision to require forfeiture in the case of noncompliance violates the familiar precept that ambiguities in an insurance policy are to be construed in favor of the policyholder. See *Jones v. Bituminous Casualty Corp.*, 821 S.W.2d 798, 802 (Ky. 1991) (holding that without contractual language "clearly spelling out the meaning and parameters of prompt notice and automatic forfeiture consequences, the reach of the term and the consequences are vague. The policy has a latent ambiguity which is subject to the rule of construction that applies to a contract of adherence").

135. Young, *supra* note 83, at 4 (citing Kenneth S. Abraham, *Distributing Risk* 32, 79-82 (1986), and Robert E. Keeton & Alan I. Widiss, *Insurance Law* § 6.3(4) (1988)).

136. 1 Miller & Lefebvre, *supra* note 41, at 456.

137. *Id.*

tion under oath are not introduced with a similar boldfaced statement.¹³⁸ The policyholder would not reasonably expect,¹³⁹ in reading the policy, that non-compliance with the proof of loss condition or the examination under oath condition would result in a loss or restriction of insurance coverage.

The historical development of the Standard Fire Insurance Policy supports the argument that forfeiture should not be read into the policy language. The 1886 New York Standard Fire Insurance policy contained thirteen express conditions.¹⁴⁰ A breach of any of the conditions voided the insurance coverage, whether or not the breach caused the loss to the insurance company. There was a great deal of litigation concerning these conditions which "was a good measure of the public's dissatisfaction with the form."¹⁴¹ In response, a number of states adopted a new form, the 1918 New York Standard Form, in which only a violation of the first five conditions, involving ownership of the building, voided the policy.¹⁴² Later, the 1943 standard policy eliminated all but two—the vacancy clause and the increase-of-hazard clause.¹⁴³ Despite this history, forfeiture persists as a remedy for failure to comply with the proof of loss provision, or the examination under oath requirement.¹⁴⁴ Considering the long historical development of the standard fire insurance policy and the gradual elimination of express conditions, forfeiture for noncompliance with two *implied* conditions, the examination under oath or the proof of loss provisions, makes little sense.¹⁴⁵

138. *Id.* at 456.1.

139. The reasonable expectations doctrine has been applied in a majority of jurisdictions, totalling 33 states. Ostrager & Newman, *supra* note 10, § 1.03[b][2], at 21-24 (noting that California, New Jersey, and New York are among the jurisdictions that follow this doctrine). The doctrine, advanced most prominently by Professor Robert Keeton, holds that policy language will be construed in accordance with the objectively reasonable expectations of the policyholder. Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 Harv. L. Rev. 961, 967 (1970).

140. Herbert C. Brook, *Recent Contract Developments and Their Implication for Future Litigation*, Ins. L.J., Jan. 1954, at 170, 171.

141. *Id.* at 171.

142. *Id.*

143. *Id.* at 172.

144. See *Whitehead v. Lumbermens Mut. Casualty Co.*, 543 F. Supp. 967, 969-70 (N.D. Ga. 1982), *aff'd*, 703 F.2d 580 (11th Cir. 1983); *Aryeh v. Westchester Fire Ins. Co.*, 525 N.Y.S.2d 628, 629 (App. Div. 1988); *Scott v. Exchange Mut. Ins. Co.*, No. 86-45-II, 1986 WL 6276, at *5 (Tenn. Ct. App. June 4, 1986).

145. Insurance companies' arguments that insurance coverage should be forfeited are similar to what is known as "post-loss" underwriting. This is a practice by some insurance companies by which, following a loss or damage, they argue that they did not provide coverage for the loss. For an excellent fictional account of post-loss underwriting, see John Grisham, *The Rainmaker* (1995). For a compilation of articles concerning this novel, see *Law and Literature: A Collection of Essays on John Grisham's The Rainmaker*, 26 Mem. St. U.L. Rev. 1251 (1996).

B. *Insurance Companies Are Opposed to Forfeiture*

Although the insurance industry is quick to demand that courts impose draconian forfeitures on policyholders,¹⁴⁶ insurance companies who are involved in insurance coverage disputes with reinsurers routinely assert that their breach of a policy condition is merely a "technical breach" of the insurance policy. These arguments by insurance companies are perhaps the best evidence of the absurdity of total forfeiture of insurance coverage for noncompliance with insurance policy provisions. The insurance industry does not play by the rules that it promulgates and attempts to enforce against policyholders. In essence, what is good for the insurance company goose is not good for the policyholder gander.¹⁴⁷

There are a number of instances that illustrate the insurance industry's duplicity. Hartford Accident and Indemnity Company, in arguing that its reinsurance company could not deny insurance coverage based upon late notice, asserted that "[a]n insurance policy is not to be construed as a game of cat and mouse, in which the insurer . . . can avoid liability if he succeeds in catching his insured in a technical breach."¹⁴⁸ Moreover, two Hartford Insurance Group members, New

146. See *Commercial Union Ins. Co. v. International Flavors & Fragrances, Inc.*, 822 F.2d 267, 271 (2d Cir. 1987); *Steelcase, Inc. v. American Motorists Ins. Co.*, No. G87-553 CA1, at *2 (W.D. Mich. Feb. 24, 1989), *aff'd*, 907 F.2d 151 (6th Cir. 1990); *Halstead Oil Co. v. Northern Ins. Co.*, 579 N.Y.S.2d 266, 267 (App. Div. 1991).

147. This, however, is not unusual. Insurance companies spend a great deal of money and time battling policyholders. Insurance companies "spend (conservatively) a billion dollars a year in so-called 'coverage litigation.'" Brief of *Amicus Curiae* American Insurance Association at 3, *Affiliated FM Ins. Co. v. Constitution Reins. Corp.*, 626 N.E.2d 878 (Mass. 1994) (No. SJC-06165); see also Brief and Appendix of *Amicus Curiae* Insurance Environmental Litigation Association ("IELA"), in Support of Continental Insurance Company, Aetna Casualty & Surety Company and Firemen's Insurance Company of Newark, NJ, at 25 n.21, County of Columbia, N.Y. v. Continental Ins. Co., 634 N.E.2d 946 (N.Y. 1994) (No. 65599) (stating that "insurance companies have filed tens of thousands of briefs across the country in a number of courts and in a vast variety of contexts"). There are no lobbyists, trade organizations, and precious few special interest groups representing insurance policyholders in the United States. In contrast, there are scores of insurance trade organizations representing hundreds of insurance companies. See State of Washington Office of Insurance Commissioner, Comments on Insurance Commissioner Matter R 94-30: Proposed Rule Making Regarding Environmental Claims Regulation (Mar./Apr. 1995) (illustrating the practices of various insurance companies and insurance industry organizations). Some of these organizations include the Insurance Environmental Litigation Association, Defense Research Institute, Pollution Liability Insurance Association, National Association of Independent Insurers, Alliance of American Insurers, Association of California Insurance Companies, and the Georgia Association of Property & Casualty Insurance Companies. For a discussion of the insurance industry's strategy in claims handling from the viewpoint of counsel for policyholders, see Eugene R. Anderson et al., *Insurance Nullification by Litigation*, Risk Mgmt., Apr. 1994, at 46.

148. Brief of Plaintiff-Appellee Hartford Accident and Indemnity Co. at 41, *Hartford Accident & Indem. Co. v. Calvert Ins. Co.*, 826 F.2d 1055 (3d Cir. 1987) (No. 86-5898).

England Reinsurance Company and First State Insurance Company, characterized the forfeiture rule as a triumph of form over substance arrived at through a "17th Century type of analysis."¹⁴⁹ In attacking the forfeiture rule, these insurance companies recognized "the need to protect an insured from the severe consequences of a forfeiture of a rightful payment, based on technical grounds"¹⁵⁰ The insurance companies characterized California law as having "recognized [that] the public, i.e. the ultimate beneficiary of malpractice insurance, will be deprived of any possibility of recovering damages if insurance is declared forfeit."¹⁵¹

Similarly, National Casualty Company, a member of the Nationwide Group, argued that "[a]n insurer may avoid coverage for late notice where the notice has been so late as to prejudice the insurer. The burden to avoid coverage is extremely heavy, as the law abhors forfeitures in this situation."¹⁵² Great American Insurance Company, a member of the American Financial Insurance Group, echoed that position:

Where the insurance company's interests have not been harmed by a late notice, even in the absence of extenuating circumstances to excuse the tardiness, the reason behind the notice condition in the policy is lacking, and it follows neither logic nor fairness to relieve the insurance company of its obligations under the policy in such a situation.¹⁵³

The Insurance Company of the State of Pennsylvania, a part of the American International Group, argued in court that "[t]he notice requirement serves to protect insurers from prejudice, but is not intended to shield them from their contractual obligations."¹⁵⁴

Hartford Accident and Indemnity Company continued, stating that "a majority of jurisdictions have held that a technical breach of a notice provision in an insurance or reinsurance contract will not excuse the insurer from liability unless the insurer can prove a likelihood of actual prejudice from the breach." *Id.* at 42.

149. Appellant's Reply Brief at 7, *New Eng. Reins. Corp. v. National Union Fire Ins. Co.*, 829 F.2d 840 (9th Cir. 1987) (No. 86-6432).

150. Appellant's Opening Brief at 12, *New Eng. Reins. Corp. v. National Union Fire Ins. Co.*, 829 F.2d 840 (9th Cir. 1987) (No. 86-6432) (quoting *National Semiconductor Corp. v. Allendale Mut. Ins. Co.*, 549 F. Supp. 1195, 1199 (D. Conn. 1982)).

151. *Id.* at 6.

152. Reply Brief of Petitioner at 4, *National Casualty Co. v. Great Southwest Fire Ins. Co.*, 833 P.2d 741 (Colo. 1992) (en banc) (No. 91SC562) (citing *Emcasco Ins. Co. v. Dover*, 678 P.2d 1051 (Colo. Ct. App. 1983)).

153. Defendant's Memorandum of Law in Support of Its Cross-Motion for Partial Summary Judgment at 33, *Christiania Gen. Ins. Corp. v. Great Am. Ins. Co.*, 745 F. Supp. 150 (S.D.N.Y. 1990) (No. 87 Civ. 8310 (PKL)) (quoting *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193, 197 (Pa. 1977)), *aff'd in part*, 979 F.2d 268 (2d Cir. 1992)).

154. Appellant's Opening Brief of Insurance Company of the State of Pennsylvania at 17, *Insurance Co. v. Associated Int'l Ins. Co.*, 922 F.2d 516 (9th Cir. 1990) (No. 89-55639); *see also* Memorandum of the Travelers Insurance Company in Opposition to INA's Motion for Summary Judgment at 8, *Travelers Ins. Co. v. Feld Car & Truck Leasing Corp.*, 517 F. Supp. 1132 (D. Kan. 1981) (No. 76-179-C6) ("[T]he better reasoned line of authority holds that an insured's coverage is not forfeited by reason of

[W]here there is no prejudice, the notice requirement should not provide a technical escape-hatch by which to deny coverage. In the absence of prejudice, regardless of the reasons for or the length of the delayed notice, there is no reason to excuse the insurer from its obligations under the certificate.¹⁵⁵

Finally, when Liberty Life Insurance Company sought to obtain reinsurance coverage from its reinsurers, but failed to notify its reinsurers immediately of the lawsuit, it argued that reinsurers should not be permitted to "renege on their contractual obligations."¹⁵⁶ Liberty noted that under applicable South Carolina law,¹⁵⁷ an insurance company must show "substantial prejudice" in order to avoid paying the policyholder's defense costs.¹⁵⁸ Liberty maintained that the reinsurers were not prejudiced "since each denied coverage and refused to provide a defense."¹⁵⁹

In sum, insurance companies argue that forfeiture is anachronistic when they are the potential victims of forfeiture. This reveals that insurance companies who deny coverage and argue for forfeiture against policyholders are motivated solely by financial considerations, not the interests of equity. As the insurance industry has demonstrated through its own contradictory arguments,¹⁶⁰ forfeiture is an unnecessary result in insurance cases.

delayed notice unless the [insurance company] proves that the failure to give timely notice resulted in prejudice to the insurer.").

155. Opening Brief for Appellant at 22, *Insurance Co. v. Associated Int'l Ins. Co.*, 922 F.2d 516 (9th Cir. 1990) (No. 89-55639).

156. Reply Brief for Plaintiff-Appellant at 20, *Liberty Life Ins. Co. v. Commercial Union Ins. Co.*, 857 F.2d 945 (4th Cir. 1988) (No. 86-2111).

157. *Id.* at 24 (citing *Factory Mut. Liab. Ins. Co. v. Kennedy*, 182 S.E.2d 727, 729-30 (S.C. 1971)). Liberty also made the same argument under North Carolina, Florida, Minnesota, and Missouri law, other states in which the underlying complaints against Liberty were filed. *Id.*

158. *Id.* (citing *Whittington v. Ranger Ins. Co.*, 201 S.E.2d 620, 623 (S.C. 1973) and *Factory Mut. Liab. Ins. Co. v. Kennedy*, 182 S.E.2d 727, 729-30 (S.C. 1971)).

159. Reply Brief of Plaintiff-Appellant at 25, *Liberty Life Ins. Co. v. Commercial Union Ins. Co.*, 857 F.2d 945 (4th Cir. 1988) (No. 86-2111).

160. The insurance industry frequently argues inconsistent positions. One of the areas in which the insurance industry has taken inconsistent litigation positions involves litigation concerning the meaning of the "polluters" exclusion. See Eugene R. Anderson et al., *Environmental Insurance Coverage in New Jersey: A Tale of Two Stories*, 24 Rutgers L.J. 83, 106-14 (1992) (cited with approval in *Northern States Power Co. v. Fidelity & Casualty Co.*, 523 N.W.2d 657, 660 n.5 (Minn. 1994)).

Courts, however, have consistently condemned the practice of asserting inconsistent positions. The U.S. Supreme Court stated:

It may be laid down as a general proposition that, where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him.

Davis v. Wakelee, 156 U.S. 680, 689 (1895).

The Michigan Supreme Court has expressed the rationale for this rule in the following manner:

C. Forfeiture Is a Disfavored Remedy in Contract Law

If a contract has been breached, the non-breaching party is entitled to a remedy if that party has been damaged.¹⁶¹ The remedies generally applied in breach of contract cases are damages, restitution, coercive remedies such as injunctions, and declaratory relief.¹⁶²

Treatises on remedies or contracts do not identify forfeiture as a remedy for breach of contract.¹⁶³ Forfeitures of contractual rights have long been disfavored by courts and legislatures. A frequently repeated aphorism is that "forfeitures are not favored in the law."¹⁶⁴ The courts of equity created the rule against arbitrary forfeiture of contractual rights in the seventeenth century.¹⁶⁵ As one court described the equity approach more recently, "[c]ourts of equity frown upon the principle of forfeiture. As the keeper of the conscience of

If parties in court were permitted to assume inconsistent positions in the trial of their causes, the usefulness of courts of justice would in most cases be paralyzed; the coercive process of the law, available only between those who consented to its exercise, could be set at naught by all. But the rights of all men, honest and dishonest, are in the keeping of the courts, and consistency of proceeding is therefore required of all those who come or are brought before them.

Mertz v. Mertz, 18 N.W.2d 271, 276 (Mich. 1945) (quoting Bigelow on Estoppel 783 (6th ed. 1872)).

Courts have adopted several doctrines and rules to preclude litigants from asserting inconsistent positions. These include: (1) judicial estoppel, which is also known as the doctrine of "preclusion" against inconsistent positions, 18 Charles A. Wright et al., *Federal Practice and Procedure* § 4477 (1981 ed. & Supp. 1992); (2) equitable estoppel, which bars a party from asserting an inconsistent position when another person has relied upon the prior position, *Edwards v. Aetna Life Ins. Co.*, 690 F.2d 595, 599 (6th Cir. 1982); (3) quasi-estoppel, which is also known as "estoppel by acceptance of the benefits," 31 C.J.S. *Estoppel* §§ 107, 109 (1964 & Supp. 1996); (4) collateral estoppel, which precludes relitigation of an issue of fact or law which a court or administrative agency has determined by a final judgment and which a party previously has litigated or had an opportunity to litigate, *Restatement (Second) of Judgments* § 27 (1980); (5) judicial admissions, which recognizes that a litigant's judicial admission is binding upon the speaker and may not be contradicted in a later proceeding, *Davis v. A.G. Edwards & Sons, Inc.*, 823 F.2d 105, 108 (5th Cir. 1987); (6) "mend the hold" doctrine which "forbids a party to a contract to take inconsistent litigating positions concerning the contract's meaning," *AM Int'l, Inc. v. Graphic Management Assocs.*, 44 F.3d 572, 576 (7th Cir. 1995); and (7) various evidentiary rules under which a litigant's prior inconsistent statement is admissible as "not hearsay," see, e.g., *Fed. R. Evid.* 801(d)(2) (exception to hearsay rule); *Cal. Evid. Code* §§ 1220, 1222 (same).

161. See *Calamari & Perillo, supra* note 34, § 14-2, at 588.

162. See *Dobbs, supra* note 4, ch. 12; *Farnsworth, supra* note 4, ch. 12.

163. See, e.g., 5A *Corbin on Contracts* (West 1964) (excluding forfeiture in its discussion of alternative remedies for breach of contract).

164. See *Insurance Co. v. Norton*, 96 U.S. 234, 242 (1877); *Ross v. State Life Ins. Co.*, 143 So. 827, 828 (Ala. 1932); *Johnson v. Life Ins. Co.*, 52 So. 2d 813, 815 (Fla. 1951); *Russell v. Granite State Fire Ins. Co.*, 116 A. 554, 556 (Me. 1922); *Ley v. Home Ins. Co.*, 251 N.W. 137, 141 (N.D. 1933); *Von Uhl v. Trempealeau County Mut. Ins. Co.*, 146 N.W.2d 516, 520 (Wis. 1966).

Even insurance law treatises repeat this statement. See, e.g., *George J. Couch, Cyclopedia of Insurance Law* 3d § 22:35 (1995) (citing over 30 cases).

165. See *Loyd, supra* note 5, at 125-26.

the king, equity will ameliorate the harshness of the full application of legal forfeitures, when, in a given case, justice demands such action."¹⁶⁶ The law courts borrowed the rules against forfeiture after their development in equity,¹⁶⁷ and those rules are now widely applied in a variety of contract cases.¹⁶⁸

The disfavor in which forfeiture is held by the courts is consistent with the courts' general disfavor of unduly harsh liquidated damages. Liquidated damages provisions are lawful, but courts have been cautious about enforcing such clauses.¹⁶⁹ Generally, if the court believes the provision is a penalty, it will not be enforced.¹⁷⁰ This rule, which arose in equity to prevent over-reaching and to give relief from unconscionable bargains, was later adopted by the law courts.¹⁷¹

IV. REFORM PROPOSAL

This part discusses the various manners in which courts have sought to reduce the likelihood of forfeiture resulting from minor breaches of an insurance policy. This part argues, however, that such measures are inadequate and proposes that, under the doctrine of substantial performance, an insurance company's remedy should be limited to the

166. *Rockaway Park Series Corp. v. Hollis Automotive Corp.*, 206 Misc. 955, 957 (N.Y. Sup. Ct. 1954).

167. Loyd, *supra* note 5, at 126.

168. Note, though, that forfeiture may be a remedy prescribed by statute for a violation of a statute. *See, e.g.*, Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961, 1963 (1994) (prescribing forfeiture when the RICO statute is violated). Because this Article discusses forfeiture as it relates to insurance, forfeiture prescribed by statute is not discussed here. However, it should be noted that courts are hesitant to impose forfeiture even in those cases. *See, e.g.*, *United States v. Kramer*, 73 F.3d 1067, 1076 (11th Cir. 1996) (overturning verdict that ordered forfeiture of defendant's interest in property). It seems anomalous, to say the least, that drug traffickers get more protection from the courts in forfeiture cases than do insurance policyholders. *See Bennis v. Michigan*, 116 S. Ct. 994, 1000-01 (1996) (holding that forfeiture order concerning automobile, jointly owned by husband and wife, as a result of husband's activity did not offend the Due Process Clause of the Fourteenth Amendment or the Takings Clause of the Fifth Amendment).

169. Dobbs, *supra* note 5, § 12.1. For example, one of the parties may deposit some form of security as a guarantee of performance, with the agreement that in the event of a breach, the non-breaching party will keep the security. This arrangement is often found in lease agreements, when a deposit of money secures against damage to the property or non-payment of rent. Or, a bank may require a borrower to execute a mortgage of property as security for a debt. If the debtor defaults, the bank seizes the property. Bank seizures, however, have been severely restricted by courts and legislatures.

Procedures to be followed in the event of default can likewise be specified in advance. The parties may agree to authorize a court to order specific performance in the event of breach, or may stipulate that disputes will be arbitrated.

Parties to a contract have only limited power to bargain over their rights to a remedy, however, and limitations are imposed by statute, public policy, and the doctrine of unconscionability. *See Farnsworth, supra* note 4, § 12.18 n.1, at 895.

170. Charles T. McCormick, *Handbook on the Law of Damages* § 146 (1935).

171. Calamari & Perillo, *supra* note 34, § 14-31, at 639.

actual harm it has suffered from a policyholder's noncompliance with a condition.

A. *Current Methods of Avoiding Forfeiture*

Insurance law has not been entirely oblivious to contract law's antipathy for penalties. Courts have commonly avoided forfeiture of insurance by construing the neglected policy provision as a promised performance, rather than as a "condition."¹⁷² Corbin describes the technique as follows:

If a contract contains a provision providing for some performance that does not constitute any substantial part of the subject-matter of exchange by the parties, the courts much prefer the interpretation that this provision is a promise to render the performance, rather than that it makes the performance a condition precedent to the defendant's duty. By the former interpretation, the failure to render the performance merely creates a right to damages for such injury as may be caused thereby: while by the latter interpretation, the failure to render the performance would privilege the defendant to refuse to render his part of the agreed exchange. Express provisions in a contract, therefore, providing for an arbitration and award under certain circumstances, or for the certificate of an architect or engineer, or for the giving of a notice, or for the making of proof of loss, will be held to be merely promissory in nature, and not to create a condition precedent to the defendant's duty of performing unless the express words of the contract very clearly show a different intention.¹⁷³

This technique of contractual interpretation may be applied to insurance policies.

Alternatively, because the general American rule is to construe insurance policies in favor of the policyholder where possible,¹⁷⁴ courts avoid forfeitures by construing the language in favor of the policyholder:

It has become a settled rule in the construction of contracts of insurance that policies of insurance will be liberally construed to uphold the contract and conditions contained in them which create forfeitures will be construed most strongly against the insurer and will never be extended beyond the strict words of the policy.¹⁷⁵

Therefore, any ambiguity in the insurance contract should be interpreted in favor of the policyholder.

172. In the insurance context, for example, see *Elberton Cotton Mills, Inc. v. Indemnity Ins. Co.*, 145 A. 33, 35 (Conn. 1929) (holding that the insurance policy does not make the filing of the claim a condition precedent to the insurance company's liability).

173. 3A Corbin on Contracts § 748 (West 1960 & Supp. 1996).

174. See *supra* note 134.

175. *Baylor v. State Mut. Life Assurance Co.*, 174 A. 526, 529 (N.J. 1934) (quoting *Carson v. Jersey City Ins. Co.*, 43 N.J.L. 300, 304 (1881)).

Rules of waiver may also be used to avoid forfeiture of insurance coverage. A common insurance law principle states that “[f]orfeitures are not favored if there are any circumstances indicating a waiver thereof.”¹⁷⁶ Courts have deemed that insurance companies have waived objections to the policyholder’s failure to file a proof of loss,¹⁷⁷ failure to give notice of vacated premises in connection with a policy requiring such notice,¹⁷⁸ and failure to comply with various other conditions when the insurance company admitted liability.¹⁷⁹ Moreover, when an insurance company has repudiated the policy and denied all liability, it has waived the right to insist upon compliance with *any* clause inserted for its benefit.¹⁸⁰

Rules of construction and waiver can be useful palliatives but they are, ultimately, inadequate solutions to the problem of forfeiture. If a court can be persuaded by the insurance company that the language in question is “unambiguous” or that no waiver occurred, forfeiture may be the unfortunate result.

A few courts have denied the imposition of forfeitures on the basis of unconscionability. One frequently-cited formulation of the doctrine is that “unconscionability . . . requires some showing of ‘an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.’”¹⁸¹ Unconscionability is both a common law¹⁸² and a statutory¹⁸³ doctrine.

Unconscionability is plainly a readily-available technique for avoiding the punitive effects of insurance coverage forfeiture. Because the unconscionability doctrine is a rule of decision rather than a rule of construction,¹⁸⁴ the courts may require insurance companies to honor those policies for which premiums have been paid, notwith-

176. 16B Appleman & Appleman, *supra* note 27, § 9082, at 506-07.

177. *See* Provident Mut. Life Ins. Co. v. Ehrlich, 374 F. Supp. 1134, 1137 (E.D. Pa. 1973), *aff’d in part, vacated in part*, 508 F.2d 129 (3d Cir. 1975); *Lewis v. Continental Life & Accident Co.*, 461 P.2d 243, 249 (Idaho 1969).

178. *Travelers Fire Ins. Co. v. Bank of New Albany*, 146 So. 2d 351, 353 (Miss. 1962); *Cashen v. Camden Fire Ins. Ass’n*, 348 S.W.2d 883, 886-87 (Tenn. Ct. App. 1961).

179. *See English & Am. Ins. Co. v. Swain Groves, Inc.*, 218 So. 2d 453, 457 (Fla. Dist. Ct. App. 1969) (co-insurance clause); *Korch ex rel. Doody v. Indemnity Ins. Co.*, 67 N.E.2d 298, 302 (Ill. App. Ct. 1946) (forwarding of summons).

180. *See Grant v. Sun Indem. Co.*, 80 P.2d 996, 997 (Cal. 1938).

181. *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*, 465 N.Y.S.2d 606, 617 (App. Div. 1983) (quoting *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965)).

182. *See* Restatement (Second) of Contracts § 208 (1981).

183. U.C.C. § 2-302 (1987). Courts have held that contracts of insurance fall within the unconscionability provision of the Uniform Commercial Code. *See C&J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 181 (Iowa 1975); *Yankelevitz v. Royal Globe Ins. Co.*, 435 N.Y.S.2d 900, 907 (Sup. Ct. 1981), *rev’d on other grounds*, 451 N.Y.S.2d 166, 167 (App. Div. 1982); *Bishop v. Washington*, 480 A.2d 1088, 1093-94 (Pa. Super. Ct. 1984).

184. *Calamari & Perillo*, *supra* note 34, § 9-38, at 402.

standing a technical breach of a policy clause or the fine print in the insurance policy that has been drafted for the insurance company.

For example, the Supreme Court of Iowa used the doctrine of unconscionability to avoid forfeiture of insurance in *C&J Fertilizer, Inc. v. Allied Mutual Insurance Co.*¹⁸⁵ In that case, the insurance policy provided coverage for burglary, but limited the coverage for burglary to those cases in which there were "visible marks made by tools . . . or physical damage to, the exterior of the premises at the place of . . . entry"¹⁸⁶ The policyholder was able to show that an unknown third person had committed a burglary on its premises,¹⁸⁷ but was unable to produce the specific evidence of forced entry required by the policy. The court concluded that enforcement of this restrictive definition of burglary was unconscionable in a policy intended to protect against burglary.¹⁸⁸ The court refused enforcement of the clause and granted recovery to the policyholder.

In sum, the unconscionability doctrine dictates a fair and correct result by ignoring the fiction that an unnegotiated and technical clause ultimately breached was part of the parties' "agreement." When the policyholder has paid all premiums due, and insurance is denied after a loss for an inconsequential noncompliance with a non-negotiated, boilerplate provision in the insurance policy, the requirements for invocation of the doctrine of unconscionability are squarely met.

Unconscionability, however, is a blunt instrument. It is only rarely invoked, and when it is, it is criticized as a threat to the finality and enforceability of private contracts.¹⁸⁹ The doctrine, although a principled response to the unfairness of forfeitures, is as imprecise as the forfeiture rules it is invoked to counteract.

Other courts have avoided forfeiture of insurance coverage by requiring only substantial performance of a policy condition. Substantial performance of a condition is simply another way of describing an immaterial breach, with the court focusing on the materiality of the breach rather than on the materiality of the provision at issue.¹⁹⁰ For example, in one case, submission of a proof of loss form after the policyholder brought suit seeking insurance coverage was held to be substantial compliance with a provision requiring submission of a proof of loss form within sixty days of the loss.¹⁹¹ In another case, a policyholder's submission of documentation after an initial, interrupted sworn examination was substantial performance of a sworn examina-

185. 227 N.W.2d 169 (Iowa 1975).

186. *Id.* at 171.

187. *Id.* at 171-72. The policyholder successfully refuted the suggestion that the burglary might have been an "inside job," the eventuality toward which the "visible exterior marks" requirement was presumably directed. *Id.*

188. *Id.* at 181.

189. Calamari & Perillo, *supra* note 34, § 9-38, at 401.

190. See *infra* text accompanying note 195.

191. Fehring v. Republic Ins. Co., 347 N.W.2d 595, 598-600 (Wis. 1984).

tion clause and could create a triable issue of fact concerning the insurance company's demand for forfeiture.¹⁹²

The difficulty with this approach, however, is that it only protects policyholders who make a reasonable "college try," or even those who make grudging or reluctant efforts to comply, but fails to assist policyholders who are unaware of a given provision or unable, for whatever reason, to fulfill it. Therefore, the operator of a safe plant who never makes a claim and is unaware of the need to provide notice of an occurrence is harshly penalized, although the unsafe operator, familiar with insurance, is saved by half-hearted compliance with the policy condition rather than full compliance. A more rational approach is needed.

B. *Recoupment or Damages Is the Proper Remedy*

Any remedy imposes costs and creates benefits. In choosing among remedies, courts usually choose a remedy that will "approximately vindicate the plaintiff's right."¹⁹³ In choosing forfeiture as a remedy for non-compliance with an insurance policy condition, however, courts are choosing a blunderbuss when a pistol is all that is needed. This part argues that courts should find that the regular payment of premiums constitutes substantial performance of the insurance contract as a whole. Consequently, noncompliance with a policy condition should only result in recoupment or damages for the insurance company.

1. Substantial Performance of the Insurance Contract

A policyholder's breach of a policy condition should result, at most, in recoupment or damages to the insurance company. When a policyholder fails to fulfill a provision of the policy not involving the payment of premiums, the policyholder's recoverable loss can simply be reduced by the amount of any damages that the insurance company can show it suffered as a result of the failure. That result can be achieved without the need for legislation, and in virtually any insurance case by applying the contract law doctrine of "substantial performance" to an insurance claim.¹⁹⁴

The doctrine of "substantial performance" permits recovery by a party that has substantially performed its obligations under an agreement but that has also breached the agreement:

192. *High Fashions Hair Cutters v. Commercial Union Ins. Co.*, 535 N.Y.S.2d 425, 426 (App. Div. 1988).

193. *Dobbs*, *supra* note 4, § 1.9, at 35.

194. The doctrine of substantial performance must be distinguished from the narrower rule regarding "substantial performance" of a policy condition. *See supra* notes 190-92 and accompanying text. In the former case, the entire contract is substantially performed; in the latter case, the focus is only on the performance of a single condition.

[W]hen a contract has been partially executed, and one of the parties has derived substantial benefits . . . through the [other's] partial performance of the agreement, then the first party cannot rescind the contract on account of the failure of the second party to complete his performance . . . of it, and his only remedy for the failure of the second party to completely perform is compensation in damages for that breach.¹⁹⁵

Substantial performance is frequently associated with construction litigation. In that context, courts have traditionally recognized a need to deal more equitably with the situation when a contractor has substantially completed a construction contract, and conferred a benefit on the owner of land, but has breached a term of the contract on which payment was expressly conditioned.¹⁹⁶ The solution is to award the contractor its contract price, less an offset sufficient to compensate the owner for the partial breach.¹⁹⁷ The Arkansas Supreme Court stated the operation of the rule succinctly:

[A] contractor who has substantially performed is entitled to recover the contract price, less the difference in value between the work as done and [the work] contracted to be done, or less the cost of correcting defective work where this can be done without great expense or material injury to the structure as a whole.¹⁹⁸

The court then added the following significant, and accurate, observation: "[The cited] cases involved the construction of a building. However, the doctrine of substantial performance is not restricted to building contracts but applies to contracts of all kinds."¹⁹⁹ The substantial performance doctrine is as well suited for application to insurance policies as it is to construction contracts. A policyholder who has paid premiums to an insurance company should receive payment on its claim for loss, despite a failure to comply with other provisions of the policy. The policyholder's payment may be reduced by an amount sufficient to compensate the insurance company for any damage it suffers as a result of the policyholder's noncompliance with policy provisions.

195. 6 Williston on Contracts § 843 (3d ed. 1962) (citing *German Sav. Inst. v. DeLa Vergne Refrigerating Mach. Co.*, 70 F. 146, 150 (8th Cir. 1895)).

196. 5 Corbin on Contracts § 1089 (West 1964).

197. The credit or affirmative recovery due the owner is the reasonable amount it has cost, or will cost, the owner to finish the job, less any part of the contract price remaining unpaid, plus damages for delay in securing the use of the building. *Id.*; see McCormick, *supra* note 170, § 68. The owner has the burden of proving the cost of completion or repair, and thus bears the burden of proof on the claim for recoupment. See *Hopkins Constr. Co. v. Reliance Ins. Co.*, 475 P.2d 223, 224-25 (Alaska 1970).

198. *Prudential Ins. Co. v. Stratton*, 685 S.W.2d 818, 821 (Ark. Ct. App.).

199. *Id.*

In the insurance context, substantial performance is easily identified.²⁰⁰ When the policyholder has made timely payment of all premiums due, the contract has been substantially performed. As the United States Bankruptcy Court for the Southern District of Florida noted:

United Capitol [Insurance Company] . . . has already received the most material and substantial performance required under the Policies: the payment in full of over \$1.4 million in premiums. At this point, a material breach of the Policies by [policyholder] FIE . . . absent bankruptcy, would not have relieved United Capitol of its coverage obligations under the Policies

United Capitol is not remediless [sic] in this situation, however. If [the policyholder] . . . failed to fund the SIR [self-insured retention] . . . United Capitol, assuming it has complied with the proper procedures . . . may be entitled to maintain a claim against [the policyholder] for those same damages.²⁰¹

In sum, draconian forfeitures can be eliminated by application of this rule and the result will be eminently fair to policyholders and insurance companies alike.

2. The Proper Remedy Applied

Because many harms that might be suffered by an insurance company from a policyholder's noncompliance with a condition are quantifiable, they can often be remedied by an award of recoupment, or by an award of damages to the insurance company.²⁰² For example, unnecessary investigation costs incurred due to a policyholder's failure to provide information in her files, or as a result of refusing to submit a sworn proof of loss, can be calculated. If the policyholder fails to provide timely notice of a claim resulting in a default judgment against the policyholder, the insurance company should be compensated for attorneys' fees expended to have the judgment reopened.

Lost settlement opportunities are another quantifiable harm resulting from a policyholder's noncompliance with a notice provision. If the policyholder has rejected a third party's demand before notice to the insurance company has been provided, the rejected demand can be compared to the ultimate liability. If the insurance company can

200. The requisite level of performance necessary to sustain a substantial performance claim is unclear. See 3A Corbin on Contracts § 704 (West 1960). Thus, a builder must render a minimum, somewhat ill-defined level of performance before the substantial performance rule will be applied. See *id.* The key factor is whether the performing party has conferred a substantial benefit on the other party—and that factor should be satisfied where premiums have been timely paid.

201. *In re Firearms Import & Export Corp.*, 131 B.R. 1009, 1014 (Bankr. S.D. Fla. 1991).

202. An affirmative award of actual damages, as opposed to recoupment, would be most appropriate where the harm to the insurance company is quantifiable, but the insurance company's performance is being rendered in kind.

show that it would likely have accepted and paid the demand, its liability for the claim should be capped at the amount of the demand.

Additional investigation expenses caused by late notice are a component of a recoupment or damages award in favor of the insurance company. If the defense requires a lengthy face-to-face interview with a witness who has moved to China, and the insurance company could have held such an interview at the site of the event had notice been given earlier, the additional cost of this interview might be considered a result of the policyholder's noncompliance. The insurance company should be entitled to recover that extra cost.

Admittedly, harm alleged by insurance companies due to late notice of a claim can sometimes be difficult to quantify. The insurance company may argue that it cannot demonstrate the loss of favorable evidence as a result of starting its investigation late, and should not bear the burden of proving the unprovable. After all, it was the policyholder who caused a problem by providing late notice. Therefore the policyholder should bear the risk of lost evidence.

All litigation, however, is affected by the passage of time, whether or not it begins with timely notice. Witnesses die, move away, forget what they saw, and change their stories. It will be a rare case indeed when defeat could have been turned into triumph if only the insurance company could have talked to a mystery witness within the notice period. It is possible to imagine such a result, but speculation about its occurrence should not dictate the results in countless cases of late notice.

Application of a forfeiture rule based upon the notion that the insurance company "does not know what it does not know," e.g., that it cannot specify the cost of an absence of early investigation, would deny insurance because uncertainty exists. The purpose of insurance, however, is to spread the risk of uncertainty. If the insurance company cannot quantify the harms from a breach of a condition, within the broad limits of American rules on damages, then the uncertainty should be reflected in the rate base, and not in a loss of insurance to a single policyholder.

The notion that only those policyholders who "follow the rules" and comply fully with policy conditions should be covered is, in itself, inconsistent with the purpose of insurance. Insurance is normally available for negligent conduct, for wrongful acts, and very often for intentional conduct.²⁰³ If the insurance company cannot demonstrate or quantify harm from a breach of a condition, then folding the effects of the noncompliance into the rate base does no more violence to the

203. See Eugene R. Anderson et al., *Employment Discrimination and Liability Insurance: Even Insurance Companies Say You May Be Covered*, Merrit Risk Mgmt. Rev., Dec. 4, 1995, at 3.

concept of insurance than does insuring negligent and intentional conduct in the first place.

CONCLUSION

Forfeiture is an unfair, draconian remedy that should no longer be applied in insurance law, routinely or otherwise. A policyholder who has paid premiums and purchased an insurance policy that is affected with a public interest should be treated at least as favorably as a party to any type of contract. In the world of insurance, forfeiture as a punishment does not fit the crime. Draconian forfeitures can be eliminated by the simple application of traditional contractual remedies, notably, the doctrine of substantial performance. When a policyholder has regularly paid premiums on his policy, courts should find that the insurance policy has been substantially performed and that the insurance company's recovery for noncompliance with a policy condition should be limited to damages or recoupment for the harm suffered.

APPENDIX

*Late Notice Rules By State*²⁰⁴

STATE	RULE	CASE
Alabama	Forfeiture; Notice is a condition precedent.	<i>Liberty Mut. Ins. Co. v. Bob Roberts</i> , 357 So. 2d 968, 971 (Ala. 1978); see <i>Correll v. Fireman's Fund Ins. Cos.</i> , 529 So. 2d 1006, 1008-09 (Ala. 1988).
Alaska	Insurance company has burden of showing it has been prejudiced.	<i>Weaver Bros. v. Chappel</i> , 684 P.2d 123, 125-26 (Alaska 1984).
Arizona	Insurance company has burden of showing it has been prejudiced.	<i>Globe Indem. Co. v. Bloomfield</i> , 562 P.2d 1372, 1374 (Ariz. Ct. App. 1977).
Arkansas	If timely notice by the policyholder is an express condition precedent to recovery under the policy, then failure to give timely notice results in forfeiture. If timely notice is a condition subsequent, then failure to give timely notice does not result in forfeiture unless the insurance company has been prejudiced.	<i>Haskins v. Occidental Life Ins. Co.</i> , 349 F. Supp. 1192, 1197 (E.D. Ark. 1972).
California	Insurance company has burden of showing it has been prejudiced.	<i>Sinton v. Hartford Accident & Indem. Co.</i> , 261 Cal. Rptr. 163, 166-67 (Cal. Ct. App. 1989).
Colorado	Forfeiture.	<i>Dairyland Ins. Co. v. Marez</i> , 601 P.2d 353, 355 (Colo. Ct. App. 1979) <i>aff'd</i> , 638 P.2d 286 (Colo. 1981); <i>Leadville Corp. v. United States Fidelity & Guar. Co.</i> , 55 F.3d 537,

204. Different notice rules may be applied for certain types of claims or suits, pursuant to statute. A previous version of this chart appeared as part of Bart Tesoriero et al., *The Draconian Late Notice Forfeiture Rule: "Off with the Policyholders' Heads,"* 15 Ins. Litig. Rep. 113 (1993).

		541-42 (10th Cir. 1995) (applying Colorado law).
Connecticut	Insurance company is presumed to have been prejudiced; policyholder may rebut.	<i>Aetna Casualty & Sur. Co. v. Murphy</i> , 538 A.2d 219, 224 (Conn. 1988).
Delaware	Insurance company has burden of showing that it has been prejudiced.	<i>State Farm Mut. Auto. Ins. Co. v. Johnson</i> , 320 A.2d 345, 347 (Del. 1974); see <i>Falcon Steel v. Maryland Cas. Co.</i> , 366 A.2d 512, 518 (Del. Super. Ct. 1976).
District of Columbia	Forfeiture.	<i>Waters v. American Auto. Ins. Co.</i> , 363 F.2d 684, 689-90 (D.D.C. 1966) (applying D.C. law); see <i>Greycoat Hanover F St. Ltd. Partnership v. Liberty Mut. Ins. Co.</i> , 657 A.2d 764, 768 (D.C. Cir. 1995).
Florida	Prejudice to insurance company is presumed; policyholder may rebut.	<i>Bankers Ins. Co. v. Macias</i> , 475 So. 2d 1216, 1217-18 (Fla. 1985).
Georgia	Forfeiture. NOTE: if motor vehicle liability policy is at issue, Ga. Code Ann. §33-7-15 (1992) provides that insurance company has burden of showing it has been prejudiced.	<i>Atlanta Int'l Properties, Inc. v. Georgia Underwriting Ass'n</i> , 256 S.E.2d 472, 473 (Ga. Ct. App. 1979); <i>Caldwell v. State Farm Fire & Cas. Ins. Co.</i> , 385 S.E.2d 97, 99-100 (Ga. Ct. App. 1989).
Hawaii	Insurance company has burden of showing it has been prejudiced.	<i>Standard Oil Co. v. Hawaiian Ins. & Guar. Co.</i> , 654 P.2d 1345, 1348 n.4 (Haw. 1982).
Idaho	If timely notice by policyholder is a condition precedent to recovery under the policy, then failure to give timely notice results in forfeiture. If timely notice is not a condition precedent,	<i>Viani v. Aetna Ins. Co.</i> , 501 P.2d 706, 710-14 (Idaho 1972), <i>overruled on other grounds</i> , <i>Sloviaczek v. Estate of Puckett</i> , 565 P.2d 564, 568 (Idaho 1977).

- prejudice to the insurance company is considered.
- Illinois Forfeiture when the policy requires "prompt" notice. *INA Ins. Co. v. City of Chicago*, 379 N.E.2d 34, 37 (Ill. App. Ct. 1978); *Transamerica Ins. Co. v. Interstate Pollution Control, Inc.*, No. 92 C 20247, 1995 U.S. Dist. LEXIS 8413, at *44 (N.D. Ill. June 16, 1995) (applying Illinois law).
- Indiana Insurance company is presumed to have been prejudiced by untimely notice. *Miller v. Dilts*, 463 N.E.2d 257, 265 (Ind. 1984); *Lumpkins v. Grange Mut. Co.*, 553 N.E.2d 871, 874 (Ind. Ct. App. 1990)
- Iowa Insurance company is presumed to have been prejudiced by delayed notice; presumption may be rebutted by policyholder by demonstrating that insurance company was not actually prejudiced. *Estate of Wade v. Continental Ins. Co.*, 514 F.2d 304, 305-06 (8th Cir. 1975) (applying Iowa law)
- Kansas Insurance company has burden of showing it has been prejudiced. *Home Life Ins. Co. v. Clay*, 719 P.2d 756, 763 (Kan. Ct. App.), review denied, 239 Kan. 693 (1986); *Travelers Ins. Co. v. Feld Car & Truck Leasing Corp.*, 517 F. Supp. 1132, 1134-36 (D. Kan. 1981) (applying Kansas law).
- Kentucky Insurance company has burden of showing it has been prejudiced. *Jones v. Bituminous Casualty Corp.*, 821 S.W.2d 798, 803 (Ky. 1991).
- Louisiana Forfeiture. *Jackson v. Transp. Leasing Co.*, 893 F.2d 794, 795-96 (5th Cir. 1990) (applying Louisiana law); *Auster Oil & Gas, Inc. v. Stream*, 891 F.2d 570,

		575-76 (5th Cir. 1990) (applying Louisiana law).
Maine	Insurance company has burden of showing it has been prejudiced.	<i>Ouellette v. Maine Bonding & Cas. Co.</i> , 495 A.2d 1232, 1235 (Me. 1985).
Maryland	Insurance company has burden of showing it has been prejudiced.	Md. Code Ann., Ins., § 482 (1957); <i>Harleysville Ins. Co. v. Rosenbaum</i> , 351 A.2d 197, 202 (Md. Ct. Spec. App. 1976).
Massachusetts	Insurance company has burden of showing it has been prejudiced.	<i>Johnson Controls, Inc. v. Bowes</i> , 409 N.E.2d 185, 187 (Mass. 1980); see Mass. Gen. L. ch. 175, § 112 (1994).
Michigan	Insurance company has burden of showing it has been prejudiced.	<i>Burgess v. American Fidelity Fire Ins. Co.</i> , 310 N.W.2d 23, 24-25 (Mich. Ct. App. 1981); <i>West Bay Exploration Co. v. AIG Specialty Agencies</i> , 915 F.2d 1030, 1036 (6th Cir. 1990) (applying Michigan law).
Minnesota	Under an "occurrence"—based liability policy, the insurance company has burden of showing it has been prejudiced. Under a "claims-made" policy, forfeiture is the result.	<i>Reliance Ins. Co. v. St. Paul Ins. Co.</i> , 239 N.W.2d 922, 924 (Minn. 1976); <i>Esmailzadeh v. Johnson & Speakman</i> , 869 F.2d 422, 424-25 (8th Cir. 1989) (applying Minnesota law).
Mississippi	If timely notice by the policyholder is a condition precedent to recovery under the policy, then failure to give timely notice results in forfeiture. If timely notice is not a condition precedent, then the insurance company has the burden of showing prejudice.	<i>Bolivar County Bd. of Supervisors v. Forum Ins. Co.</i> , 779 F.2d 1081, 1085-86 (5th Cir. 1986) (applying Mississippi law).

Missouri	Prejudice is one of the factors to be considered in determining the reasonableness of the delay. Insurance company has burden of showing prejudice substantially disabled it in its defense.	<i>Greer v. Zurich Ins. Co.</i> , 441 S.W.2d 15, 32 (Mo. 1969).
Montana	Insurance company has the burden of showing it has been prejudiced.	<i>J.G. Link & Co. v. Continental Casualty Co.</i> , 470 F.2d 1133, 1139 (9th Cir. 1972), (applying Montana law), <i>cert. denied</i> , 414 U.S. 829 (1973).
Nebraska	Insurance company has the burden of showing it has been prejudiced.	<i>MFA Mut. Ins. Co. v. Sailors</i> , 141 N.W.2d 846, 849 (Neb. 1966).
Nevada	Forfeiture.	<i>State Farm Mut. Auto. Ins. Co. v. Cassinelli</i> , 216 P.2d 606, 616 (Nev. 1950).
New Hampshire	Court weighs three factors: (1) length of delay; (2) reasons for delay; (3) whether delay resulted in prejudice to the insurance company.	<i>Commercial Union Assurance Cos. v. Monadnock Regional Sch. Dist.</i> , 428 A.2d 894, 896 (N.H. 1981).
New Jersey	Insurance company has the burden of showing it has been prejudiced.	<i>Cooper v. Government Employees Ins. Co.</i> , 237 A.2d 870, 874 (N.J. 1968); <i>see Morales v. National Grange Mut. Ins. Co.</i> , 423 A.2d 325, 327-28 (N.J. Super. Ct. Law Div. 1980).
New Mexico	Insurance company has the burden of showing it has been prejudiced.	<i>Foundation Reserve Ins. Co. v. Esquibel</i> , 607 P.2d 1150, 1152 (N.M. 1980).
New York	Forfeiture. Note: A reinsurance company must prove prejudice.	<i>Security Mut. Ins. Co. v. Acker-Fitzsimons Corp.</i> , 293 N.E.2d 76, 78 (N.Y. 1972); <i>Reliance Ins. Co. v. Garsart Bldg. Corp.</i> , 517 N.Y.S.2d 189, 190 (N.Y. App. Div. 1987), <i>appeal denied</i> , 70

		N.Y.2d 610 (1987); see <i>Unigard Sec. Ins. Co. v. North River Ins. Co.</i> , 594 N.E.2d 571, 571 (N.Y. 1992).
North Carolina	Two-step test: (1) Did policyholder act in good faith? If no, then notice is untimely; if yes, then: (2) insurance company has the burden of showing it has been prejudiced.	<i>Great Am. Ins. Co. v. C.G. Tate Constr. Co.</i> , 279 S.E.2d 769, 774-75 (N.C. 1981), <i>rev'd on other grounds</i> , 340 S.E.2d 743 (N.C. 1986).
North Dakota	Insurance company has the burden of showing it has been prejudiced.	<i>Finstad v. Steiger Tractor, Inc.</i> , 301 N.W.2d 392, 398 (N.D. 1981).
Ohio	Insurance company is presumed to have been prejudiced. Policyholder may rebut.	<i>Zurich Ins. Co. v. Valley Steel Erectors, Inc.</i> , 233 N.E.2d 597, 599 (Ohio Ct. App. 1968) (citing <i>Security Ins. Co. v. Snyder-Lynch Motors, Inc.</i> , 7 Cal. Rptr. 28 (Cal. Dist. Ct. App. 1960)).
Oklahoma	Insurance company has the burden of showing it has been prejudiced.	<i>Independent Sch. Dist. v. Jackson</i> , 608 P.2d 1153, 1155 (Okla. 1980).
Oregon	Two-step test: (1) Insurance company must show that it was prejudiced by untimely notice; if it does, then: (2) Did policyholder act reasonably? If yes, then insurance company must defend even if it was prejudiced.	<i>Lusch v. Aetna Casualty & Sur. Co.</i> , 538 P.2d 902, 905 (Or. 1975).
Pennsylvania	Insurance company has the burden of showing it has been prejudiced.	<i>Brakeman v. Potomac Ins. Co.</i> , 371 A.2d 193, 196 (Pa. 1977).
Rhode Island	Insurance company has the burden of showing it has been prejudiced.	<i>Cooley v. John M. Anderson Co.</i> , 443 A.2d 435, 437 (R.I. 1982).
South Carolina	Insurance company has burden of showing it has been prejudiced.	<i>Squires v. National Grange Mut. Ins. Co.</i> , 145 S.E.2d 673, 677

		(S.C. 1965); <i>see Noisette v. Ismail</i> , 384 S.E.2d 310, 315 (S.C. Ct. App. 1989), <i>rev'd on other grounds</i> , 403 S.E.2d 122 (S.C. 1991).
South Dakota	Forfeiture.	<i>Wolff v. Royal Ins. Co. of Am.</i> , 472 N.W.2d 233, 236-37 (S.D. 1991).
Tennessee	Forfeiture.	<i>Hartford Accident & Indem. Co. v. Creasy</i> , 530 S.W.2d 778, 781 (Tenn. 1975); <i>see North River Ins. Co. v. Johnson</i> , 757 S.W.2d 334, 335 (Tenn. Ct. App. 1988).
Texas	If policy is pre-1976, late notice results in forfeiture. If policy is post-1976, insurance company must prove prejudice.	<i>Shelton v. Ray</i> , 570 S.W.2d 419, 420 (Tex. Civ. App. 1978).
Utah	Failure of policyholder to comply with notice requirement in insurance policy which conforms to statute (Utah Code Ann. § 31-33-3) results in forfeiture.	<i>Hunter v. Fireman's Fund Ins. Co.</i> , 448 F.2d 805, 810 (10th Cir. 1971) (applying Utah law).
Vermont	Policyholder has the burden of explaining or excusing delay in giving notice to the insurance company but substantial compliance with notice requirements will suffice.	<i>Putney Sch. v. Schaaf</i> , 599 A.2d 322, 327 (Vt. 1991); <i>Stonewall Ins. Co. v. Moorby</i> , 298 A.2d 826, 829 (Vt. 1972).
Virginia	Policyholders must make a prima facie case that notice was given to shift ultimate burden of notice to issuer.	<i>Erie Ins. Exch. v. Meeks</i> , 288 S.E.2d 454, 456-57 (Va. 1982).
Washington	Insurance company has burden of showing it has been prejudiced.	<i>Castle & Cooke, Inc. v. Great Am. Ins. Co.</i> , 711 P.2d 1108, 1111 (Wash. Ct. App. 1986); <i>Simms v. Allstate Ins. Co.</i> , 621 P.2d 155, 157 (Wash. Ct. App. 1980).
West Virginia	Insurance company has the burden of showing it has been prejudiced.	<i>State Farm Mut. Auto. Ins. Co. v. Milam</i> , 438 F. Supp. 227, 231-32

(S.D. W. Va. 1977)
(applying West Virginia law).

- Wisconsin Under Wis. Stat. Ann. § 631.81 (West 1995), when notice is given as soon as reasonably possible and within one year of the time notice is required by the policy, the insurance company is presumed to not have been prejudiced; but the insurance company may rebut the presumption. Under case law, when notice is given more than one year after the time required by the policy, the insurance company is presumed to have been prejudiced; but policyholder may rebut presumption. *Gerrard Realty Corp. v. American States Ins. Co.*, 277 N.W.2d 863, 872 (Wis. 1979).
- Wyoming No case law found.

