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Insurance--Breach of the Notice Condition in Automobile Liability Policies

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COMMENTS

INSURANCE — BREACH OF THE NOTICE CONDITION IN AUTOMOBILE LIABILITY POLICIES*

I. INTRODUCTION

Under the terms of a typical automobile liability insurance policy a policyholder is required to provide his insurer with prompt notice of any accident and immediate notice of any claim or suit as a condition of the company's obligation to defend and indemnify its insured against financial loss.[1] All auto liability policies require compliance with the "notice" clause as a condition precedent to any action against the insurer to enforce the insuring agreements.[2] The notice clause itself has been generally recognized as a valid stipulation in the policy;[3] the purpose of which has been "to enable the insurer to inform itself promptly concerning the accident, to in-

*Factory Mut. Liab. Ins. Co. v. Kennedy, 256 S.C. 376, 182 S.E.2d 727 (1971).

1. The typical clause contained in these policies may be illustrated by the following language quoted in *Factory Mut. Liab. Ins. Co. v. Kennedy,* 256 S.C. 376, 379, 182 S.E.2d 727, 728 (1971):

> When an accident occurs written notice shall be given by or on behalf of the insured to the company or any of its authorized agents as soon as practicable. Such notice shall contain particulars sufficient to identify the insured and also reasonably obtainable information respecting the time, place and circumstances of the accident, the names and addresses of the injured and of available witnesses.
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> . . . .
>
> If claim is made or suit is brought against the insured, the insured shall immediately forward to the company every demand, notice, summons or other process received by him or his representative.

Although there are minor variations among clauses appearing in the policies written by the many companies in this field, the clause reproduced above contains the standard basic requirements.

2. Again referring to the policy quoted in n. 1, *supra,* "No action shall lie against the company, unless as a condition precedent thereto, the insured shall have complied with all the terms of this policy, . . ."

3. *See, generally,* Annot. 18 A.L.R. 2d 443, 450 (1951).

vestigate the circumstances and prepare a timely defense, if necessary, on behalf of the insured."[4]

Difficulties have arisen, however, in the interpretation of the notice clause by the courts. Extensive litigation has resulted, interpreting practically every significant term and subclause within the provision.[5] In addition the courts have been called upon to balance the effects of non-compliance with the notice provision against the effect of leaving a policyholder or third party claimant with damages for which he has no satisfactory remedy. In balancing the various competing interests, in the interpretation of policies generally, the courts have given weight to many considerations ranging from the traditional concept of contract law which regards the plain language of the policy as binding on the parties, to the more recently developed rationale which would give more weight to public policy,[6] with particular focus on the policy of most legislatures in requiring automobile liability insurance or an equivalent personal financial responsibility.[7] In the recent case of *Factory Mutual Liability Insurance Company v. Kennedy*,[8] the South Carolina Supreme Court, in considering an alleged breach of the notice provisions of an automobile liabil-

4. Washington v. Nat'l. Serv. Fire Ins. Co., 252 S.C. 635, 641, 168 S.E.2d 90, 93 (1969).

5. *See,* Annot. 76 A.L.R. 23 (1932); Annot. 123 A.L.R. 952 (1939) and Annot. 18 A.L.R. 2d 442 (1951) for collected cases.

6. In reviewing the decisions of the South Carolina Supreme Court we find no exception to the general statement. In *Walker v. Commercial Cas. Ins. Co.*, 191 S.C. 187, 191, 4 S.E.2d 248, 249 (1939) the court stated, "[W]hen such contracts are capable of clear interpretation the court's duty is confined to the enforcement thereof; it cannot exercise its discretion as to the wisdom of such contract or substitute its own for that which was agreed upon." (citation omitted). And in *Stanky v. Reserve Ins. Co.*, 238 S.C. 533, 538, 121 S.E.2d 10, 13 (1961), the court stated, "We cannot read into insurance contracts, under the guise of public policy, provisions which are not required by law and which the parties thereto clearly and plainly have failed to include. *See also,* Carroway v. Johnson, 245 S.C. 200, 139 S.E.2d 908 (1965); S.S. Newell & Co. v. Am. Mut. Liab. Ins. Co., 199 S.C. 325, 19 S.E.2d 423 (1942); *and,* Sauls v. Sovereign Camp, W.O.W., 193 S.C. 289, 8 S.E.2d 500 (1940). The public policy argument was given weight in *Evans v. Am. Home Assurance Co.*, 252 S.C. 417, 166 S.E.2d 811 (1969) and, more particularly, in other cases when a breach of the cooperation condition was involved.

7. *See, e.g.,* Motor Vehicle Safety Responsibility Act, S.C. CODE ANN. §46-701-705.54 (1962) *and* GA. CODE ANN. §92A-605 (Supp. 1971).

8. 256 S.C. 376, 182 S.E.2d 727 (1971).

ity policy, found the public policy of protecting innocent victims of motor vehicle accidents to be a decisive factor.[9]

On February 18, 1966, Albert Kennedy, an insured under the Factory Mutual policy issued to his wife, was involved in a collision with Norman and Myrnai Barkoot. On February 25, 1966, Kennedy was served with a Summons (Complaint not served). On March 23, 1966, Kennedy was served with the Complaint. No answer or other pleading was served on Barkoot's counsel, resulting in a default judgment being entered against Kennedy in the Richland County Court of Common Pleas on May 12, 1966. Though the testimony before the master was in conflict, it was decided as a matter of fact that Factory Mutual received no notice of the collision until July 29, 1967.[10] On May 31, 1968, an order was entered opening the default, under which Factory Mutual filed an answer, reserving its right to contest the applicability of the policy.[11] Factory Mutual then filed for a declaratory judgment asking the court below to find that it owed no duty to defend or indemnify Kennedy in the civil action by virtue of his failure to comply with the notice provisions of the policy in question.[12] Along with Kennedy, his wife and the Barkoots, Factory Mutual named Fireman's Fund American Insurance Company, the uninsured motorist carrier for the Barkoots, as a defendant.[13]

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9. *Id.* at 381, 182 S.E.2d at 729.

10. Record at 71.

11. Record at 72.

12. Record at 3-7.

13. In retrospect, a question is raised on the advisibility of adding Fireman's Fund as a defendant in the case. The question is not clearly answered in this state. S.C. Code Ann. §10-2008 (1962) provides that ". . . all persons shall be made parties who have or claim any interest which would be affected by the declaration, and no declaration shall prejudice the rights of persons not parties to the proceeding. . . ." It is clear that the Barkoots were necessary parties under the authority of *Pharr v. Canal Ins. Co.*, 233 S.C. 266, 104 S.E.2d 394 (1958). But whether Fireman's Fund could be considered as such a party has not been ruled on. It would seem that Fireman's Fund's obligation, if any, would have depended solely upon whether they owed the Barkoots under a separate policy, not involved in the litigation, which obligation would only become a right upon payment and under the subrogation provisions of its policy. Since the Barkoots did not appeal the ruling below, Fireman's Fund's complaint would have been with the failure of the Barkoots to appeal rather than the result of the litigation in the Court of Common Pleas. This writer recognizes the mootness of the point in respects of this case and further that sub-

The Master found, *inter alia,* that an unreasonable delay in giving notice of an accident or in forwarding suit papers was sufficient, irrespective of prejudice to the insurer, to relieve the insurer of its obligation to defend and indemnify its policyholder.[14] This ruling was appealed and, thus presented the court with its first opportunity[15] to resolve whether prejudice to the insurer was to be a prerequisite to the avoidance of the obligations imposed by the policy when (A) there has been an alleged breach of the notice requirments of the policy and (B) the rights of an innocent third party might be affected by the avoidance.[16] In resolving the issue, the court *held,*

> We think the sound rule to be that, in an action affecting the rights of innocent third parties under an automobile liability insurance policy, the noncompliance by the insured with policy provisions as to notice and forwarding of suit papers will not bar recovery, unless the insurer shows that the failure to give such notice has resulted in substantial prejudice to its rights.[17]

II. DEVELOPMENT OF THE RULE

A. *Prior Case Law*

Prior cases decided by the South Carolina Supreme Court, though not directed to the specific question resolved in *Factory Mutual v. Kennedy,* contain considerable discussion of the no-

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stantial conjecture on the probable conduct of the parties raises the question in the first instance, but does feel this alternative remains to be explored by our court.

14. Record at 87.

15. One earlier case, *Squires v. Nat'l. Grange Mut. Ins. Co.,* 247 S.C. 58, 145 S.E.2d 673 (1965) mentioned prejudice in the context of the notice clause, but seems to have turned on the Court's interpretation of the phrase "as soon as practicable." *Id.* at 67-68, 145 S.E.2d at 678.

16. One may question whether, in a strict sense, the rights of an innocent third party were at stake in *Factory Mut. v. Kennedy.* The Barkoots had uninsured motorists coverage with Fireman's Fund which must, according to S.C. CODE ANN. §46-750.14 (1962), provide limits of recovery identical (with the exception of a $200.00 property damage deductible) to that required of an assigned risk policy by S.C. CODE ANN. §46-750.13 (1962). Mr. Kennedy was allegedly insured under the assigned risk plan by Factory Mutual.

Consequently, the Barkoots had a maximum potential recovery under either policy of $20,000.00 for bodily injury. The balance of the judgment would have been the individual obligation of defendant Kennedy. It might also be noted that the appellant was Fireman's Fund. *See* note 13, *supra.*

17. 256 S.C. 376, 381, 182 S.E.2d 727, 729-30.

tice requirements in various type policies. Other cases, usually dealing with the cooperation clause in automobile liability policies, have discussed the rights and duties of the primary parties to the contract, as well as those of interested third parties. From a composite of these cases it is not at all surprising that the Federal District Court of South Carolina would find that, "It is unnecessary to determine whether the insurers were prejudiced by the delay since the question of prejudice has been held immaterial in such cases."[18]

The case law which led the District Court to this decision, along with other cases could best be said to have begun with *Free v. United Life & Accident Insurance Co.*,[19] and *Lee v. Metropolitan Life Insurance Co.*[20] In each of these cases a policyholder was denied certain first party benefits as a result of an alleged breach of notice conditions contained in the policies.[20a] In *Lee* the court, citing *Free*, stated,

> No rule of law is more firmly established in this jurisdiction than that one suing on a policy of insurance, where notice required by the policy is not timely given, cannot recover. And the Court has gone so far as to hold that the failure to give the required notice in the alloted time is fatal to the right of recovery, even if it be shown that the insurance company has suffered no harm by the delay.[21]

In the later cases of *Boyle Road & Bridge Co. v. American Employers' Insurance Co.*[22] and *Hatchett v. Nationwide Mutual Insurance Co.*[23] the court seemed to reinforce the rule stated in *Free* and *Lee*.[24]

18. Bruce v. U.S.F&G. Co., 277 F. Supp. 439, 445 (D.S.C. 1967).

19. 178 S.C. 317, 182 S.E. 754 (1935).

20. 180 S.C. 475, 186 S.E. 376 (1936).

20a. The use of the term "first party" refers to the insured; "second party," the insurer; and, "third party", any claimant not a party to the insurance contract.

21. *Id.* at 486, 186 S.E. at 381.

22. 195 S.C. 397, 11 S.E.2d 438 (1940).

23. 244 S.C. 425, 137 S.E.2d 608 (1964).

24. Both of these actions were, again, first party actions. In *Boyle* the court refused to pass the burden of a default judgment on an employer's liability loss to the insurer when it found the neglect of Boyle in failing to notify its insurer led to the default. In *Hatchett* the court again refused to require payment by the insurer in a default situation on an uninsured motorist policy when the case was irretrievably in default prior to the forwarding of notice to the insurer. However, in neither case did the court indicate dissatisfaction with *Free* and *Lee*, nor did it specifically state the rule on notice was being modified.

These cases coupled with the court's position on third party rights under an insurance contract would have allowed some to conclude that the notice condition must be complied with precedent to any recovery from the insurer by any interested party, irrespective of prejudice to the insurer.[25]

The court was, however, developing a line of authority in another closely related area which was to have a decisive effect on the *Kennedy* situation. In *Pharr v. Canal Insurance Co.*,[26] among other questions, the court was confronted with an alleged breach of both the notice and cooperation conditions of an automobile liability policy. In that case Canal's policyholder never gave notice of the accident or suit to Canal and failed or refused to meet with Canal's attorneys, who were attempting to defend the action. The only notice received by Canal was from the attorneys for Pharr. In reversing a directed verdict in favor of Canal, the court held, *inter alia*, a jury question was presented on whether the alleged breach of the cooperation clause had, in fact, taken place and ". . .whether such failure to cooperate has operated to the substantial prejudice of the insurer. . . ."[27]

On the question the court stated:

> The attorneys for the respondents sent copies of the suit papers, in each of the cases, to the adjuster, who forwarded them to the appellant. In the case of *Royal Indemnity Co. v. Morris*, 9 Cir., 37 F. (2d) 90, it

25. In *Crook v. State Farm Mut. Ins. Co.*, 235 S.C. 452, 460, 112 S.E.2d 241, 245 (1960), the court said,

> "[T]he injured person has no greater right under the liability policy than has the insured. . . . The present action is one plainly upon contract. It is, therefore, subject to any proper defense by the Insurance Company under the terms of its contract. The issue between the parties here is the same as it would be had the assured brought the action. *Crook v. State Farm Mut. Ins. Co.*, 231 S.C. 257, 98 S.E.2d 431."

And, in *Park v. Safeco Ins. Co.*, 251 S.C. 410, 413, 162 S.E.2d 709, 710 (1968), the court stated, "An injured person has no greater right against an insurer under a liability insurance policy than the insured."

26. 233 S.C. 266, 104 S.E.2d 394 (1958).

27. *Id.* at 282, 104 S.E.2d at 402. In stating that the insurer must show it was "substantially prejudiced" by the insured's failure to cooperate, the court cited, with approval, *Am. Fire & Cas. Co. v. Vliet*, 148 Fla. 568, 4 So.2d 862 (1941). Interestingly, Florida also requires prejudice to the insurer as a condition of forfeiture, but presumes prejudice from delayed notice and places the burden on the proponent of the policy. *See*, Niesz v. Albright, 217 So.2d 606 (Fla. App. 1969); Fidelity & Cas. Co. v. Tiedtke, 207 So.2d 40 (Fla. App. 1968).

> was held that the failure of the insured to forward copies of the summons and complaint to the insurer was no defense to recovery on the policy where the insurer was given timely notice by the mailing to it of a copy of the summons and complaint by the Plaintiff in the action.[28]

The holding in *Pharr* was followed by the court in the later cases of *Crook v. State Farm Mutual Ins. Co.*[29] and *Squires v. National Grange Mutual Ins. Co.*[30] In *Crook* the court merely reaffirmed the rule as stated in *Pharr* in relation to the insurer's burden when asserting a forfeiture by virtue of an alleged breach of the cooperation clause. In *Squires,* we find the first indications that the court might be amenable to the expansion of the *Pharr* rule to cover other conditions in an automobile liability policy. The court was squarely faced with a contention by an uninsured motorist carrier that its policyholder had breached the conditions requiring Proof of Claim as soon as practicable and in not providing proper notice of a legal action. In considering the issues the court stated:

> It is well settled that, unless waived by the insurer, the failure of an insured to comply with policy provisions as to notice or forwarding suit papers, which are by the terms of the contract made conditions precedent to liability, will bar recovery. *Hatchett v. Nationwide Mutual Ins. Co.,* 244 S.C. 425, 137 S.E. (2d) 608. The burden of proof is upon the insurer to show not only that the insured has failed to perform the terms and conditions invoked upon him by the policy contract but in addition that it was substantially prejudiced thereby. *Pharr v. Canal Ins. Co.,* 233 S.C. 266, 104 S.E.(2d) 394, and *Crook v. State Farm Mutual Ins. Co.,* 235 S.C. 452, 112 S.E.(2d) 241.[31]

However, the court did not find it necessary to rely on *Pharr*

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28. *Id.* at 279-80, 104 S.E.2d at 401. Since the case appears to have turned on the cooperation issue, this statement could well be considered as dictum. However, even though the court made no further comment on the notice issue, the Ninth Circuit decision was cited with apparent approval implying that the insured may be totally relieved of the responsibility of providing notice if the *plaintiff* provides timely notice.

29. 235 S.C. 452, 112 S.E.2d 241 (1960).

30. 247 S.C. 58, 145 S.E.2d 673 (1965).

31. *Id.* at 67, 145 S.E.2d at 677. It should be noted that the first quoted paragraph is directly quoted from *Hatchett* (244 S.C. at 250, 137 S.E.2d at 613) while the second quoted paragraph appears to substantially broaden the actual statement in *Pharr* (233 S.C. at 278-79, 104 S.E.2d at 667) by deleting any reference to the cooperation clause which was at issue in the *Pharr* case.

or *Hatchett* in reaching its decision. Relying on other cases,[32] the court found that the policyholder had given notice of the claim "as soon as practicable" making any consideration of prejudice to the insurer moot. *Hatchett,* it was decided, did not control the result in *Squires* due to clearly distinguishing factual considerations.[33] The rule requiring substantial prejudice, nevertheless, was stated and was subsequently relied on in *Kennedy.*[34]

B. Public Policy Considerations

An attempt to characterize *Kennedy* as a misconstruction of precedent or as an unfounded departure from accepted doctrine would be begging the question. The statement of the "new rule" in this case was, more importantly, the end result of the court's considered recognition of a pressing public interest in protecting innocent victims of automobile accidents from economic loss.[35] Those who would criticize the court's posture after *Kennedy* might say the court has, "under the guise of public policy",[36] changed the terms of the agreement. But, has it? May not, and should not, the court look beyond the technical terms of the policy and, where reasonable, effectuate its basic purpose? As the Federal District Court for South Carolina stated, "In construction of insurance contracts, courts should not ignore the fact that the primary object of all insurance is to insure. . . ."[37]

For many years the courts have recognized that the insurance contract is of a separate breed which should be con-

32. Allstate Ins. Co. v. Jahrling, 16 A.D.2d 501, 229 N.Y.S.2d 707 (1962); Brown v. Motor Vehicle Accident Indem. Corp., 24 Misc.2d 550, 206 N.Y.S.2d 294 (1960); North River Ins. Co. v. Gibson, 244 S.C. 393, 137 S.E.2d 264 (1964); Brown v. State Farm Mut. Ins. Co., 233 S.C. 376, 104 S.E.2d 673 (1958).

33. 247 S.C. at 70, 145 S.E.2d at 679.

34. 256 S.C. at 381, 182 S.E.2d at 730. Or, considering the statements in *Squires* as *obiter dicta,* one may correctly say the "rule" was first stated for value as precedent in *Kennedy.*

35. *Id.* at 380, 182 S.E.2d at 729. The consideration of the importance of the public policy issue cannot be properly diminished by the fact that the Barkoots only stood to lose a maximum of $200.00 in this case, as discussed in note 16 *supra,* had the judgment of the lower court been affirmed. Nor does the fact that the "innocent victim" did not appeal diminish the importance of the court's decision.

36. Stanky v. Reserve Ins. Co., 238 S.C. 533, 538, 121 S.E.2d 10, 13 (1961). Also cited in note 6, *supra.*

37. Heffron v. Jersey Ins. Co., 144 F. Supp. 5, 9 (D.S.C. 1956).

strued favorably toward the policyholder, not the result of arms-length bargaining by parties possessed of equal power.[38] With this rule of construction firmly embedded in our law, it should not seem inconsistent that other public policy areas would be considered. In the early case of *Ott v. American Fidelity & Casualty Co.*,[39] the court applied legislation requiring public passenger carriers to purchase and maintain public liability insurance.[40] In giving effect to the acknowledged legislative purpose, the court said,

> It appears to us that to allow the insured's failure to give notice of the accident to prevent the injured person's recovery would be to pratically nullify the statute by making the enforcement of the rights of the person intended to be protected dependent upon the acts of the very person who caused the injury.[41]

In another case area the court again has pointed out that a breach of policy conditions would not be allowed to defeat recovery by the injured party if the policyholder was insured under a "certified" policy because of a specific legislative mandate.[42]

One of the first clear statements of public policy in the absence of a direct legislative act in the general area of insurance appeared in *Evans v. American Home Assurance Co.*[43] The case dealt with an insured who failed to appear for trial of a civil action and the company's resulting refusal to pay a judgment. The company's position was based on an alleged violation of the cooperation condition in the policy. Though the court reached its decision on the basis of earlier holdings in *Pharr* and *Crook*, the public policy rationale first stated in

38. *See, e.g.*, Am. Fire & Cas. Co. v. Allstate Ins. Co., 214 F.2d 523 (4th Cir. 1954); S.S. Newell & Co. v. Am. Mut. Liab. Ins. Co., 199 S.C. 325, 19 S.E.2d 463 (1942). Admittedly the courts have generally required that some ambiguity exist which would lend itself to an interpretation in favor of a policyholder. However, most close observers of the broad range of cases in this area would agree that ambiguities have been found in unsuspected areas, and that public policy has been the driving force behind many decisions, whether specifically identified as such, or not.

39. 161 S.C. 314, 159 S.E. 635 (1931).

40. Cited as 34 Stat. at Large, p. 255, §5 (1925).

41. 161 S.C. at 319, 159 S.E. at 637.

42. Though clearly dictum, the Court cited S.C. CODE ANN. §46-707(7)(b) (Supp. 1970) as an expression of *public policy* in *Evans v. Am. Home Assur. Co.*, 252 S.C. 417, 166 S.E.2d 811 (1969).

43. *Id.* at 420, 166 S.E.2d at 812.

Evans was to reappear as an important part of *Kennedy*.[44] It is here we find reference to the "innocent victim" and "protection" as operative points in the decision making process. We see the court moving toward considerations outside the language of the contract in giving effect to the public purpose of insurance rather than the private purpose of the parties to the contract itself.[45]

CONCLUSIONS

The result in *Kennedy* places South Carolina in a minority position with respect to the requirement of prejudice to the carrier prior to a forfeiture of benefits by the third party. At least twelve other jurisdictions are squarely in line with not only the new South Carolina rule, but with the policy rationale used in reaching it.[46] At least one state presumes prejudice and, thereby shifts the burden of proof to the person claiming the benefits of the policy,[47] while a majority of the jurisdictions find prejudice immaterial in their deliberations.[48]

It should be recalled that *Kennedy* purports to deal with *only* the rights of innocent third parties who have been injured by the policyholder. There is no reason to assume the holdings in *Free* and *Lee* have been disturbed as they apply to first party losses. In view of this an unresolved question may remain in the area of uninsured motorists coverage.[49] In the

44. 256 S.C. at 381, 182 S.E.2d at 729.

45. To discuss the appropriateness of resting decisions on public policy or purpose is, this writer feels, outside the scope of this article. The principle is so well grounded in our system of jurisprudence little could be added to the many prior publications in this area.

46. Miller v. Lindgate Developers, Inc., 274 F. Supp. 980 (E.D. Mo. 1967); Lindus v. Northern Ins. Co., 103 Ariz. 160, 438 P.2d 311 (1968); Campbell v. Allstate Ins., Co., 60 Cal. 2d 303, 384 P.2d 155, 32 Cal. Reptr. 827 (1963); Weller v. Cummins, 330 Mich. 286, 47 N.W.2d 612 (1951); Cooper v. Gov't Employees Ins. Co., 51 N.J. 86, 237 A.2d 870 (1968); Nationwide Mut. Ins. Co. v. Motorists Mut. Ins. Co., 116 Ohio App. 22, 186 N.E.2d 208 (1961); Fox v. Nat'l Savings Ins. Co., 424 P.2d 19 (Okla. 1967); Nationwide Mut. Ins. Co. v. Gentry, 202 Va. 338, 117 S.E.2d 76 (1960); *cf.* Motorists Mut. Ins. Co. v. Johnson, 139 Ind. App. 622, 218 N.E.2d 712 (1966) (Cooperation clause); *but cf.* U.S.F.&G. Co. v. Gable, 125 Vt. 519, 220 A.2d 165 (1966).

47. *See,* Fidelity & Cas. Co. v. Tiedtke, 207 So.2d 40 (Fla. App. 1968).

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

49. This coverage is decidedly "first party" by virtue of the contract. *Squires,* as indicated above, implied the court would look to the question of prejudice, but did not so hold.

instances of collision losses, accident and health claims, disability claims, fire or homeowner losses and life insurance claims, the rationale of *Free* and *Lee* would still appear to control, thus requiring strict compliance with the notice conditions of the various policies as a condition precedent to recovery.

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