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## AT THE APEX OF THE ARC OF THE PENDULUM

### *DOES FDIC v. INA<sup>1</sup> SPELL THE BEGINNING OF THE END OF THE NOTICE PREJUDICE RULE IN FIDELITY CASES?*

*Richard S. Mills and Frederick M. Zauderer*

*In physics, when a simple pendulum has swung as far as possible, the bob reaches a point of extreme excursion of the arc where, for an instant, the swing is arrested, kinetic energy is at a minimum, and potential energy is at a maximum. In the next instant, the momentum shifts and the pendulum begins to swing the other way ...*

#### I. INTRODUCTION

The purpose of this article is threefold. First, to analyze the decisions of the district and appellate courts in *Federal Deposit Insurance Corp. v. Insurance Co. of North America*<sup>2</sup> which, notwithstanding Massachusetts' ostensible adherence to the Notice Prejudice Rule, refused to require the fidelity insurer to demonstrate that it was prejudiced by the insured's late notice of a claim in a case governed by Massachusetts law. Second, to suggest that courts shall adopt the traditional condition precedent analysis in analyzing the issue of late notice. And third, to provide claim professionals and counsel with a reference tool by which they can readily determine whether and to what extent a particular jurisdiction requires fidelity insurers to demonstrate prej-

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<sup>1</sup> 928 F. Sup. 54 (D. Mass. 1996), *aff'd*, 105 F.3d 778 (1st Cir. 1997).

<sup>2</sup> 105 F.3d 778 (1st Cir. 1997) [hereinafter *FDIC v. INA*].

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udice resulting from an insured's late notice of a claim, late proof of loss, or late suit.<sup>3</sup>

*A. The Notice Prejudice Rule*

During the 1930s and 40s, certain state courts began to depart from the common law of contracts to alleviate the result from application of the notice provisions of an insurance policy which regularly are included as conditions precedent to coverage in standard form insurance contracts. Starting in the 1950s, various state legislatures codified these holdings, enacting statutes abrogating the common law, thereby codifying what has since come to be known as the Notice Prejudice Rule,<sup>4</sup> which may be stated simply as follows:

Regardless of any policy provision conditioning coverage upon the receipt of timely notice of loss by the insurer, it is incumbent upon the insurer to demonstrate that it has been substantially prejudiced by reason of the insured's late notice before it is relieved of liability under the policy.

In general, this Rule, whether embodied in court decisions or statutory provisions, was designed to counteract the common law rule pursuant to which the notice provisions contained in an insurance policy were strictly enforced as conditions precedent to recovery.<sup>5</sup>

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<sup>3</sup> In this regard, we note the seminal work published by the Practising Law Institute over ten years ago in its Litigation and Administrative Practice Course Handbook Series [320 PLI/Lit 189] PLI Order No. H4-5010, *Insurance, Excess, & Reinsurance Coverage Disputes* 1987, SURVEY OF THE LAW RELATING TO THE DEFENSE OF LATE NOTICE AND WHETHER THE INSURER MUST SHOW PREJUDICE (PLI Jan. 1, 1987); see also Charles C. Marvel, Annotation, *Modern Status of Rules Requiring Liability Insurer to Show Prejudice to Escape Liability Because of Insured's Failure or Delay in Giving Notice of Accident or Claim, or in Forwarding Suit Papers*, 32 A.L.R. 4th 141 (1984); see also Comment, *The Materiality of Prejudice to the Insurer as a Result of the Insured's Failure to Give Timely Notice*, 74 DICK. L. REV. 260, 261, 262 (1970); Edward Etcheverry, *Discovery, Notice, Proof of Loss & Suit Limitations*, COMMERCIAL CRIME POLICY COURSE MATERIALS (Fid. Sur. Comm. T.I.P.S., A.B.A. 1996); Lawyers Co-operative Publishing Co., Annotation, *Effect of Failure to Give Notice or Delay in Giving Notice or Proof of Loss, upon Fidelity Bond or Insurance*, 23 A.L.R.2d 1065 (1952).

<sup>4</sup> Maryland was the first state to enact a statute requiring a liability insurer to demonstrate that the insured's delay in giving notice resulted in prejudice to the insurer. MD. CODE ANN. (1957, 1994 Repl. Vol.) Art. 48A, §482. Other states soon followed; see e.g., MASS. GEN. L. ch. 175 §112; MICH. COMP. LAWS ANN. §500.3009 (West 1983); UTAH CODE ANN. § 31 A-21312(2); WIS. STAT. ANN. §§ 631.81, 632.26(2) (1997).

<sup>5</sup> In resisting judicial abrogation of private insurance contracts in this manner, at least one judge has argued (unsuccessfully) that the alteration of the right to contract freely is better left to the legislative and executive branches. See *Jones v. Bituminous Cas. Co.* 821 S.W.2d 798 (Ky. 1991) (dissenting opinion).

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The three most widely followed methods employed by courts to resolve late notice of claim issues are neatly summarized by the Tenth Circuit Court of Appeals in *Jennings v. Horace Mann Mutual Insurance Co.*,<sup>6</sup> as follows:

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.<sup>7</sup>

One can easily see how judges and legislators believed that the "modern rule" would alleviate an unduly harsh result - the forfeiture of (liability) insurance coverage that ensued whenever an insured's notice of claim was late. In the majority of states where the legislature did not enact a prejudice requirement, the courts took the lead, imposing as a prerequisite to the successful assertion of a late notice defense that the insurer demonstrate actual prejudice resulting from the insured's delay in providing notice of a claim.

### *B. Contracts of Adhesion*

The leading recent cases rejecting the strict contractual approach all purport to interpret notice conditions in insurance contracts "in accord with the reasonable expectations of the parties."<sup>8</sup> One of the principal justifications offered for the departure from application of strict contract law to insurance cases was succinctly stated by the Supreme Court of Pennsylvania when it rejected a condition precedent analysis in favor of the notice prejudice rule:

The rationale underlying the strict contractual approach reflected in our past decisions is that courts should not presume to interfere with the freedom of private contracts and redraft insurance policy provisions where the intent of the parties is expressed by clear and unambiguous language. We are of the opinion, however, that this argument, based on the view that insurance policies are private contracts in the traditional sense, is no longer persuasive. Such a position fails to recognize the true nature of the relationship between insurance companies and their insureds. An insurance contract is not a negotiated agreement; rather, its conditions are by and large dictated by the insurance company to the insured. The only aspect of this

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<sup>6</sup> 549 F.2d 1364 (10th Cir. 1977).

<sup>7</sup> *Id.* at 1367-68 (citations omitted).

<sup>8</sup> 8. See *State Farm Mut. Auto. Ins. Co. v. Milam*, 438 F. Supp. 227 (S.D. W. Va. 1977); *Johnson Controls, Inc. v. Bowes*, 409 N.E. 2d 185 (Mass. 1980); *Cooper v. Government Employees Ins. Co.*, 51 N.J. 86, 237 A.2d 870 (N.J. 1968); *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193 (Pa. 1977); *Pickering v. American Employers Ins. Co.*, 282 A.2d 584 (R.I. 1971).

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contract over which the insured can "bargain" is the monetary amount of coverage.<sup>9</sup>

The New Jersey Supreme Court echoed this approach:

[W]e have recognized that the terms of an insurance policy are not talked out or bargained for as in the case of contracts generally, that the insured is chargeable with its terms because of a business utility rather than because he read or understood them, and hence an insurance contract should be read to accord with the reasonable expectations of the purchaser so far as its language will permit. And although the policy may speak of the notice provision in terms of "condition precedent," ... nonetheless what is involved is a forfeiture; for the carrier seeks, on account of a breach of that provision, to deny the insured the very thing paid for.<sup>10</sup>

By contrast, the First Circuit has recognized that these contract of adhesion and unequal bargaining position arguments simply do not apply in the fidelity insurance context, where the standard form contract has been the product of years of arms length negotiation between the insurance industry and the brokerage and banking industries:

Here, in contrast, the Bond is an agreement whose basic terms are negotiated between two industries. Over the years, the banking industry and the fidelity bond companies have negotiated various standard forms of the Financial Institution Bonds. As one commentator has noted, 'the fidelity bond is an arms length, negotiated contract between sophisticated business entities, the standard form for which was drafted by the joint efforts of the Surety Association of America and the American Bankers Association.' For example, at the request of the American Bankers Association, the 1986 Bond added coverage for Uncertificated Securities, and adopted the UCC definitions of these financial instruments.<sup>11</sup>

Similarly, New York's appellate courts have recognized that the current Stockbrokers Blanket Bond is the product of negotiations between representatives of the securities industry and various fidelity insurers.<sup>12</sup> In 1976, the New York Stock Exchange formed the Securities Industry Insurance Committee to study the existing fidelity bond coverage and to meet with representatives of the insurance industry periodically to negotiate proposed revisions to the standard form Brokers Blanket Bond.<sup>13</sup> For example, after the Surety Association of America's Financial Institutions Revision Sub committee proposed extensive revisions to the Brokers Blanket Bond in

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<sup>9</sup> *Brakeman*, 371 A.2d at 196.

<sup>10</sup> *Cooper*, 237 A.2d at 873-874 (citations omitted).

<sup>11</sup> *FDIC v. INA*, 105 F.3d at 786 (citations omitted).

<sup>12</sup> *Aetna Cas. & Sur. Co. v. Kidder, Peabody & Co., Inc.*, No. 89, 89A, 1998 N.Y. App. LEXIS 8818 (N.Y. Ct. App. Aug. 6, 1998) (distinguishing fidelity insurance from liability insurance).

<sup>13</sup> See Memorandum No. 71-41, New York Stock Exchange Information (Oct. 7, 1977).

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1986, the NYSE committee submitted a letter regarding the proposed revisions to the SAA,<sup>14</sup> and on March 3 and 4, 1987, representatives of the two industries met to consider, and deliberate the revisions.<sup>15</sup>

The ongoing dialogue and periodic negotiations between representatives of the securities industry, the banking industry and the insurance industry concerning the standard form insurance policies, pursuant to which employee fidelity coverage is generally made available, belies the assertion that employee fidelity policies are contracts of adhesion offered on a take it or leave it basis. Nevertheless, some courts apparently find that following what they have been told is the "modern trend," heeding dramatic rhetoric about "take it or leave it" contracts irresistible.

In *National Union Fire Insurance Co. of Pittsburgh, Pennsylvania v. Federal Deposit Insurance Corp.*,<sup>16</sup> the Supreme Court of Kansas was asked, via a certified question from the Court of Appeals for the Tenth Circuit, whether, in effect, Kansas would extend the Notice Prejudice Rule to require a fidelity insurer to demonstrate that it had been prejudiced by the untimely filing of a proof of loss. In answering that the Notice Prejudice Rule was applicable to fidelity policies, the supreme court noted, "Both parties contend that the modern trend favors them. Based on the authority cited by the parties, it appears that FDIC has the better position on this question." It also is evident that the FDIC had not drawn the attention of the Kansas court to the recent decision of the First Circuit Court of Appeals in *FDIC v. INA*.

Relying upon the findings made by the Pennsylvania Supreme Court in *Brakeman*, with respect to a liability policy,<sup>17</sup> the Kansas court laid down its *ratio decidendi*:

Given that insurance contracts are not negotiated agreements, no compelling reason appears for allowing the insurer to avoid performing a duty purchased by the insured's premium unless the insured's delay caused loss to the insurer. This would be true for both notice of loss and proof of loss provisions in the policy or bond. Thus, we conclude that an insurer must prove prejudice before denying coverage based on a late filing of proof of loss.<sup>18</sup>

Thus, at a stroke (and without any analysis of the contrary view expressed in *FDIC v. INA*), the Kansas court transmogrified an insurance contract that had been negotiated by the American Bank-

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<sup>14</sup> See letter from NYSE Chairman to SAA (January 28, 1987).

<sup>15</sup> See Surety Association of America's Memorandum Financial Institutions Revision Subcommittee on the meeting of March 3, 1987, and March 4, 1987 (March 10, 1987).

<sup>16</sup> No. 79,825, 1998 Kan. LEXIS 97 (Kan. April 17, 1998).

<sup>17</sup> *Brakeman*, 371 A.2d 193.

<sup>18</sup> *National Union Fire Ins. Co.*, 1998 Kan. LEXIS 97, at \*42.

ers Association and the Surety Association of America into a contract of adhesion. What makes the decision inexcusable is that the Kansas court purported to ground its decision upon an analysis of the "history" of the bankers blanket bond.<sup>19</sup> Apparently the court was not concerned with ascertaining whether its predicate for extending the notice prejudice rule - that the contract was not a negotiated agreement - had any basis in fact.<sup>20</sup>

A significant number of jurisdictions - Alabama,<sup>21</sup> Arkansas,<sup>22</sup> Colorado,<sup>23</sup> District of Columbia,<sup>24</sup> Georgia,<sup>25</sup> Montana,<sup>26</sup> Nebraska,<sup>27</sup> Nevada,<sup>28</sup> New Hampshire,<sup>29</sup> New York,<sup>30</sup> South Carolina,<sup>31</sup> Tennessee,<sup>32</sup> and Virginia<sup>33</sup> - have never departed from the traditional common law of contracts, and continue to enforce the notice provisions of insurance contracts - including those affording fidelity coverage - as written.<sup>34</sup> While there seems little immediate danger that one of these traditional states will apply the Notice

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<sup>19</sup> *Id.* at \*27.

<sup>20</sup> See *Resolution Trust Corp. v. Moskowitz*, 868 F. Supp. 634, 639-40 (D. N.J. 1994); see also *Federal Dep. Ins. Corp. v. Oldenburg*, 34 F.3d 1529 (10th Cir. 1994) (predicting that Utah would require showing of prejudice by fidelity insurer to succeed on late notice defense).

<sup>21</sup> *Pharr v. Continental Cas. Co.*, 429 So. 2d 1018 (Ala. 1983) (relevant factors are length of delay and reasons therefor; prejudice to the insurer is irrelevant); cf. *State Farm Mut. Ins. Co. v. Burgess*, 474 So. 2d 634 (Ala. 1985) (insurer must show prejudice in uninsured motorist cases).

<sup>22</sup> *Hartford Ace. & Indem. Co. v. Lloyd*, 173 F. Supp 7 (W.D. Ark. 1959).

<sup>23</sup> *Marez v. Dairyland Ins. Co.*, 638 P.2d 286 (Colo. 1981).

<sup>24</sup> *Hartford Ins. Group v. Liberty Mut. Ins. Co.*, 311 A.2d 506, (D.C. 1973).

<sup>25</sup> *Atlanta Int'l Properties, Inc. v. Georgia Underwriting Ass'n*, 256 S.W.2d 472 (Ga. Ct. App. 1979).

<sup>26</sup> *Glacier Gen'l Assur. Co. v. State Farm Mut. Auto Ins. Co.*, 436 P.2d 533 (Mont. 1968); *State Farm Mut. Ins. Co. v. Murnion*, 439 F.2d 945 (9th Cir. 1975).

<sup>27</sup> *MFA Mut. Ins. Co. v. Sailors*, 141 N.W.2d 846 (Neb. 1966).

<sup>28</sup> *State Farm Mut. Auto Ins. Co. v. Cassinelli*, 216 P.2d 606 (Nev. 1950).

<sup>29</sup> *Lumbermens Mut. Cas. Co. v. Oliver*, 335 A.2d 666 (N.H. 1975); *Commercial Union Assur. Co. v. Monadnock Regional School Dist.*, 428 A.2d 894 (N.H. 1981).

<sup>30</sup> *Security Mut. Ins. Co. v. Acker-Fitzsimons Corp.*, 293 N.E.2d 76 (N.Y. 1972); *Power Authority v. Westinghouse Electric Corp.*, 117 A.D.2d 336, (N.Y. 1986).

<sup>31</sup> *Humana Hospital-Bayside v. Lightle*, 407 S.E.2d 637, 639 (S.C. 1991).

<sup>32</sup> *McKimm v. Bell*, 790 S.W.2d 526, 527 (Tenn. 1990).

<sup>33</sup> *Dairyland Ins. Co. v. Hughes*, 317 F. Supp. 928 (W.D. Va. 1979); *State Farm Ins. Co. v. Porter*, 272 S.W.2d 196 (Va. 1980).

<sup>34</sup> The law, as enforced by the courts of these states, is summarized in the survey portion of this article. See Section III, *infra*.

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Prejudice Rule in a fidelity case in the first instance, the possibility always exists that - given a compelling liability case involving severe personal injuries and the denial of insurance coverage due to late notice - one of the courts in these traditional states will abandon the strict contractual approach.<sup>35</sup> It is therefore important to distinguish fidelity insurance and liability insurance in any case where the late notice issue is litigated, irrespective of the late notice jurisprudence of the forum state.

There admittedly appears to be little hope of reforming the law in those states expressly committed to following the Notice Prejudice Rule in fidelity cases. However, for those states that have not adopted the Notice Prejudice Rule in relation to fidelity policies, *FDIC v. INA*<sup>36</sup> provides a principled basis for persuading courts - even those committed to the Notice Prejudice Rule generally - to follow a condition precedent analysis when presented with the issue of late notice in the context of fidelity insurance.

## II. THE "POST MODERN TREND" REJECTING PREJUDICE ANALYSIS IN FIDELITY BOND CASE

### A. *FDIC v. INA*

In *FDIC v. INA*,<sup>37</sup> the United States District Court for Massachusetts held that the insured bank's<sup>38</sup> failure to provide the Insurance Company of North America with timely notice of its fidelity claim constituted a failure by the insured to satisfy a condition precedent to recovery for a loss that would otherwise have been encompassed by Insuring Agreement (A) of INA's standard form Financial Institution Bond. The case is noteworthy because,<sup>39</sup>

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<sup>35</sup> See Kentucky Summary, *infra*.

<sup>36</sup> 928 F. Supp. 54 (D. Mass. 1996) *aff'd*, 105 F.3d 778 (1st Cir. 1997).

<sup>37</sup> *Id.*

<sup>38</sup> The Federal Deposit Insurance Corporation took over the bank when it was put into receivership on March 20, 1992.

<sup>39</sup> The facts of the case are as follows: from 1987 to 1989, two officers of the insured conspired with a condominium development group, the Rostoff Group, to make hundreds of mortgage loans using inflated appraisals and purchase prices. Despite the fact that the insured had exceeded their participation allowance, in violation of bank regulations and the law, the insured continued to make loans on condominium projects with the Rostoff Group until February, 1989. In March, 1989, the insured received a letter from counsel for a former bookkeeper of the Rostoff Group, stating that the bookkeeper had defaulted on her loans, and accused bank officers and counsel of conspiring in a loan fraud. The insured investigated these charges. Later that year, more defaulting borrowers sued the insured for damages and asserted counterclaims for fraud in a foreclosure action brought by the bank. In January, 1990, the insured delivered INA notice of a potential loss arising from employee misconduct.

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notwithstanding the Massachusetts legislature's enactment of a statutory Notice Prejudice Rule,<sup>40</sup> and a number of decisions by the courts of the commonwealth extending and defining the scope of the Rule,<sup>41</sup> the district court concluded that, "if notice to INA was untimely, the bank is precluded from recovery, regardless of whether INA can prove any actual prejudice as a result of the delay."<sup>42</sup>

In rejecting application of the Notice Prejudice Rule, the district court (and later the circuit court) examined each of the reasons commonly offered as a justification for the Rule and found them to be inapposite in the context of fidelity insurance. The absence of specific Massachusetts case law<sup>43</sup> extending the scope of the Rule to fidelity insurance<sup>44</sup> permitted these courts to undertake an intellectually honest appraisal of the Rule, unencumbered by the type of result oriented precedents that have perverted the law in other jurisdictions. In addition to leading to the right result in the case at hand, the court's analysis exposes the jurisprudential bankruptcy of those decisions in other jurisdictions which have applied the Notice Prejudice Rule to fidelity insurance disputes.

### 1. Purpose of the Notice Provisions

The district court predicated its decision upon a straightforward appraisal of the purpose of the timely notice requirement. The accepted purpose of notice provisions is to permit insurers to investigate the occurrence giving rise to a claim. The court found that requiring timely notice, and thereby timely claim investigation, also helps to facilitate fairness in rate setting.<sup>45</sup> Another purpose of reporting requirements in insurance contracts is the protection of

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<sup>40</sup> MASS. GEN. L. ch. 175, § 112 (requiring a showing of prejudice in the context of late notice of automobile liability insurance claims); *see also* Goodman v. American Cas. Co., 643 N.E.2d 432, 434 (Mass. 1994) (extending Notice Prejudice Rule applicable to automobile liability coverage to uninsured motorist coverage); *accord* Maclnnis v. Aetna Life & Cas. Co., 526 N.E.2d 1255 (Mass. 1988).

<sup>41</sup> *See* Johnson Controls, Inc. v. Bowes, 409 N.E.2d 185 (Mass. 1980) (creating a common law notice prejudice rule for liability policies); *see also* Chas. T. Main, Inc. v. Fireman's Fund Ins. Co., 551 N.E.2d 28 (Mass. 1990) (limiting the notice prejudice rule in the context of liability policies); Darcy v. Hartford Ins. Co., 554 N.E.2d 28 (Mass. 1990).

<sup>42</sup> FDIC v. INA, 928 F. Supp. at 59.

<sup>43</sup> The parties agreed that Massachusetts law applied. *Id.* at 799 n.1.

<sup>44</sup> *Id.* at 783. "The supreme judicial court has never applied the notice prejudice rule to a Financial Institution Bond;" "when guidance is sought from Massachusetts case law concerning fidelity policies, that law, admittedly not of recent vintage, does not require our adoption of the notice prejudice rule here." *Id.* at 784.

<sup>45</sup> *Chas T Main, Inc.*, 551 N.E.2d at 29.

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insurance companies (and those who depend on the solvency of the insurance companies) against fraud and moral hazard:

The obvious purpose of the requirement of written notice to the insurer under a fidelity bond is for the benefit of the insurer, and for reasons quite consistent with public interest in avoiding an incentive structure in which the existence of fidelity insurance might become an inducement to an employer to take risks of potential fraud of employees that an employer who had no fidelity coverage would not take. In short, the requirement of written notice when the possibility of a claim is first discovered, rather than allowing notice to be deferred until proof of fraud is in hand, is entirely compatible with public interest.<sup>46</sup>

The *FDIC v. INA* court clearly demonstrated that the notice provisions in fidelity bonds serve both private and public interests, and cannot be properly characterized as mere escape hatches designed to avoid liability.<sup>47</sup>

As other cases and commentators have explained, it is not only notice that is essential, but timely notice:

The primary purpose of a notice requirement in an insurance policy is to afford the insurer a reasonable opportunity to protect its rights. Prompt notice to the insurer maximizes an insurer's opportunity to acquire information about the circumstances of a loss (usually by way of a timely investigation when witnesses are most likely to be available and while their memories of the events are generally the most accurate, as well as when there is usually the best opportunity to examine, record, or preserve any physical evidence), which may be important both (1) to the insurer's determinations in regard to whether a loss is covered and (2) to the preparation of a defense to claims by a third party against an insured who is covered by a liability insurance policy.

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Timeliness provisions relating to the filing of claims are sometimes justified by insurers on the basis that they facilitate investigations which may ferret out fraudulent claims because fraud is best detected when the evidence is "fresh."<sup>48</sup>

These considerations — coupled with the absence of specific case authority extending Massachusetts' statutory Notice Prejudice Rule to fidelity policies - satisfied the district court that the notice provision contained in INA's policy should be applied as a condition precedent, and without

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<sup>46</sup> *FDIC v. INA*, 197 N.E. 673 (Mass. 1935) (citing *Boston Mut. Life Ins. Co.*, 613 F. Supp. at 1105 (citing *Gilmour v. Standard Surety & Cas. Co.*).

<sup>47</sup> Compare Louisiana Summary, *infra*.

<sup>48</sup> ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW* § 7.2(b) at 753,759 (1988) (citations omitted).

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imposing a prejudice requirement.<sup>49</sup> With that legal premise established, and even though the district court accorded the insured a generous finding concerning the date of discovery,<sup>50</sup> it was compelled by the facts to conclude that notice had not been timely given.<sup>51</sup>

On appeal, the United States Court of Appeals for the First Circuit found that the district court had been too generous to the insured in determining the date of discovery. The discovery clause in the standard bond at issue provided that discovery could occur in two ways:

(1) when the Insured first becomes aware of facts which would cause a reasonable person to assume that a loss of the type covered by this bond has been or will be incurred ....

and,

(2) when the Insured receives notice of an actual or potential claim in which it is alleged that the Insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond.

The court noted that the district court's reliance on the first delineation - which affords some latitude in determining when discovery is "reasonable" - was not the best way to analyze the claim, which involved counterclaims by defaulting borrowers who had alleged the dishonesty and fraud of the bank's officers. Noting that lawsuits and counterclaims brought by the defaulting borrowers plainly constituted actual claims alleging knowing acts of dishonesty or fraud by bank employees, the circuit court found that the second definition of discovery applied. The court concluded that any harm caused by these alleged acts would clearly qualify as a loss under the bond.<sup>52</sup>

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<sup>49</sup> FDIC v. INA, 928 F. Supp. at 63.

<sup>50</sup> The district court found that, at the latest, the bank had discovered the loss by November 15, 1989, the date the bank retained attorneys to investigate persistent prior allegations that its counsel and mortgage officer had conspired in a fraudulent lending scheme. The court thus determined that the bank was required to give notice to INA no later than December 15, 1989, and that January 16, 1990 notice was therefore untimely. FDIC v. INA, 928 F. Supp. at 59.

<sup>51</sup> *Id.*

<sup>52</sup> FDIC v. INA, 105 F.3d at 783 n.7; (citing Duncan Clore & Michael Keeley, *Discovery of Loss, in FINANCIAL INSTITUTION BONDS* 89, 113 (Duncan L. Clore ed., 1995) ("As long as a third party's claim would constitute a covered loss under the bond if proven to be true, it matters not whether the allegations are perceived as true. Instead, the allegations can be completely false. The point is, once the allegations are made, the insurer has the right to know about them and to conduct whatever investigation it may deem appropriate."))

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The court then proceeded to analyze the applicability of the Notice Prejudice Rule<sup>53</sup> and noted that it had previously visited the issue in three prior decisions,<sup>54</sup> and for various reasons had declined "to apply the notice prejudice rule" in all three cases.<sup>55</sup>

## 2. Fidelity Bonds Are Different.

The Notice Prejudice Rule arose from a desire to avoid forfeiture of (automobile) liability coverage. Unlike many courts that have ignored this fact, the First Circuit faced the issue head on, and rejected the suggestion that a fidelity bond is analogous to an occurrence or a claims-made and reported liability insurance policy. The court first looked to the vintage case of *Gilmour v. Standard Surety & Casualty Co.*,<sup>56</sup> which applied a suretyship analysis and found that timely notice of loss was a condition precedent to recovery under a (traditional) fidelity bond.<sup>57</sup> The court noted that the requirement of timely notice was also a condition of the policy before it, and so was "a condition of coverage under the parties' agreement."<sup>58</sup>

The court then looked to *Liberty Mutual Insurance Co. v. Gibbs*,<sup>59</sup> in which the First Circuit concluded that a reinsurance contract requiring that notice of loss be given "as soon as possible" had to be enforced according to its terms; the Notice Prejudice Rule did not apply.<sup>60</sup> The court identified three questions crucial to its determination:

- First, are the parties involved lay policyholders who require protection;
- Second, are the parties experienced businesses that bargained at arms-length;
- Third, does the insurance statute distinguish between the policy at issue and liability policies.<sup>61</sup>

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<sup>53</sup> The two principal Notice Prejudice cases in Massachusetts are *Johnson Controls, Inc. v. Bowes*, 409 N.E.2d 185 (Mass. 1980), which created a common law notice prejudice rule for liability policies, and *Chas. T. Main, Inc. v. Fireman's Fund Ins. Co.*, 551 N.E.2d 28 (Mass. 1990), which limits the rule. *Id.* 105 F.3d at 784.

<sup>54</sup> *National Union Fire Ins. Co. v. Talcott*, 931 F.2d 166 (1st Cir. 1991); *J.I. Corp v. Federal Ins. Co.*, 920 F.2d 118 (1st Cir. 1990) (under a fidelity policy providing claims-made and reported coverage, insured's failure to comply with notice provisions barred recovery); and *Liberty Mut. Ins. Co. v. Gibbs*, 773 F.2d 15 (1st Cir. 1985).

<sup>55</sup> *FDIC v. INA*, 105 F.3d. at 784.

<sup>56</sup> 197 N.E. 673 (Mass. 1935).

<sup>57</sup> *Id.* at 210.

<sup>58</sup> *Conditions Precedent to Recovery: Presentation of the Insured's Claim*, in *FINANCIAL INSTITUTION BONDS* 285, 285 (Duncan L. Clore ed., 1995). "A condition, unlike an agreement or a covenant, makes the Bond's indemnity contingent upon the Insured's performance of the condition."

<sup>59</sup> 773 F.2d 15 (1st Cir. 1985).

<sup>60</sup> *Id.* at 18.

<sup>61</sup> *Id.*

These factors formed the basis of the court's opinion in *Cheschi v. Boston Edison Co.*<sup>62</sup> There, a Massachusetts appeals court rejected application of the Notice Prejudice Rule to an indemnity policy, holding it doubtful that the Notice Prejudice Rule would apply to insurance other than liability insurance when the insureds were not laypersons and the parties to the contract were two sophisticated business concerns.<sup>63</sup>

The First Circuit in *FDIC v. INA* adopted the traditional contract analysis relied upon by the *Cheschi* court and disavowed the "automatic application of notice prejudice rules designed for one type of insurance to other insuring arrangements."

a. Nature of the Risk

The court found it significant that the Financial Institution Bond possessed characteristics of a surety arrangement which distinguished it from liability policies.<sup>64</sup> More particularly, the court was persuaded that the nature of the risk assumed by a fidelity insurer is akin to the risk undertaken by a surety: the risk insured against (employee defalcation) may at least partially be managed by the insurer (who can impose controls and supervision), and the right to indemnification from the defalcating "principal(s)" renders timely notice crucially important to the fidelity insurer.<sup>65</sup> This is consistent with the district court's reasoning that strict enforcement of the timely notice condition would serve as a disincentive to insured employers tolerating fidelity risks which uninsured employers would not countenance.

b. Sophisticated Versus Lay Insured

As in *Cheschi* and *Liberty Mutual*, the court in *FDIC v. INA* considered the fact that the insurance contracts involved sophisticated insureds, and not unsophisticated consumers.<sup>66</sup> Given the sophistication of the banker insureds; the *INA* court found there was little reason to depart from the usual rule of holding parties to their bargain and held that "to the extent the notice prejudice rule is supported by the policy of protecting consumers who effectively have little or no bargaining leverage, that policy provides no basis here to extend the notice prejudice rule."<sup>67</sup>

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<sup>62</sup> 654 N.E.2d 48, 53 (Mass. Ct. 1995).

<sup>63</sup> *Id.*

<sup>64</sup> *FDIC v. INA*, 105 F.3d at 785.

<sup>65</sup> *Id.* at 785-786.

<sup>66</sup> *Id.* at 786.

<sup>67</sup> *Id.*

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c. Negotiated Contract

It was, perhaps, of particular importance to the court that the bond at issue in *INA* was the product of arms length negotiation by two powerful industries: "As one commentator has noted, 'the fidelity bond is an arms length, negotiated contract between sophisticated business entities, the standard form for which was drafted by the joint efforts of the Surety Association of America and the American Bankers Association.'"<sup>68</sup> Thus the court dispatched the "contract of adhesion" that has been invoked by jurisdictions following the Notice Prejudice Rule as justification for abandoning traditional contract analysis.

d. Statutory Distinctions

It was also important to the court's consideration that the Massachusetts legislature had distinguished between standard insurance contracts and suretyship arrangements of the type embraced within Financial Institution Bonds.<sup>69</sup> "That expression of public policy undercuts any automatic application of the insurance notice prejudice rule to surety bonds, and thus to Financial Institution Bonds to the extent that they partake of the characteristics of surety bonds."<sup>70</sup>

e. *Contra Proferentum*

Finally, the court gave short shrift to the insured's argument that the notice condition should be considered an ambiguity, to be resolved against the insurer, since the insurer drafted the policy. "This doctrine provides the bank no refuge. The presumption against the insurer is not applied where the policy language results from the bargaining between sophisticated commercial parties of similar bargaining power."<sup>71</sup>

B. *The Good, the Bad and the Others*

In *Community Savings Bank v. Federal Insurance Co.*,<sup>72</sup> the United States District Court for the District of Connecticut cited the district court's decision in *FDIC v. INA* as authority for its holding that the insured bank's failure to give timely notice and file a timely proof of loss under a fidelity bond constituted a complete defense to Federal Insurance Company

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<sup>68</sup> *Koch, supra*, at vii (citing *Calcasieu-Marine Nat'l Bank v. American Employer's Ins. Co.*, 533 F.2d 290, 295 n.6 (5th Cir.) *cert. denied*, 429 U.S. 922 (1976)).

<sup>69</sup> *FDIC v. INA*, 105 F.3d at 786.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* at 786-87 (citing *Falmouth Nat'l Bank v. Ticor Title Ins. Co.*, 920 F.2d 1058, 1062 (1st Cir. 1990)); and noting "The Fifth Circuit has also rejected the application of the doctrine of contra preferendum to Financial Institution Bonds." *Sharp v. FSLIC*, 858 F.2d 1042, 1046 (5th Cir. 1988).

<sup>72</sup> 960 F. Supp. 16 (D. Conn. 1997).

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("Federal"), by reason of the insured's failure to satisfy a condition precedent. Although the opinion does not discuss choice of law issues, Federal's counsel advises that the case was predicated upon the court's diversity jurisdiction - which would have called for the application of Connecticut law under the Erie Doctrine.

The *Community Savings Bank* case is significant because Connecticut's supreme court effectively adopted the Notice Prejudice Rule in 1988, overruling decades of condition precedent analysis.<sup>73</sup> The authors presume that the *Community Savings Bank* decision is sufficient to identify a new trend, away from the "Modern Rule" and toward a "Post Modern Rule" in which enlightened courts will come to realize that, notwithstanding their decisions with respect to liability insurance, prompt notice and timely filing of proofs of loss are conditions precedent which must be satisfied to establish coverage under fidelity bonds.

The remainder of this article will survey the law concerning late notice and prejudice in the field of fidelity insurance as a whole. Before turning to this overview, and in the interest of a balanced presentation of all the categories embraced within this subheading, at least one case is considered that presents the obverse of the well reasoned analysis typified by the First Circuit's opinion in *FDIC v. INA*.

Some of the most obtuse opinions are generated when courts attempt to distinguish claims-made policies - where coverage is said to be defined by notice to the insurer - from occurrence bonds, where coverage is "merely" conditioned upon timely notice.<sup>74</sup> One finds cases determined on the basis of the location of the notice condition within the insurance contract, as at least one court has tacitly admitted: "[Unlike a claims-made policy] [t]he provisions defining the parameters of the 'covered loss' do not require notice to the insurer during the policy period or the following discovery period. The 'notice' and 'proof of loss' requirements are discussed under independent conditions of the policy."<sup>75</sup>

If timely notice is a condition to obtaining coverage for a loss, what principled difference can it make whether the condition appears textually as part of the General Conditions of the policy or within the language of the coverage provision? What makes the distinction drawn by these "*text loci*" courts all the more egregious is that they purport to read insurance contracts "as a whole."<sup>76</sup>

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<sup>73</sup> See *Aetna Cas. & Surety Co. v. Murphy*, 538 A.2d 219 (Conn. 1988).

<sup>74</sup> See New Jersey Summary, *infra.*, Minnesota Summary, *infra.*

<sup>75</sup> *Winthrop & Weinstine v. Travelers Cas. & Sur. Co.*, No. 4-96-656 1998 U.S. Dist. LEXIS 1874 (D. Minn. February 17, 1998).

<sup>76</sup> *Id.*

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In *FDIC v. INA*, the First Circuit expressly rejected a contrary position on the Notice Prejudice Rule staked out by the Tenth Circuit in *Federal Deposit Insurance Corp. v. Oldenburg*<sup>77</sup> and in district court decisions from other jurisdictions. The First Circuit simply noted that the *Oldenburg* court was predicting what Utah's courts would do in a similar situation, a matter of little concern to a court charged with applying the law of Massachusetts. While judges sitting on the United States Court of Appeals have the luxury or dignity to ignore questionable decisions offered in support of extending the Notice Prejudice Rule to the field of fidelity insurance, claim professionals and the attorneys who advise them do not have that option. They are frequently called upon to determine whether a potential late notice defense is viable under the law of a state that has not squarely addressed the issue of late notice in the context of fidelity insurance. If *FDIC v. INA* and *Community Savings Bank* teach anything, they demonstrate that even in jurisdictions that generally follow the Notice Prejudice Rule, the decision to assert a late notice defense to a fidelity claim should not turn entirely upon whether the insurer can demonstrate prejudice. Rather, counsel should ascertain whether the relevant jurisdiction is amenable to the argument that the Notice Prejudice Rule should not apply to fidelity insurance at all.

### III. CONCLUSION

The Notice Prejudice Rule was originally developed to protect unsophisticated, lay insureds in those instances where their delay in providing notice of an insured occurrence, coupled with the court's adherence to traditional common law principles requiring performance of contractual conditions precedent, would have resulted in a forfeiture of liability insurance coverage. To avoid an "unjust result," courts purporting to follow the "modern trend" have required insurers to prove that they had been prejudiced by their insured's breach of the policy's timely notice condition, but often failed to address the question of what constituted "prejudice." This sort of result-oriented jurisprudence turned a simple legal question - did the insured give notice within the time required by the policy? - into a complicated issue of fact, with all the potential for expensive litigation that such a transformation entails. Indeed, at least one court has touted the oblique vagueness of its notice prejudice jurisprudence as an incentive for insurers to settle.<sup>78</sup>

To support their abnegation of a fundamental principle of contract law, courts following the Notice Prejudice Rule contend that they are justified in excusing the insured's performance of the notice condition by the "take it or leave it" nature of insurance contracts, and the unequal bargaining positions

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<sup>77</sup> 34 F.3d 1529 (10th Cir. 1994), *see* Utah Summary, *infra*, at p. 53-55.

<sup>78</sup> *See* Mississippi summary, *infra*.

of sophisticated insurance companies as compared to naive insureds. The Notice Prejudice Rule is predicated upon the assumption that the contract of insurance is an adhesion contract, and not the bargained for product of arms-length negotiations. By the same logic, the converse rule applies: an insurance contract freely arrived at as the product of negotiation between sophisticated business entities should be enforced as written.

In *FDIC v. INA* and other recent decisions, certain courts have acknowledged the distinction between fidelity insurance and liability insurance,<sup>79</sup> holding that the rationale and assumptions posited as a basis for requiring insurers to demonstrate prejudice in the context of liability insurance simply do not apply in the fidelity context. Because many jurisdictions have predicated their adoption of Notice Prejudice Rule upon assumptions that are not relevant to fidelity insurance, it stands to reason that any court dedicated to principled legal reasoning can be persuaded that the Notice Prejudice Rule should not be extended to fidelity policies. By identifying those courts which may be receptive to the argument that fidelity coverage is distinguishable from liability coverage, and should not be subject to "the automatic application of notice prejudice rules designed for one type of insurance to other insuring arrangements,"<sup>80</sup> persistent fidelity claims professionals and counsel can foster and develop a post modern trend away from the Notice Prejudice Rule, and toward a consistent, predictable and cost effective jurisprudence for enforcing the notice requirements contained in standard fidelity policies.

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<sup>79</sup> *Aetna Cas. & Sur. Co. v. Kidder, Peabody & Co. Inc.*, No. 89, 89A, 1998 N.Y. App. LEXIS 8818 (N.Y. 1st Dept. August 6, 1998).

<sup>80</sup> *Cheschi v. Boston Edison Co.*, 654 N.E.2d 48 (Mass. App. Ct. 1995).

# **APPENDIX A**

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## SUMMARIES OF STATE LAW CONCERNING LATE NOTICE

While the majority of states have adopted the Notice Prejudice Rule as part of their general insurance jurisprudence, it is not accurate to say that the Notice Prejudice Rule has been adopted by a majority of states in the context of fidelity insurance. Indeed, excluding cases decided prior to the advent of the Notice Prejudice Rule<sup>81</sup> (over sixty years ago), only twenty states have specifically addressed the issue of timely notice under a fidelity bond. Of these jurisdictions, eight have opted for the traditional condition precedent analysis,<sup>82</sup> and twelve have adopted or applied the Notice Prejudice Rule.<sup>83</sup> Other courts have considered the related issue of late proof of loss under fidelity policies,<sup>84</sup> concluding either that the Notice Prejudice Rule applies or that timely proof of a loss is a condition precedent to recovery under fidelity policies.<sup>85</sup> Several courts have even had occasion to apply (or reject) the Notice Prejudice Rule to the timely suit provision contained in most fidelity policies.<sup>86</sup>

In addition to the method of analysis applied by the court, the answers to two additional questions can have a considerable impact upon the success or failure of a late notice defense: (1) What constitutes discovery of a fidelity loss? and (2) What constitutes prejudice to the insurer'?

Most of the standard forms used to provide fidelity coverage measure the timeliness of notice, proof of loss and commencement of suit against the date the loss was first discovered by the insured. The discovery standard applied within a jurisdiction may therefore be critical. If discovery occurs as soon as a reasonable person would have assumed a loss has occurred, (the objective standard), notice to the insurer may be required significantly earlier than if the timeliness of the insured's notice is measured from the time the insured has actual knowledge of a loss due to employee dishonesty (the subjective standard). To the extent the courts of a particular state have addressed the issue of discovery, citations to the relevant authorities are included in the summaries of state law below.

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<sup>81</sup> For a comprehensive analysis of the law prior to the advent of the Notice Prejudice Rule, see Lawyers Co-operative Publishing Co., Annotation, *Effect of Failure to Give Notice or Delay in Giving Notice or Proof of Loss, upon Fidelity Bond or Insurance*, 23 A.L.R.2d 1065 (1997).

<sup>82</sup> See Summaries for Connecticut, Georgia, Massachusetts, New York, Oklahoma, South Carolina Tennessee and the District of Columbia, *infra*.

<sup>83</sup> See Summaries for California, Florida, Kansas, Kentucky, Louisiana, Minnesota, Missouri, New Jersey, Ohio, Pennsylvania, Utah, and Wisconsin, *infra*.

<sup>84</sup> See Summaries for Arizona, Arkansas, Kansas, New Jersey and Ohio, *infra*.

<sup>85</sup> See Summaries for Alabama, New York, Oklahoma and Texas, *infra*.

<sup>86</sup> See Summaries for Illinois, Michigan and New York, *infra*.

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In those states that require a showing of prejudice, the focus shifts first to a determination of which party bears the burden of proving or disproving prejudice, and then to a consideration of what each court considers to constitute prejudice. Cases indicating the quantity or quality of proof required to establish prejudice have been cited where reported precedent has been found.

Each of the summaries of state law set forth below includes subheadings identifying one or more of five categories of precedents, designed to assist the claim professional in determining whether a late notice defense may be applicable: (i) late notice of claim; (ii) late proof of loss; (iii) late suit; (iv) discovery of loss; and (v) prejudice. Although the authors naturally have focused upon cases involving fidelity coverage, decisions addressing analogous late notice issues in nonfidelity insurance policies have been analyzed where relevant fidelity cases are sparse or non-existent. In those instances where no relevant precedents have been identified, the associated sideheading has been omitted from the summary.

## ALABAMA

**Late Notice**

Alabama has a long line of authority holding that a primary insurer need not plead or prove prejudice in order to be relieved of its coverage obligations.<sup>87</sup> A primary insurer must receive timely notice in order to intelligently estimate and investigate its rights and liabilities.<sup>88</sup> The requirement of "notice as soon as practicable" means that the insured must deliver notice within a reasonable time in view of the circumstances.<sup>89</sup> In making this determination, Alabama courts consider only two factors - the length of the delay in giving notice and the reason therefor.<sup>90</sup> The courts do not consider prejudice or its absence in determining the reasonableness of delay.<sup>91</sup> However, Alabama courts hold that excess insurers must demonstrate prejudice arising from a delay in notice, because excess insurers do not possess the duty of investigating, handling, settling or defending claims or suits against the insured.<sup>92</sup>

**Late Proof of Loss**

*American Fire & Casualty Co. v. Burchfield*<sup>93</sup> sets forth the analysis by Alabama courts of late proof of loss within the fidelity bond context. In this case, employees of the insured misappropriated its inventory. The proof of loss provision required that the insured deliver proof of loss to the insurer within four months of discovery of the loss. The fidelity bond fur-

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<sup>87</sup> *Midwest Employers Cas. Co. v. East Alabama Health Care*, 695 So. 2d 1169, 1171 (Ala. 1997); *Correll v. Fireman's Fund Ins. Co.*, 529 So. 2d 1006 (Ala. 1988); *State Farm Mut. Auto. Ins. Co. v. Burgess*, 474 So. 2d 634 (Ala. 1985); *Big Three Motors Inc. v. Employers Ins. Co. of Alabama*, 449 So. 2d 1232 (Ala. 1984).

<sup>88</sup> *Midwest Employers Cas. Co.*, 695 So. 2d at 1171.

<sup>89</sup> *U.S. Fid. & Guar. Co. v. Bonitz Insulation Co. of Alabama*, 424 So. 2d 569, 572 (Ala. 1982); *Southern Guar. Ins. Co. v. Thomas*, 334 So. 2d 879, 882 (Ala. 1976).

<sup>90</sup> *Correll*, 529 So. 2d at 1008; *Bonitz Insulation Co.*, 424 So. 2d at 572; *Thomas*, 334 So. 2d at 883.

<sup>91</sup> *Correll*, 529 So. 2d at 1008-1009 (holding prejudice immaterial where the policy expressly makes timely notice a condition precedent to recovery); *Burgess*, 474 So. 2d at 636 (Ala. 1985) (holding that prejudice to the insurer does not bear upon the reasonableness of delay in liability policies); *Big Three Motors Inc.*, 449 So. 2d 1232 (rejecting the adoption of a prejudice rule as a factor in determining the reasonableness of delay); *Bonitz Insulation Co.*, 424 So. 2d at 572.

<sup>92</sup> *Midwest Employers Cos. Co.*, 695 So. 2d at 1171-1173.

<sup>93</sup> 232 So.2d 606 (Ala. 1970).

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ther provided, "No action shall lie against the company unless, as a condition precedent thereto, there shall have been full compliance with all the terms of this policy." The *Burchfield* court interpreted these provisions together to mean that the filing of a proof of loss shall constitute a condition precedent to the bringing of suit.<sup>94</sup> Despite this interpretation, the *Burchfield* court found that nothing in the policy expressly provided that the failure to file a proof of loss operated as a forfeiture to coverage.<sup>95</sup> The *Burchfield* court held that allowing such a forfeiture under these circumstances would directly contradict prevailing Alabama common law.<sup>96</sup>

*Brad's Machine Products v. Phoenix Assurance Co. of Discovery New York*<sup>97</sup> sets forth the analysis by Alabama courts of discovery within the fidelity bond context. In this case, the insurer issued a discovery bond. The employee of the insured misappropriated moneys for his own personal use. The court held that the notice and discovery provisions of the bond do not create a duty of diligence in discovering the employee's dishonesty.<sup>98</sup> Accordingly, the court found that a confrontation between the insured's officer and the dishonest employee did not constitute discovery, as the officer was only investigating improper accounting procedures.<sup>99</sup> Furthermore, the accountants' investigation did not constitute discovery, as the accountants did not even determine whether a loss existed.<sup>100</sup>

### **Discovery**

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<sup>94</sup> *Id.* at 610-611.

<sup>95</sup> *Id.* at 611.

<sup>96</sup> *Id.*

<sup>97</sup> 489 F.2d 622 (5th Cir. 1974).

<sup>98</sup> *Id.* at 625.

<sup>99</sup> *Id.* at 624-625.

<sup>100</sup> *Id.*

ALASKA

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***Late Notice &  
Proof of Loss***

Under Alaskan law, regardless of the reasons for the delay in giving notice, there is no justification which excuses the insurer from its coverage obligation, since the notice provisions serve to protect the insurer.<sup>101</sup> Failure to notify the insurer under an accident policy operates as a bar to recovery only when the insurer has been prejudiced.<sup>102</sup> The insurer has the burden of demonstrating prejudice caused by the insured's delay in delivering notice.<sup>103</sup>

***Late Suit***

Time limits for commencement of suit are reviewed on the basis of whether their application in a particular case advances the purpose for which they were included in the policy.<sup>104</sup>

***Prejudice***

A twenty-three month delay in providing notice of an accident to the insurer, thereby precluding the insurer from investigating the matter at a reasonable time and from negotiating a settlement prior to institution of suit, constitutes prejudice to the insurer.<sup>105</sup>

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<sup>101</sup> Weaver Brothers, Inc. v. Chappel, 684 P.2d 123 (Alaska 1984).

<sup>102</sup> Kolkman v. Greens Creek Mining Co., 936 P.2d 150, 156 (Alaska 1997).

<sup>103</sup> MAPCO Alaska Petroleum, inc. v. Central Nat'l Ins. Co., 795 F. Supp. 941 (D. Alaska 1991); *Weaver Bros. Inc.*, 684 P.2d at 125.

<sup>104</sup> Estes v. Alaska Ins. Guar. Ass'n, 774 P.2d 1315 (Alaska 1989).

<sup>105</sup> General Acc. Fire & Life Ins. Corp. v. Prosser, 239 F. Supp. 735 (D. Alaska 1965).

## ARIZONA

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An insurer cannot escape coverage based upon a late notice defense unless the insurer can demonstrate prejudice.<sup>106</sup>

*Late Notice*

Arizona courts strongly construe proof of loss requirements against the insurers.<sup>107</sup> So long as the insured substantially complies with the proof of loss provision, the insurer cannot escape liability.<sup>108</sup> Absence of prejudice acts as a significant factor in determining whether or not to release the insurer from liability.<sup>109</sup>

*Late Proof of Loss*

Arizona adheres to the objective standard in determining when of discovery occurs.<sup>110</sup> The courts question whether the insured, as a reasonable person, based upon facts known to him at the time, should have perceived that the insured's employee engaged in dishonest acts.<sup>111</sup> The fact that such insured might not have actually recognized or subjectively characterized the employee's acts as "dishonest" does not constitute a definitive factor in determining discovery.<sup>112</sup>

*Discovery*

The insurer has the burden of proving that the failure the insured to deliver timely notice resulted in prejudice to the insurer.<sup>113</sup> The mere fact of delay does not constitute a sufficient showing of prejudice.<sup>114</sup>

*Prejudice*

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<sup>106</sup> American Home Assur. Co. v. Sand, 253 F.Supp. 942 (D. Ariz. 1965); Globe Indem. Co. v. Blomfield, 7, 562 P.2d 1372 (Ariz. 1977); Lindus v. Northern Ins. Co. of N.Y., 438 P.2d 311 (Ariz. 1968).

<sup>107</sup> Truck Ins. Exch. v. Hale, 386 P.2d 846 (Ariz. 1963).

<sup>108</sup> Maryland Cas. Co. v. Clements, 487 P.2d 437 (Ariz. Ct. App. 1971).

<sup>109</sup> *Id.* at 443.

<sup>110</sup> *Id.* at 441.

<sup>111</sup> *Id.* at 442-445.

<sup>112</sup> *Id.* at 441.

<sup>113</sup> *Id.* at 443.

<sup>114</sup> *Globe Indem. Co.*, 562 P.2d at 1372.

ARKANSAS

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**Late Notice**

The policy provision requiring "notice as soon as practicable" has been deemed to mean as soon as reasonable under the circumstances.<sup>115</sup> A three-year delay in providing information to a homeowner's insurer breached the "as soon as practicable" policy provision, and the insurer was thereby relieved of any duty to defend or indemnify the insureds.<sup>116</sup>

**Late Proof of Loss**

A fidelity bond's stated four-month time limit from the date of discovery of loss for filing a proof of loss did not constitute an absolutely binding requirement, where the insurers exercised an unreasonable amount of control over the filing procedure and where the notices and proofs of claim in all instances excepting one were provided within a reasonable time under the circumstances.<sup>117</sup>

**Discovery**

The insured under a blanket fidelity bond is not bound to give notice until he has acquired knowledge of some specific fraudulent or dishonest act: the facts must be such that a reasonable insured would understand the significance of them as connoting the commission of a fraud.<sup>118</sup> The policy's discovery provisions are to be construed to avoid frustrating the object of the bonding agreement and the intent of the parties. Therefore, the construction of the discovery provision should be consistent with the terms of the insuring agreement.<sup>119</sup>

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<sup>115</sup> Home Ins. Co. v. Arkansas Mechanical Contractors, Inc., 531 F.2d 906 (8th Cir. 1976).

<sup>116</sup> State Farm Fire & Cas. Co. v. Mitchell, 822 F.Supp. 575 (W.D. Ark. 1993).

<sup>117</sup> Chandler Trailer Co. v. Lawyer's Surety Co., 535 F. Supp. 204 (E.D. Ark. 1982); *see also* Arkansas Burial Ass'n v. Dixon Funeral Home, Inc., 751 S.W.2d 356 (Ark. Ct. App. 1980) (denial of funeral benefits on grounds of late notice, where the notice was not given until after the funeral, was not unconscionable.)

<sup>118</sup> Perkins v. Clinton State Bank, 593 F.2d 327 (8th Cir. 1979).

<sup>119</sup> *Id.*

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**CALIFORNIA**

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Under California common law, it is settled that an insurer, in order to avoid liability on the basis of a breach of the notice clause, must establish actual and substantial prejudice.<sup>120</sup> California does not follow a contractual approach. Rather, certain courts have stated the applicable rules as follows: "In the absence of clarity, 'stipulations for notice will not be construed as conditions precedent if reasonably open to other construction.' Furthermore, under California law, contractual provisions are not deemed to be conditions precedent unless stated 'in conspicuous, unambiguous, and unequivocal language....'" It is also noteworthy that California courts have held that even if the notice provision is made a condition precedent to the liability of the insurer, the insurer must still prove prejudice in order to avoid liability based upon the insured's breach of the notice requirement."<sup>121</sup>

**Late Notice**

There is no presumption of prejudice: the insurer has the burden of proving actual and substantial prejudice, and a "mere possibility" of prejudice will not suffice.<sup>122</sup> Although no categorical definition of prejudice has been handed down, California case law "place[s] a heavy burden on an insurer seeking to defend on the ground of breach of the notice clause."<sup>123</sup> Indeed, prejudice is not established merely because the late notice prevented the insurer from "contemporaneously investigating the claim," nor does it arise from the mere "denial of the opportunity to make an early settlement of the claim."<sup>124</sup> Furthermore, it is not sufficient for the insurer simply to "display end results; the probability

**Prejudice**

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<sup>120</sup> *Campbell v. Allstate Ins. Co.*, 384 P.2d 155, 156-57 (Cal. 1963); *see Clemmer v. Hartford Ins. Co.*, 587 P.2d 1098, 1107, (Cal. 1978); *see also Pacific Employers Ins. Co. v. Superior Court*, 270 Cal. Rptr. 779, 783 (Cal. Ct. App. 1990).

<sup>121</sup> *Insurance Co. of the State of Pa. v. Associated Int'l Ins. Co.*, 922 F.2d 516 (9th Cir. 1990) (Notice Prejudice Rule applied to reinsurers) (citations omitted).

<sup>122</sup> *Moe v. Transamerica Title Ins. Co.*, 98 Cal. Rptr. 547, 555 (Cal. Ct. App. 1971); *see also Campbell*, 384 P.2d at 156-158.

<sup>123</sup> *Colonial Gas Energy Systems v. Unigard Mut. Ins. Co.*, 441 F.Supp. 765, 769 (N.D. Cal. 1977).

<sup>124</sup> *Northwestern Title Sec. Co. v. Flack*, 85 Cal. Rptr. 693, 697 (Cal. Ct. App. 1970).

that such results could or would have been avoided absent the claimed default or error must also be explored."<sup>125</sup> Thus, under California case law, the only prejudice sufficient to allow an insurer to avoid liability based on late notice is found in those cases where the insurer actually demonstrated that there was a "substantial likelihood" that it could have either defeated the underlying claim against its insured, or settled the case for a lesser sum than that for which its insured ultimately settled the claim.<sup>126</sup>

#### **Discovery**

In *Downey Savings & Loan Ass 'n v. Ohio Casualty & Surety*,<sup>127</sup> the court rejected the fidelity insurer's assertion that the Notice Prejudice Rule should not apply to fidelity insurance. Citing *Pacific-Southern Mortgage Trust Co. v. Insurance Co. of North America*,<sup>128</sup> the court interpreted:

The term "discovery of the loss" under a bond to mean the time when the insured discovers it has suffered a loss, not the time when the insured discovers a potential loss. As the court said, "[It] is logical to start the running of the bond's limitation period upon discovery of a real loss rather than discovery of an anticipated loss." Under *Pacific-Southern*, therefore, *Downey* did not suffer a loss until it settled the American Funding lawsuit for \$ 55,000. Also, here the bond did not provide indemnity against liability, but indemnity against loss, and thus did not cover anticipated or even uncertain future losses but only actual losses. If Ohio had wanted written notice upon discovery of the fraud, it could have so stated in the bond. As the court in *Pacific-Southern* noted, some blanket fidelity bonds specifically require an insured to report "an occurrence which may give rise to a claim."<sup>129</sup>

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<sup>125</sup> *Clemmer*, 587 P.2d 1107 n.12.

<sup>126</sup> *Northwestern*, 85 Cal. Rptr. At 697; *Ins. Co of Stat of Pa.*, 922 F.2d at 525 (citing Trustees of the Univ. of Pa. of Lexington Ins. Co., 815 F.2d 890, 899 (3d cir. 1987).

<sup>127</sup> 234 Cal. Rptr. 835 (Cal. Ct. App. 1987).

<sup>128</sup> 212 Cal. Rptr. 754 (Cal. Ct. App. 1985).

<sup>129</sup> *Id.* (affirming punitive damage award of 32 times compensatory damages as "reasonable").

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COLORADO

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The Colorado supreme court has expressly rejected requiring a showing of prejudice.<sup>130</sup> Compliance with the notice clause is a condition precedent to coverage. Non-compliance with the notice provision creates a presumption of prejudice, and the burden is upon the party seeking to impose liability to prove that no prejudice did, in fact, occur.<sup>131</sup> "Express provisions in an insurance policy requiring that the insured give notice of an accident and forward suit papers to the insurer as a condition precedent to coverage are enforceable."<sup>132</sup> "Where delay in giving notice is unexcused, prejudice to the insurer need not be shown."<sup>133</sup>

*Late Notice*

Colorado is in the category of states that presumes prejudice to the insurer resulting from late notice, and such presumed prejudice will void an insurer's liability unless the insured can show that the insurer did not suffer prejudice.<sup>134</sup>

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<sup>130</sup> *Marez v. Dairyland Ins. Co.*, 638 P.2d 286 (Colo. 1982).

<sup>131</sup> *Id.*

<sup>132</sup> *Leadville Corp. v. U.S. Fid. & Guar. Co.*, 55 F.2d 537 (10th Cir. 1995).

<sup>133</sup> *Graton v. United Sec. Ins. Co.*, 740 P.2d 533 (Colo. Ct. App. 1987).

<sup>134</sup> *Dairyland Ins. Co. v. Cunningham*, 360 F.Supp. 139 (D. Colo. 1973).

CONNECTICUT

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*Late Notice*

Connecticut appears to represent the second segment of what we have termed the Post-Modern Trend. In the past decade, courts in Connecticut have gradually abandoned their prior and well-established rule that enforces the notice requirements of insurance policies on the basis of a condition precedent analysis. However, in *Community Savings Bank v. Federal Insurance Co.*,<sup>135</sup> the federal district court held that the insured's failure to give timely notice warranted the entry of summary judgment against it. The court held: "Prompt notice permits the insurer to immediately protect its rights and interests by allowing it to investigate, minimize and possibly recoup purported losses. The timely giving of notice and filing of a proof of loss are conditions precedent to coverage, and the insured's failure to comply with notice provisions is a complete defense to a bond claim. The insurer need not demonstrate that it was prejudiced in order for late notice or a late proof of loss to constitute a defense to coverage."<sup>136</sup>

By contrast, in 1988 the Connecticut Supreme Court in *Aetna Casualty & Surety Co. v. Murphy*<sup>137</sup> held that in order to properly balance the interests of the insurer and the insured, it was necessary to factually inquire, in the circumstances of the particular case, whether the insurer had been prejudiced by the insured's delay in giving notice of the event that triggered the insurance coverage. If it could be shown that the insurer suffered no material prejudice from the delay, then the insured's noncompliance with the condition of timely notice would be excused. In so holding, the court specifically acknowledged that it was overruling the trial and intermediate appellate courts, despite their proper application of the prior decisions of the Connecticut Supreme Court, stating "In our appraisal of the continued vitality of this line of cases, it is noteworthy that they do not reflect a searching analysis of what role prejudice, or its absence, should play in the

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<sup>135</sup> 960 F. Supp. 16 (D. Conn. 1997).

<sup>136</sup> *Id.* at 21 (citations omitted).

<sup>137</sup> 538 A.2d 219 (Con. 1988).

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enforcement of such standard clauses in insurance policies."<sup>138</sup> The line of cases referred to, including at least one case involving a bankers blanket bond, had held that, absent a waiver, an unexcused and unreasonable delay in notification constitutes a failure of a valid policy condition, discharging the insurance company from further liability under its policy.

In its holding in *Aetna Casualty & Surety Co. v. Murphy*, the court also decided that, since it was the insured who was seeking relief from its failure to comply with the policy's notice provision, the insured would bear the burden of proof in showing that the insurer had not been materially prejudiced by the insured's delay in providing notice.

***Prejudice***

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<sup>138</sup> *Murphy*, 528 A.2d at 220.

DELAWARE

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**Late Notice**

Delaware courts have interpreted insurance policy notice provisions that require notice "as soon as practicable" as requiring notice in a reasonable time under the circumstances.<sup>139</sup> Furthermore, whether or not the delay in providing notice was unreasonable is a separate consideration that is to be determined before ascertaining whether or not the unreasonable delay has prejudiced the insurer.<sup>140</sup>

**Prejudice**

The insurer has the burden of establishing that the insured's breach of the notice provision was unreasonable, and that such unreasonable delay caused the insurer to suffer prejudice.<sup>141</sup> To prove prejudice, an insurer must demonstrate that it lost something of "substance," not merely the opportunity to follow its normal procedures. To meet its burden, the insurer must rely upon evidence and reasonable inferences, and not on mere speculation.<sup>142</sup>

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<sup>139</sup> *Nationwide Mut. Ins. Co. v. Starr*, 575 A.2d 1083 (Del. 1990).

<sup>140</sup> *State Farm Mut. Ins. Co. v. Johnson*, 320 A.2d 345 (Del. Super. Ct. 1974).

<sup>141</sup> *Nationwide*, 575 A.2d 1083.

<sup>142</sup> *Falcon Steel Co. v. Maryland Cas. Co.*, 366 A.2d 512 (Del. Super. Ct. 1976).

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DISTRICT OF COLUMBIA

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From the very limited reported cases on point, it appears that District of Columbia courts generally apply a condition precedent analysis to insurance policy notice provisions.<sup>143</sup> An insurer need not prove prejudice to the insurer from the insured's failure to comply with the notice provisions of a liability policy in order to successfully establish a breach of notice defense.<sup>144</sup> This rule is consistent with the court's 1938 decision in *United States Shipping Board Merchant Fleet Corp. v. Aetna Casualty & Surety Co.*,<sup>145</sup> which held that the late notice provision in a fidelity bond was a condition precedent to recovery, and that it was immaterial whether prejudice from failure to receive notice was shown

*Late Notice*

*Ace Van & Storage Co. v. Liberty Mutual Insurance Co.*<sup>146</sup> sets forth the analysis by District of Columbia courts regarding late proof of loss. In this case, the court barred recovery where the insured submitted the proof of loss three weeks after the ninety-day period provided for in the policy.<sup>147</sup> Even where the insurer engaged in conduct that would give rise to a waiver defense, the *Ace Van* court denied recovery, because the insurer engaged in the specific conduct after the ninety-day time limit had expired.<sup>148</sup>

*Late Proof of Loss*

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<sup>143</sup> *Hartford Ins. Group v. Liberty Mut. Ins. Co.*, 311 A.2d 506, 507-508 (D.C. 1973); *Greenway v. Selected Risks Ins. Co.*, 307 A.2d 753 (D.C. App. 1973).

<sup>144</sup> *Id.*

<sup>145</sup> 98 F.2d 238 (D.C. Cir. 1938).

<sup>146</sup> 336 F.2d 925 (D.C. Cir. 1964).

<sup>147</sup> *Id.* at 926.

<sup>148</sup> *Id.* at 927.

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 FLORIDA
 

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**Late Notice &  
Proof of Loss**

The Florida courts have held that the question of whether an insurance policy's notice provision has been complied with must be evaluated by the facts of each particular case.<sup>149</sup> Failure to provide an insurer with timely notice of an occurrence creates a presumption of prejudice that constitutes a legal basis for denying coverage.<sup>150</sup> That presumption automatically arises when the insured fails to give its insurer timely notice.<sup>151</sup> However, an insurer will not be relieved of its liability merely by demonstrating that notice of an accident was not given as soon as practicable after its occurrence: the presumption may be overcome by a showing that the insurer has not been substantially prejudiced.<sup>152</sup> The burden of proof rests with the insured.<sup>153</sup>

Florida's version of the Notice Prejudice Rule applies to bonds providing fidelity coverage. In *Miami National Bank v. Pennsylvania Insurance Co.*,<sup>154</sup> the bankers blanket bond required that the insured provide notice at the earliest practicable moment. In the absence of a showing of lack of prejudice to the insurer, the court barred recovery when the insured filed the claim six months after discovery of loss, even though the insurer's notification of forfeiture was untimely.

**Discovery**

In *Royal Trust Bank v. National Union Fire Insurance Co.*,<sup>155</sup> the United States Court of Appeals concluded that, because the definition of discovery contained in the Financial Institution Bond at issue imposed a duty of inquiry upon the insured, the bank was chargeable with discovery when it first became aware of facts that would have caused a "reasonable person" to assume

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<sup>149</sup> Laster v. U.S. Fid. & Guar. Ins. Co., 293 So.2d 83 (Fla. 1974).

<sup>150</sup> Ideal Mut. Ins. Co. v. Waldrep, 400 So.2d 782, 785 (Fla. 1981).

<sup>151</sup> Bankers Ins. Co. v. Macias, 475 So.2d 1216 (Fla. 1985).

<sup>152</sup> National Gypsum Co. v. Travelers Indem. Co., 417 So. 2d 254 (Fla. 1982) (surety bond case); Tredke v. Fidelity & Cas. Co. of N.Y., 222 So. 2d 206 (Fla. Ct. App. 1969); Florida Municipal Liability Self Ins. Program v. Mead Rein. Corp., 796 F.Supp. 509 (Fla. 1992).

<sup>153</sup> *Id.*; see also H.S. Equities v. Hartford Acc. & Indem. Co., 334 So.2d 573 (Fla. 1976).

<sup>154</sup> 240 So.2d 832 (Fla. 1997).

<sup>155</sup> 788 F.2d 719 (11th Cir. 1986).

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that a loss covered by the bond had occurred. The court acknowledged that in the absence of the foregoing bond definition, Florida law would not impose such a duty of inquiry; anything short of actual discovery would be insufficient.<sup>156</sup>

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<sup>156</sup> *Id.*

GEORGIA

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**Late Notice**

Georgia, which relies upon a condition precedent analysis, upholds the strict interpretation of an insurance policy's notice provisions, and an insurer need not show that it suffered prejudice by the insured's failure to comply with the policy's notice requirements.<sup>157</sup>

**Discovery**

Georgia uses an objective test for determining the issue of discovery and imposes a duty of inquiry upon an insured to ascertain whether suspicious activity constitutes dishonesty.<sup>158</sup>

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<sup>157</sup> *KHD Deutz of Am. Corp. v. Utica Mut. Ins. Co.*, 469 S.E.2d 336, (Ga. Ct. App. 1996); *Bates v. Holyoke Mut. Ins. Co.*, 318 S.E.2d 777 (Ga. Ct. App. 1984); *In re Prime Comm. Corp.*, 187 B.R. 785 (Bankr. N.D. Ga. 1995).

<sup>158</sup> *See also United States Fid & Guar. Co. v. Macon-Bibb County Economic Opportunity Council, Inc.*, 381 S.E.2d 539 (Ga. App. 1989); *In re Prime Comm. Corp.*, 187 B.R. 785.

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## HAWAII

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Hawaii has not reported a case dealing with late notice in the context of fidelity coverage. In *Standard Oil Co. of California v. Hawaiian Insurance Co.*,<sup>159</sup> the court noted that the function of an insurance policy's notice requirement is to prevent the insurer from being prejudiced, not to provide the insurer with a "technical escape hatch by which to deny coverage in the absence of prejudice."<sup>160</sup> This case is remarkably unusual because of the court's perspective that the insurer would have had more timely notice, but for its own conduct. In *Standard Oil*, an airplane crash resulted in a suit involving multiple defendants where Standard Oil was brought in as a third party defendant. Standard Oil allegedly delayed in notifying Hawaiian Insurance Company ("HIC") that it had been named in the suit. HIC was also the insurer of one of the other defendant for whom it had denied coverage. The court reasoned that if HIC had not denied coverage for its other insured (apparently incorrectly), then it would have had more timely notice of the joinder of Standard Oil, when all of the parties were served with the third party complaint.

### *Late Notice*

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<sup>159</sup> 654 P.2d 1345 (Hawaii 1982).

<sup>160</sup> *Standard Oil*, 654 P.2d at 1349 n.4.

IDAHO

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*Late Notice*

The general rule in Idaho is that notice provisions in insurance policies are conditions precedent to coverage. However, strict adherence is not required and reasonable compliance will suffice. In *Viani v. Aetna Insurance Co.*,<sup>161</sup> the Supreme Court of Idaho held that insurance policy provisions requiring the insured to submit written notice of claim "as soon as practicable" and to forward suit papers to the insurer immediately, and limiting suits against the insurer to insureds which had complied with such conditions, were valid and reasonable. In so holding, the court relied upon *Leach v. Farmer's Automobile Insurance Exchange*,<sup>162</sup> which had also concluded that such provisions were valid and reasonable. However, the court also stated that violations of these conditions will not release the insurer unless it can show that it was prejudiced thereby. Furthermore, the *Leach* court distinguished between an insured that made a reasonable attempt at compliance and an insured that failed to reasonably comply. Relying upon its decision in *Berg v. Associated Employers Reciprocal & Illinois Indemnity Exchange*,<sup>163</sup> the court held that notice to the insurer after entry of judgment against the insured failed to achieve any degree of compliance, and thus excused the insurer from liability under its policy.<sup>164</sup>

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<sup>161</sup> 501 P.2d 706 (Idaho 1976); *but see* *Sloviaczek v. Pucket*, 565 P.2d 564 (Idaho 1977).

<sup>162</sup> 213 P.2d 920 (Idaho 1950).

<sup>163</sup> 279 P.2d at 627 (Idaho 1929).

<sup>164</sup> *Id.*

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**ILLINOIS**

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Illinois does not "require" a showing of prejudice to prevail on a late notice defense: prejudice is just one factor that the courts consider in determining whether the insured has provided the insurer with proper notice. That is, absence of prejudice does excuse the insured from its obligation to give timely notice.<sup>165</sup> A recent appellate holding in *Millers Mutual Insurance Assn v. Graham Oil Co.*,<sup>166</sup> a case involving late notice under a liability policy, is most instructive:

**Late Notice &  
Proof of Loss**

Notice of occurrence provisions in insurance liability policies are valid prerequisites to coverage, and should not be considered mere technical requirements for the convenience of the insurer. A provision calling for notice "as soon as practicable," such as the one at bar, requires notice to the insurer within a reasonable time. The test for the reasonableness of the notice given is "whether any reasonably prudent person could foresee a lawsuit upon receipt of the first notice that would involve the insurer's policy and would either contact his attorney or his liability carrier." Whether notice was given within a reasonable time is usually a question of fact and depends upon the facts and circumstances of each individual case. Where there is no controversy as to the facts, however, the issue becomes one of law. *Sears, Roebuck*, 254 Ill. App. 3d at 692.<sup>167</sup>

Section 143.1 of the Illinois Insurance Code<sup>168</sup> provides that whenever a policy of insurance contains a provision limiting the period within which the insured may bring suit, the running of such period is tolled from the date the proof of loss is filed until the date the claim is denied in whole or in part. The courts regularly uphold suit limitation provisions. However, most of the decisions concern provisions requiring that suit be commenced within one or two years following the "date of

**Late Suit**

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<sup>165</sup> *Equity Gen. Ins. Co. v. Patis*, 456 N.E.2d 348 (Ill. App. Ct. 1983); *see also* *USF&G v. Maren Eng'g Corp.*, 403 N.E.2d 508 (Ill. App. Ct. 1980).

<sup>166</sup> 668 N.E.2d 223 (Ill. App. Ct. 1996).

<sup>167</sup> *Id.* (citation omitted).

<sup>168</sup> ILL. REV. STAT., ch. 73, para. 775.1 (1985).

loss,"<sup>169</sup> as opposed to "the date loss is discovered" provision of most fidelity policies. In *Central National Life Insurance Co. v. Fidelity & Deposit Co. of Maryland*,<sup>170</sup> the court held that, under a fidelity bond providing coverage only for losses sustained through employee dishonesty or fraud, the period of limitations for giving notice to the insurer and for bringing action upon the bond (twenty-four months) ran from the time the insured possessed knowledge that the loss was due to its employee's "dishonest or fraudulent" acts. Although the district court had dismissed the insured's complaint for failure to commence an action within two years of discovering that it had sustained a loss, the circuit court reversed, holding that the determination of when the insured discovered that it had sustained a loss "due to dishonesty" was an issue of fact for the jury to be determined by a subjective standard.<sup>171</sup>

### **Prejudice**

While the absence of actual prejudice to the insurer may be a factor to be considered in determining the propriety of the notice and the diligence of the insured, it does not conclusively establish whether notice was timely.<sup>172</sup> Thus, the issue in a case involving late notice is not whether the insurer has been prejudiced, but rather, whether reasonable notice has been given.<sup>173</sup>

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<sup>169</sup> *Wabash Power Equipment Co. v. Int'l Ins. Co.*, 540 N.E.2d 960 (Ill. App. Ct. 1989). The court declined to construe the suit limitation provision in a (property) theft policy, requiring the insured to commence suit within one year of the date of loss, to validate a suit commenced within one year from the date the insured discovered the loss.

<sup>170</sup> 626 F.2d 537 (7th Cir. 1980).

<sup>171</sup> *Cf. Kinzer v. Fidelity & Dep. Co. of Md.*, 652 N.E.2d 20 (Ill. App. Ct. 1995).

<sup>172</sup> *Mitchell Buick & Oldsmobile Sales, Inc. v. National Dealer Svcs., Inc.*, 458 N.E.2d 1281 (Ill. App. Ct. 1985).

<sup>173</sup> *U.S. Fid. & Guar. Co. v. Maren Engineering Corp.*, 403 N.E.2d 508 (Ill. App. Ct. 1980).

## INDIANA

Indiana courts have ruled in general that a showing of actual prejudice arising from an insured's noncompliance with insurance policy provisions is required before an insurer can be relieved of liability. The burden of proof lies with the insurer.<sup>174</sup> Nevertheless, the court in *Miller v. Dilts*<sup>175</sup> stated that the insured's failure to provide the insurer with timely notice created a presumption of prejudice, i.e., that the insurer was denied the opportunity to prepare an adequate defense, thereby relieving the insurer of the burden of establishing actual prejudice. However, the presumption is rebuttable, as an insured (or an injured claimant) is permitted to come forward with some evidence to show that the insurer was not prejudiced, in which case the issue becomes a question for the jury. In *Stuyvesant Insurance Co. v. United Public Insurance Co.*,<sup>176</sup> a case involving timely notice under a reinsurance contract, the court indicated that it would hold insured corporations to a higher standard of timeliness than individual claimants, and concluded that a lapse of eight months was unreasonable in light of the reinsurance contract. In *Muncie Banking Co. v. American Surety Co.*,<sup>177</sup> the court applied Indiana law, and rejected the insured's assertion that, in the absence of prejudice, a delay of more than nine months in presenting a non-fidelity claim under a bankers blanket bond could satisfy the requirement that notice be given within a "reasonable time."

*Late Notice*

In *Fletcher Savings & Trust Co. v. American Surety Co. of New York*,<sup>178</sup> a case dealing with notice under a fidelity bond, the court held that the notice provision requiring notice "as soon as practicable" requires only that the insured provide notice "within a reasonable amount of time" after it had "learned" of the loss.

*Discovery*

<sup>174</sup> *Miller v. Dilts*, 463 N.E.2d 257 (Ind. 1984).

<sup>175</sup> *Id.*

<sup>176</sup> 221 N.E.2d 358 (Ind. Ct. App. 1966).

<sup>177</sup> 200 F.2d 115 (7th Cir. 1952).

<sup>178</sup> 175 N.E. 247 (Ind. Ct. App. 1931).

IOWA

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**Late Notice**

It appears that Iowa has yet to consider the issue of late notice in the context of employee fidelity insurance. Generally, when timely notice is a condition precedent to coverage in a liability policy, the claimant must show substantial compliance.<sup>179</sup> In order to maintain an action against the insurer, absent this showing of substantial compliance, the claimant must demonstrate that the failure to comply was excused, that the requirements of the condition were waived, or that the failure to comply did not prejudice the insurer.<sup>180</sup>

Unless the claimant meets the burden of showing substantial compliance, or alternatively establishes excuse, waiver, or lack of prejudice, prejudice to the insurer must be presumed.<sup>181</sup> In *Dico, Inc. v. Employers Insurance of Wausau*,<sup>182</sup> an environmental clean-up case, the court held that where the insured's delay in providing timely notice to its comprehensive general liability carrier was a matter of weeks, compliance was an issue for the jury. In so holding, the court distinguished its decision in *Fireman's Fund Insurance Co. v. ACC Chemical Co.*,<sup>183</sup> where it held that an insured's lack of compliance with notice requirements can be determined as a matter of law when the delay is measured in terms of months and years.

**Discovery**

In the turn-of-the-century case *Perpetual Building & Loan Ass'n v. United States Fidelity & Guaranty Co.*,<sup>184</sup> the court noted that discovery of an employee defalcation often depends upon "a long train of events or the examination of extended accounts," which frequently appear to be consistent with innocence. Accordingly, the court held that the insured was not required to notify the bonding company until it was "reasonably certain" that it had sustained a loss due to dishonesty.

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<sup>179</sup> *Met Coil Sys. Co. v. Columbia Indem. Co.*, 524 N.W.2d 650 (Iowa 1994).

<sup>180</sup> *Burns v. Hartford Acc. & Indem. Co.*, 407 N.W.2d 876 (Iowa 1987).

<sup>181</sup> *American Guar. & Lib. Ins. Co. v. Chandler Mfg. Co.*, 467 N.W.2d 226, 228 (Iowa 1991).

<sup>182</sup> No. 102 / 96-1824, 1998 Iowa Sup. LEXIS 152 (July 1, 1998).

<sup>183</sup> 538 N.W.2d 259, 265 (Iowa 1995).

<sup>184</sup> 92 N.W. 686 (Iowa 1902).

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**KANSAS**

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An insurer must show that it suffered prejudice by late notice in order to avoid liability under an insurance contract.<sup>185</sup>

***Late Notice***

Where discovery under a bankers blanket bond occurred on January 2, 1977 (but the court stated that it suspected that the bank had some knowledge as early as October, 1976) and notice was given to the insurer on January 19, 1977, the insurer was prejudiced by the bank's failure to give "notice as soon as practicable," because the surety's loss increased between discovery and notice when the bank continued to pay additional kited checks.<sup>186</sup>

Failure to submit a proof of loss within the time limit provided by a fidelity bond does not justify a denial of coverage under the bond unless the insurer shows that it has been substantially prejudiced by the untimely proof of loss.<sup>187</sup>

***Late Proof of Loss***

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<sup>185</sup> Continental Ins. Co. v. Wichita Federal Sav. & Loan Ass'n, No. 84 1218, 1988 U.S. Dist. LEXIS 18253 (D. Kan. June 17, 1988).

<sup>186</sup> Security Nat'l Bank of Kansas City v. Continental Ins. Co., 586 F. Supp. 139 (Kansas 1982).

<sup>187</sup> National Union Fire Ins. Co. of Pittsburgh, Pa. v. Federal Dep. Ins. Corp., 1998 Kan. LEXIS 97 (Kan. April 17, 1998).

## KENTUCKY

*Late Notice*

In *Jones v. Bituminous Casualty Corp.*,<sup>188</sup> Kentucky's supreme court abandoned the traditional condition precedent analysis that had characterized Kentucky law until 1991, and held that an insurer cannot withdraw coverage on the ground that a notice condition has not been met, unless the insurer can show that it was prejudiced by the act of the insured.<sup>189</sup> The burden is on the insurance carrier to prove there was, in fact, some "substantial prejudice" caused by the delay in reporting the occurrence. In the absence of conclusive proof, or a failure of proof, the issue is for the jury.

Whether the Kentucky Supreme Court's adoption of the Notice Prejudice Rule in 1991 should be read as vitiating its decision in *Shatz v. American Surety Co.*<sup>190</sup> is an open question. There, in the face of the insured's contention that it should not be held to strict compliance with the policy's fifteen day notice requirement, the court concluded that, although the issue of whether notice had in fact been given within fifteen days was for the jury, the provision requiring notice to be given within such time was a condition precedent to recovery. Specifically, the court stated that "It is well settled that in fidelity insurance of this kind the notice and proof of loss must be given within the time limits fixed by the policy."<sup>191</sup>

The *Jones* court does not include the *Shatz* case (or the cases cited therein as precedent) in the list of cases it specifically overrules in abandoning a traditional condition precedent analysis. Moreover, in deciding the *Jones* case, Kentucky's supreme court relied upon the

<sup>188</sup> 821 S.W.2d 798 (Ky. 1991).

<sup>189</sup> The following cases turned upon a condition precedent analysis, and accordingly their validity as Kentucky precedence on this issue should no longer be relied upon: *Fidelity & Dep. Co. of Md. v. Courtney*, 225 S. Ct. 833 (1902); *Reserve Ins. Co. v. Richards*, 577 S.W.2d 417 (Ky. 1978) (notice thirteen months after action filed did not comply with "as soon as practicable" provision of the policy and thus failed to satisfy condition precedent to coverage); *Aetna Cas. & Sur. Co. v. Martin*, 377 S.W.2d 583 (Ky. 1964); *Shipley v. Kentucky Farm Bureau Ins.*, 747 S.W.2d 596 (Ky. 1988). The latter three cases were expressly overruled by the Kentucky supreme court in *Jones*, 821 S.W.2d 798.

<sup>190</sup> 295 S.W.2d 809 (Ky. 1955).

<sup>191</sup> *Id.* at 816.

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same rationale for adopting the Notice Prejudice Rule as has formed the predicate for that decision elsewhere, i.e., that insurance policies are contracts of adhesion, etc. Accordingly, a principled argument can be made that Kentucky still adheres to a condition precedent analysis in fidelity cases.

Assuming that the *Schatz* case continues to be viable precedent,<sup>192</sup> notice is not required to be given under a fidelity bond until there is actual knowledge on the part of the insured of a dishonest act or loss, "mere suspicion thereof not being sufficient."<sup>193</sup> "[A]fter suspicion is aroused, the obligee in the bond 'ought to pursue its inquiries with reasonable diligence, and when satisfied that the defalcation exists, and the extent, or the substantial extent, of it notice of the fact ought to be given promptly to the insurer'."<sup>194</sup>

#### *Discovery*

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<sup>192</sup> *Schatz* has been cited by the Kentucky Supreme Court in post-*Jones* decisions bearing upon issues unrelated to late notice. See *Steelevest Inc. v. Scansteel Serv. Ctr.*, 908 S.W.2d 104 (Ky. 1995).

<sup>193</sup> *Id.*

<sup>194</sup> *Maryland Cas. Co. v. Magoffin County Board of Educ.*, 358 S.W.2d 353, 357 (Ky. Ct. App. 1961).

## LOUISIANA

**Late Notice**

In *Peavey Co. v. Zurich Insurance Co.*,<sup>195</sup> the court held that the "rule in Louisiana is that where the requirement of timely notice is not an express condition precedent, the insurer must demonstrate that it was sufficiently prejudiced by the insured's late notice."<sup>196</sup> "[T]ime limits on notice or proof of loss provisions are generally valid,"<sup>197</sup> insofar as their purpose is served, i.e., "to furnish the insurer with all relevant data necessary to determine the extent of its potential liability and to prevent the insured from committing fraud or ill practices and the insurer from being placed at a disadvantage in obtaining evidence."<sup>198</sup> However, as the purpose is not to provide [a surety] with a "technical escape-hatch [sic] by which to deny coverage ..."<sup>199</sup> both state and federal courts have held that failure to comply with any notice provision in an insurance contract can void coverage only if the insurer proves that it was actually prejudiced by the lapse.<sup>200</sup>

**Prejudice**

In *Resolution Trust Corp. v. Gaudet*,<sup>201</sup> the insurer, United States Fidelity and Guaranty ("USF&G"), asserted that it had been prejudiced (i) by the insured's failure to object to the principal defalcator's discharge in bankruptcy; (ii) by the loss of part of the record in underlying litigation concerning the transactions that gave rise to the claim; and (iii) by the risk that relevant documents had been lost and witnesses' memories had faded during the five years that elapsed between discovery and notice. The court rejected these assertions holding that (i) the principal's penalty raised a material issue of fact as to the actual prejudice to USF&G arising from his bankruptcy; (ii) USF&G had not demonstrated that

<sup>195</sup> 971 F.2d 1168, 1173 (5th Cir. 1992).

<sup>196</sup> *Id.*

<sup>197</sup> *J.S. Fraering, Inc. v. Employers Mutual Liability Ins. Co.*, 242 F.2d 609 (5th Cir. 1957).

<sup>198</sup> *Resolution Trust Corp. v. Gaudet*, 907 F. Supp. 212 (E.D. 1995).

<sup>199</sup> *Miller v. Marcantel*, 221 So.2d 557, 559 (La. App. 3rd Cir. 1969).

<sup>200</sup> *Gaudet*, 907 F. Supp. 212; *Resolution Trust Corp. v. Ayo*, Civ. A. No. 98-0082, 1992 U.S. Dist. LEXIS 13649 (E.D. La. Sept. 9, 1992).

<sup>201</sup> 907 F. Supp. 212 (E.D. La. 1995).

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the missing record contained relevant information; and (iii) the "risk" of lost documents was not sufficient, absent proof that documents had actually been destroyed or lost.<sup>202</sup>

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<sup>202</sup> *Id.* at 218-219; *cf.* Jackson v. State Farm Mut. Auto. Ins. Co., 239 So. 2d at 173, 177 (La. 1970) (prejudice is only one of the factors to be considered in "balancing the equities" on a determination of whether late notice bars coverage); *see also* Elevating Boats, Inc. v. Gulf Coast Marine, Inc., 766 F.2d 195, 199-200 (5th Cir. 1985) (insurer prejudiced by insured's late notice of an accident, given insured's failure to file a third-party demand against clearly negligent owner of the accident site).

MAINE

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*Late Notice*

Maine does not appear to have a reported case involving fidelity insurance. A liability insurer must show that the notice provision was in fact breached, and that the insurer was prejudiced by the insured's delay. Proof of prejudice presents a question of fact for the jury.<sup>203</sup>

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<sup>203</sup> Ouellette v. Maine Bonding & Cas. Co., 495 A.2d 1232 (Me. 1985).

## MARYLAND

Maryland does not maintain any precedent relating to late notice in the context of fidelity bonds.<sup>204</sup> However, as the first state to enact a statute requiring that the insurer demonstrate prejudice when the insured fails to provide timely notice,<sup>205</sup> Maryland was the vanguard of the "modern trend" toward prejudice. Later, in reaction to *Watson v. U. S. Fid. & Guar. Co.*,<sup>206</sup> which limited the effect of the statute, Maryland's General Assembly expressly expanded the scope of its statute from motor vehicle liability policies to cover all liability policies.<sup>207</sup>

*General*

Under Maryland law, an insurer cannot avoid coverage on grounds of late notice unless the insurer proves by a "preponderance of affirmative evidence" that it suffered "actual prejudice."<sup>208</sup>

*Late Notice*

In *St. Paul Fire & Marine Insurance Co. v. House*,<sup>209</sup> the Court of Special Appeals of Maryland first confronted the issue of whether Article 48, Section 482 applies to liability policies written in the form of "claims-made" or "discovery" policies. At that time, the statute applied to "any policy of liability insurance." Interpreting "any" to signify "every" or "all," the *House* court found that a "professional liability policy" fell within the language of the statute.<sup>210</sup> The *House* court further commented on the breadth of the statute, and stated that it discovered nothing in the language of the statute that excludes "claims-made" policies.<sup>211</sup> On stat-

<sup>204</sup> Cf. *First Nat'l Bank & Trust Co. v. Security Mut. Cas. Co.*, 285 F. Supp. 337 (D. Md. 1968).

<sup>205</sup> MD. CODE ANN. 1957, Art. 48A, § 482.

<sup>206</sup> 189 A.2d 625 (1963).

<sup>207</sup> *St. Paul Fire & Marine Ins. Co. v. House*, 554 A.2d 404 (1989).

<sup>208</sup> MD. CODE ANN. 1957, Art. 48A, § 482; see *Commercial Union Ins. Co. v. Porter Hayden Co.*, 698 A.2d 1167, 1197 (Md. 1997).

<sup>209</sup> 533 A.2d 301 (1987).

<sup>210</sup> *Id.*

<sup>211</sup> *Id.*

utory construction grounds, the court of appeals affirmed *House* by a four to three decision.<sup>212</sup>

In *T.H.E. Insurance Co. v. P.T.P., Inc.*,<sup>213</sup> the court of appeals discussed an issue that the *House* court did not reach, namely the effect Article 48A, Section 482 has upon late notice when the claims-made liability policy under which the claim is made has expired. Following Chief Judge Murphy's dissent in the *House* decision, the *T.H.E.* court opined that when a claims-made policy has expired, no breach could occur.<sup>214</sup> Because the policy ceases to exist when it expires, the statute cannot apply to claims-based policies when the insured delivers such late notice.<sup>215</sup>

**Discovery**

The insured's obligation to deliver notice accrues when circumstances known to the insured at that time would suggest the possibility of a claim to a reasonable person.<sup>216</sup>

**Prejudice**

Allegations of only "possible, theoretical, conjectural, or hypothetical" prejudice do not constitute "actual prejudice."<sup>217</sup> The Maryland courts will not surmise nor presume prejudice from the length of delay, even when the insured fails to notify the insurer two and one-half years after the loss has occurred.<sup>218</sup> Nevertheless, as a practical reality, when the insured provides notice in a "gross and inexcusable" manner, the insurer can satisfy the prejudice requirement more easily.<sup>219</sup> The court will measure prejudice only at the time of trial.<sup>220</sup>

<sup>212</sup> *House*, 554 A.2d 404.

<sup>213</sup> 628 A.2d 223 (Ct. App. 1993).

<sup>214</sup> *Id.* at 227-228 (late notice after a claims-made policy expires does not constitute a breach by the insured, as no coverage exists).

<sup>215</sup> *Id.*

<sup>216</sup> *Commercial Union Ins. Co.*, 698 A.2d at 1194.

<sup>217</sup> *Id.* at 1197 (citing *Hartford Acc. & Indem. v. Sherwood*, 680 A.2d 554, 561-562 (Md. Ct. App. 1996)); see *House*, 554 A.2d at 406.

<sup>218</sup> *Woodfin Equities Corp. v. Hartford Mut. Ins. Co.*, 678 A.2d 116, 136; *Sherwood*, 680 A.2d at 561-562.

<sup>219</sup> *Commercial Union Ins. Co.*, 698 A.2d at 1195.

<sup>220</sup> *Warren v. Hardware Dealers*, 224 A.2d 271 (Md. 1966).

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MASSACHUSETTS

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The Notice Prejudice Rule has been effectively abrogated in respect to contracts providing fidelity insurance. A detailed discussion of *FDIC v. INA*, with reference to the principal Massachusetts decisions applying the Notice Prejudice Rule in situations involving liability insurance, appears in the preceding article.<sup>221</sup>

*Late Notice*

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<sup>221</sup> See *Johnson Controls, Inc. v. Bowes*, 409 N.E.2d 185 (Mass. 1980) (notice prejudice rule in liability insurance context); see also *United States v. National Grange Mut. Ins. Co.*, Civil Action No. 92-12813-MAP, 1994 WL 13321 (D. Mass. Sept. 16, 1994) (held, notice requirement would be strictly enforced against the government, where 300 days lapsed before government provided notice of employee fidelity loss. see also *J.I. Corp v. Federal Ins. Co.*, 920 F.2d 118 (1st Cir. 1990) (under a fidelity policy providing claims-made and reported coverage, insured's failure to comply with notice provisions barred recovery).

## MICHIGAN

<b>General</b>	There exists a "general reluctance on the part of Michigan courts to allow insurers to escape liability due to [failure to comply with] notice provision[s]." <sup>222</sup> Nevertheless, and contrary to the current trend in Michigan, two fidelity cases, which focus upon late notice and late suit have favored insurers. In <i>Franklin Electric v. Home Ins. Co.</i> <sup>223</sup> and <i>Goosen v. Indemnity Ins. Co.</i> , <sup>224</sup> the courts held that the insured's failure to comply with a fidelity policy's late notice and late suit conditions barred an action by the trustee for bankrupt insured.
<b>Late Notice</b>	Michigan case law covering late notice centers on liability insurance. Under Michigan cases involving liability policies, late notice by the insured can act as an absolute defense to coverage only where the insurer can demonstrate prejudice by the delay. <sup>225</sup> Otherwise, late notice will not eliminate the insurer's obligation under the policy. <sup>226</sup> Furthermore, in cases involving liability policies, failure to deliver the required notice within the specified time "shall not" invalidate any claim if the insured could not reasonably give notice within the specified period, and in fact gives notice as soon as reasonably possible. <sup>227</sup>
<b>Late Proof of Loss</b>	As a general rule, Michigan courts strictly enforce the standard sixty-to ninety-day requirement to file a proof of loss. <sup>228</sup> Despite significant case law requiring prejudice, Michigan courts have barred recovery where the

<sup>222</sup> *West Bay Exploration Co. v. AIG Specialty Agencies of Texas, Inc.*, 915 F.2d 1030 (6th Cir. 1990).

<sup>223</sup> No. 89-005C(3), 1990 U.S. Dist. LEXIS 19529 (E.D. Mo. June 15, 1999).

<sup>224</sup> 234 F.2d 463, 465 (6th Cir. 1956).

<sup>225</sup> *Employers Ins. of Wausau v. Petroleum Specialties*, No. 91-1182, 1997 U.S. Dist. LEXIS 2553 at \*20 (E.D. Mich. Jan. 31, 1997); *West Bay Exploration Co.*, 915 F.2d 1030 (6th Cir. 1990); *Wendel v. Swanberg*, 185 N.J.W.2d 348 (Mich. 1971).

<sup>226</sup> *West Bay Exploration Co.*, 915 F.2d at 1036; *Upjohn Co. v. Aetna Cas. & Sur. Co.*, 768 F. Supp. 1186 (1990); *Wood v. Duckworth*, 401 N.W.2d 258 (1986); *Burgess v. American Fid. Fire Ins. Co.*, 310 N.W.2d 23 (1981); *Wendel*, 185 N.W.2d at 353.

<sup>227</sup> MICH. COMP. LAWS ANN. § 500.3009 (West 1983); see *Minott v. Gen'l Elec. Credit Auto Lease, Inc.*, No. 91-1182, 1991 U.S. App LEXIS 29846 at \*4 (6th Cir. Dec. 10, 1991).

<sup>228</sup> *Tom Thomas Organization, Inc. v. Reliance Ins. Co.*, 242 N.W.2d 396 (Mich. 1975).

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policy makes filing a proof of loss within sixty days a condition precedent, regardless of prejudice.<sup>229</sup> These cases that have barred recovery relate to insurance contracts with specific time limits for notice or proof of loss.<sup>230</sup> The Michigan courts, however, have created a second line of authority distinguishing policies employing language open to interpretation, e.g., "as soon as practicable." Policies that contain the language "as soon as practicable" require a showing of prejudice.<sup>231</sup>

In *Franklin Electric*,<sup>232</sup> the insured filed suit against the insurer, claiming that the insurer breached its duty to indemnify each of the four fidelity losses that the insured had suffered. The employee dishonesty bond at issue stated that no action could lie against the insurer unless the insured commenced it within two years from the date of discovery. Although recognizing the well-settled precedent requiring prejudice for untimely notice of loss, the *Franklin Electric* court found that the insured presented no case law extending the prejudice analysis from the timely notice of loss to the timely suit provision. The *Franklin Electric* court further held, as a matter of law, that the provision requiring the insured to file suit within two years of discovery of loss made the action untimely, barring recovery.

#### **Late Suit**

In general, absent a statute, Michigan courts will find late suit provisions valid if reasonable, even though the applicable statutes of limitation may prescribe a longer time limit.<sup>233</sup> In *Tom Thomas Organization, Inc. v. Reliance Insurance Co.*,<sup>234</sup> the court found that the running of the limitation for suit against the insurer

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<sup>229</sup> See *Continental Studios, Inc. v. American Auto, Ins. Co.*, 64 N.W.2d 615 (Mich. 1954).

<sup>230</sup> *Id.*

<sup>231</sup> *Minott*, 1991 U.S. App. LEXIS at \*7-\*8; *Dellar*, 433 N.W.2d at 382-383; *Reynolds*, 332 N.W.2d at 583-584 (expressly distinguishing prejudice cases involving "as soon as practicable" policies from cases involving specific notice period policies).

<sup>232</sup> Civil Action No. 89-CV-40064-FL, 1990 U.S. Dist. LEXIS 19529 (E.D. Mich. Apr. 5, 1990).

<sup>233</sup> *Tom Thomas*, 242 N.W.2d at 397-398.

<sup>234</sup> *Id.*

should be tolled from the time the insured gives notice until the insurer formally denies liability.<sup>235</sup>

**Prejudice**

In analyzing the purpose of notice provisions, Michigan courts have found prejudice where the delay "materially" impairs an insurer's ability to contest its liability to an insured or the liability of the insured to a third party.<sup>236</sup> The burden of showing prejudice rests upon the insurer.<sup>237</sup> Although the insurer need not prove that, but for the delay, it would have avoided liability,<sup>238</sup> prejudice to the insurer is a material element in determining whether the insured delivered notice in a reasonable manner.<sup>239</sup> Although the trier of fact normally determines the question of prejudice, where only "one conclusion is reasonably possible," the issue of prejudice becomes a matter of law.<sup>240</sup>

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<sup>235</sup> *Id.* at 399-400.

<sup>236</sup> *West Bay Exploration Co.*, 915 F.2d at 1036-1037, *Anderson v. Kemper*, 254, 340 N.W.2d 87 (1983).

<sup>237</sup> *West Bay Exploration Co.*, 915 F.2d at 1036; *Burgess*, 310 N.W.2d at 24-25.

<sup>238</sup> *Steelcase, Inc. v. American Motorists Ins. Co.*, 907 F.2d 151 (6th Cir. 1990).

<sup>239</sup> *Wendel*, 310 N.W.2d at 353.

<sup>240</sup> *West Bay Exploration Co.*, 915 F.2d at 1037.

## MINNESOTA

A fidelity insurer is obligated to establish prejudice before it can avoid coverage under a standard "discovery bond."<sup>241</sup> However, a claims-made policy obviates the need to demonstrate prejudice. Because the notice requirement in a claims-made policy defines the scope of coverage, "a delay in notice beyond the policy period would alter a basic term of the insurance contract."<sup>242</sup>

*Late Notice*

Minnesota courts uphold notice provisions to serve an underlying policy of giving the insurer "an opportunity for prompt investigation so as to protect itself against fraudulent or exorbitant claims and, while the matter is fresh in the minds of all, to appraise and determine a disposition by way of settlement or defense."<sup>243</sup> An insurer must show prejudice from the insured's delay in giving notice of a claim or proof of loss, unless the notice and proof of loss requirements are express conditions precedent to liability.<sup>244</sup>

Failure to give notice may prejudice the insurer, as the lapse of time can deprive it of the opportunity to promptly investigate the loss and protect its rights of subrogation and other interests.<sup>245</sup> "The definitive factor is not how much time elapses ... it is what happens during that time."<sup>246</sup> In *Winthrop & Weinstine P.A. v. Travelers Casualty & Surety Co.*,<sup>247</sup> the court held that the insured's execution of a release and assignment of its rights and claims against the defalcating employee to another insurance company constituted actual prejudice, as did its delay in pursuing its rights against various banks that paid on altered checks. The court

*Prejudice*

<sup>241</sup> *Winthrop & Weinstine, P.A., v. Travelers Cas. & Surety Co.*, No. 4-96-656, 1998 U.S. Dist. LEXIS 1874 (D. Minn. Feb. 17, 1998).

<sup>242</sup> *Esmailzadeh v. Johnson*, 869 F.2d 422, 424 (8th Cir. 1989).

<sup>243</sup> *Sterling State Bank v. Virginia Surety Co.*, 173 N.W.2d 342, 346 (Minn. 1969).

<sup>244</sup> *Sterling*, 173 N.W.2d at 346; *cf.* *Bowlin v. Hekla Fire Ins. Co.*, 31 NW. 859 (Minn. 1887).

<sup>245</sup> *See American Family Mut. Ins. Co. v. Baumann*, 459 N.W.2d 923, 927 (Minn. 1990) (recognizing prejudice to insurer absent notice of settlement).

<sup>246</sup> *Hooper v. Zurich Am. Ins. Co.*, 552 N.W.2d 31, 36 (Minn. Ct. App. 1996).

<sup>247</sup> *Winthrop & Weinstine, P.A., v. Travelers Cas. & Surety Co.*, No. 4-96-656, 1998 U.S. Dist. LEXIS 1874 (D. Mn. Feb. 17, 1998).

rejected the insured's assertion that its recovery should merely be reduced in proportion to the rights prejudiced, and held that actual prejudice operates as a complete bar to recovery.

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MISSISSIPPI

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Mississippi is a prejudice state that has unabashedly identified the ambiguity in its law as a proper basis for imposing a prejudice requirement. In *Lawler v. Government Employees Insurance Co.*,<sup>248</sup> the state supreme court held:

*Late Notice*

First a prejudice requirement ameliorates incentives to litigation otherwise emanating from notice clauses, together with the arbitrary results certain to flow from multiple decisions construing and applying those "roomy words": "as soon as practicable." Second, absent prejudice, we perceive no legitimate interest of insurers that might be thwarted by a late notice. We balance this view against the catastrophe the average citizen experiences from an uninsured loss and have little trouble concluding that prudent public policy points to a prejudice requirement.<sup>249</sup>

Nevertheless, an insured must comply literally with conditions precedent, because a breach of a condition precedent bars recovery even if the insurer suffers no prejudice by the breach.<sup>250</sup> It therefore seems safe to predict that a fidelity insurer would have to prove prejudice where the policy at issue did not expressly identify its notice requirements as "conditions precedent."<sup>251</sup>

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<sup>248</sup> 569 So.2d 1151 (Miss. 1990) (dissenting opinion).

<sup>249</sup> *Id.*

<sup>250</sup> See Comment, *Insurance Notice Clauses in Mississippi*, 44 Miss. L.J. 947, 964-66 (1973) (if the language of the insurance policy clearly makes timely notice a condition precedent to liability under the policy, the policy must be strictly construed and prejudice is not a factor).

<sup>251</sup> See *International Ins. Co. v. McMullan*, No. J84-0760(W), 1990 U.S. Dist. LEXIS 19940 (S.D. Miss. March 7, 1990) (declaratory judgment precluding coverage on certain bank indemnification policies which expressly required, as a condition precedent to recovery, 'notice as soon as practicable in writing'); *Mississippi v. Richardson*, 817 F.2d 1203 (5th Cir. 1987) (affirming district court's denial of recovery as barred due to late notice given under a public officials liability policy, on grounds that bond language expressly made timely notice a "condition precedent" to recovery under the policy).

In the absence of express condition precedent language, the issue becomes whether notice has been given so late or under such circumstances that it becomes presumptively prejudicial.<sup>252</sup> On the issue of timeliness, Mississippi courts appear irreconcilably erratic.<sup>253</sup>

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<sup>252</sup> Young v. Travelers Ins. Co., 119 F.2d 877, 880 (5th Cir. 1941); Aetna Life Ins. Co. v. Walley, 164 So. 16 (Miss. 1935); see Hartford Acc. & Indem. Co. v. Hattiesburg Hardware Stores, Inc., 49 So. 2d 813, 819 (Miss. 1951).

<sup>253</sup> West v. Bankers & Shippers Ins. Co. of New York, 643 F. Supp. 992 (N.D. Miss. 1986), *aff'd*, 814 F.2d 657 (5th Cir. 1987) (held, notice given three years after an original state court action was filed against the insured, and one and one-half years after a default judgment had been entered was not notice given "as soon as practicable"); Bolivar County Bd. of Supervisors v. Forum Ins. Co., 779 F.2d 1081, 1084 (5th Cir. 1986) (notice of a claim for reimbursement of attorneys' fees was not "as soon as practicable" when given after insured spent \$ 88,000 to litigate a suit); Reliance Ins. Co. v. County Line Place, 692 F. Supp. 694 (S.D. Miss. 1988) ("excessive" 10 month delay in providing notice was dated from the subsequent lawsuit commenced some two months after the insured knew of an occurrence); Harris v. American Motorist Ins. Co., 126 So. 2d 870 (Miss. 1961); Lawler v. Government Employees Ins., 569 So. 2d 1151 (Miss. 1990) (six year and eight month delay not deemed presumptively prejudicial; *cf.* Ross v. Crane Co., 350 So. 2d 697, 698-99 (Miss. 1977) (six-year delay *per se* unreasonable).

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MISSOURI

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Missouri courts have consistently placed the burden on insurers to demonstrate that they have been prejudiced by a delay before allowing them to avoid coverage on the grounds of late notice of claim.<sup>254</sup> Prejudice to the insurer will not be presumed from the mere fact of an insured's delay in giving notice,<sup>255</sup> and the presence or absence of prejudice in this context is an issue of fact to be determined on the particulars of each case.<sup>256</sup> In *Hendrix v. Jones*,<sup>257</sup> the state supreme court held that the insurer bears the burden of proving prejudice, and noted that a presumption in favor of the insurer was undesirable on public policy grounds, since it "could unfairly deprive innocent injured persons of the benefit of a valid judgment and provide the insurer an undeserved windfall."<sup>258</sup>

*Late Notice*

Nevertheless, in *Columbia Union National Bank v. Hartford Accident & Indemnity Co.*,<sup>259</sup> the Court of Appeals for the Eighth Circuit, applying Missouri law, affirmed a grant of summary judgment by the district court, which held that the insured had failed to give timely notice of its loss, to the insurer's prejudice. Because timely notification would have allowed the insurer, Hartford, to minimize its potential loss by freezing an account from which checks were being improperly paid, Hartford was prejudiced by the insured's delay. Because this late notice violated a condition precedent to coverage under the policy, the court

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<sup>254</sup> Greer v. Zurich Ins. Co., 441 S.W.2d 15 (Mo. 1969).

<sup>255</sup> Katz Drug Co. v. Commercial Standard Ins., 647 S.W.2d 831, 836 (Mo. Ct. App. 1983).

<sup>256</sup> Reid v. Connecticut Gen'l Life Ins. Co., 17 F.3d 1092, 1098 (8th Cir. 1994).

<sup>257</sup> 580 S.W.2d 740, 744 (Mo. 1979) (*en banc*).

<sup>258</sup> *Id.*; see also Cockrell v. Farmers Mut. Auto Ins. Co., 427 S.W.2d 303, 308-09 (Mo. Ct. App. 1968).

<sup>259</sup> 669 F.2d 1210 (8th Cir. 1982).

held that Hartford's refusal to defend was "not vexatious."<sup>260</sup>

In *Tresner v. State Farm Insurance Co.*,<sup>261</sup> Missouri's supreme court made it clear that an insurer must prove that it was prejudiced in order to avoid coverage for breach of timely notice requirements. The court recognized that ordinarily an insured must either prove that it complied with policy provisions requiring some kind of performance on its part, or show a sufficient excuse for non-performance.<sup>262</sup>

In reaching the foregoing conclusions in *Tresner*, Missouri's supreme court relied upon the Massachusetts case of *Johnson Controls, Inc. v. Bowes*<sup>263</sup> which was effectively distinguished from fidelity insurance cases by the First Circuit in *FDIC v. INA*, to support the requirement that an insurer prove prejudice before avoiding coverage on the grounds of late notice. Although recognizing its position as "a departure from a strict contractual approach to insurance policies," Missouri's supreme court offers the following justifications: (1) the insurance policy is a contract of adhesion; and (2) the denial of coverage for failure to comply with a notification requirement amounts to a forfeiture, since the insurer seeks to deny the insured the very thing for which the insured has paid.

#### *Discovery*

When an insurer seeks to successfully charge its insured with failure to give timely notice after discovery of a loss, the time of the asserted discovery must be the time when it was reasonable for the insured to believe and recognize that a loss had been suffered. There must be facts known to the insured at that time which would lead a reasonable person to believe that a loss had been suffered.<sup>264</sup> However, such facts should not be viewed as they may later appear in the light of subsequently

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<sup>260</sup> *Id.*

<sup>261</sup> 913 S.W.2d 7 (Mo. 1995).

<sup>262</sup> *Miles v. Iowa Nat'l Mut. Ins. Co.*, 690 S.W.2d 138, 142 (Mo. Ct. App. 1984).

<sup>263</sup> 409 N.E.2d 185, 187-88 (Mass. 1980).

<sup>264</sup> *Columbia Union Nat' Bank*, 669 F.2d at 1214.

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acquired knowledge.<sup>265</sup> Actual written notice is not required in every case.<sup>266</sup>

The requirement that the insurer bear the burden of proving prejudice from late notice is a judicially-created exception to the rule, expressed in *Missouri Commercial Investment Co. v. Employers Mutual Casualty Co.*<sup>267</sup> which establishes that the insured bears the burden of showing compliance with the requisite policy conditions, including any notice provisions, in order to make a case for recovery. *Meyers v. Smith*<sup>268</sup> holds that, while it is the general rule that the insured has the burden of proving facts essential to the insurer's liability, when the insurer seeks to escape coverage because of an alleged breach of a policy provision, the burden is on the insurer to prove facts that would relieve it from liability. This holding is a further expression of Missouri courts' aversion to forfeiture.<sup>269</sup>

**Prejudice**

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<sup>265</sup> *Jefferson Bank & Trust Co. v. Central Surety & Ins. Co.*, 408 S.W.2d 825, 823 (Mo. 1966).

<sup>266</sup> *Id.*

<sup>267</sup> 680 S.W.2d 397, 400 (Mo. Ct. App. 1984).

<sup>268</sup> 375 S.W.2d 9, 15 (Mo. 1964).

<sup>269</sup> *See Weaver v. State Farm Mut. Auto. Ins. Co.*, No. 68057, 1996 Mo. App. LEXIS 280 (Mo. Ct. App. Feb. 13, 1996) (despite uncontroverted affidavit detailing prejudice held, insurer did not sustain its burden of proving prejudice arising from one year delay in reporting auto accident).

MONTANA

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*Late Notice*

Under Montana law, timely notice is a condition precedent to recovery,<sup>270</sup> and a party seeking recovery against its insurer has the burden of proving that the requisite notice has been timely given.<sup>271</sup> Montana's courts do not appear to have recently considered the issue of late notice within the context of employee fidelity insurance.<sup>272</sup>

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<sup>270</sup> State Farm Mut. Ins. Co. v. Murnion, 439 F.2d 945 (9th Cir. 1975).

<sup>271</sup> Glacier Gen'l Assur. Co. v. State Farm Mut. Auto. Ins. Co., 436 P.2d 533 (Mont. 1968); cf. J.G. Link v. Continental Cas. Co., 470 F.2d 1113 (9th Cir. 1972).

<sup>272</sup> Annotation, *Effect of Failure to Give Notice or Delay in Giving Notice or Proof of Loss, upon Fidelity Bond or Insurance*, 23 A.L.R.2d 1065 (1997).

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NEBRASKA

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Nebraska does not require insurance companies to demonstrate prejudice.<sup>273</sup> In *First Security Savings v. Aetna Casualty & Surety Co.*,<sup>274</sup> the court affirmed a grant of summary judgment in favor of the defendant fidelity insurer, holding that, in order to recover under a "discovery" bankers blanket bond, the insured had to establish, *inter alia*, that it provided written notice at the earliest practicable moment after discovery of the loss, and furnished proof of loss with full particulars within the time specified by bond.

*Late Notice &  
Late Proof of Loss*

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<sup>273</sup> MFA Mut. Ins. Co. v. Sailors, 141 N.W.2d 846 (Neb. 1966).

<sup>274</sup> 445 N.W.2d 596 (Neb. 1989).

NEVADA

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*Late Notice*

Although Nevada has not directly considered the issue of late notice within the context of a fidelity claim, the general rule governing liability policies calls for a traditional condition precedent analysis.<sup>275</sup>

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<sup>275</sup> State Farm Mut. Auto. Ins. Co. v. Cassinelli, 216 P.2d 606 (Nev. 1950).

## NEW HAMPSHIRE

No recent cases involving late notice within the context of fidelity insurance have been reported.<sup>276</sup> New Hampshire follows its own version of the Notice Prejudice Rule, which requires the insured to demonstrate that the insurer has not been prejudiced by the insured's delay in giving notice. "A policy requirement that notice of the accident be given 'as soon as practicable' is commonly considered to require notice as soon as is reasonably possible."<sup>277</sup> Courts generally interpret this language to call for notice within a reasonable time in view of all the facts and circumstances of each particular case.

*Late Notice*

In *Sutton Mutual Insurance Co. v. Notre Dame Arena*,<sup>278</sup> the court held that the purpose of the notice requirement is to give the insurer an opportunity to make timely investigation of the incident and to prepare an adequate defense on behalf of the insured. The insured must comply with this "reasonable and valid stipulation" in order to obligate the insurer to defend and pay under the terms of its policy.<sup>279</sup> A material and substantial breach of this provision by the insured destroys its right to claim indemnity under the policy.<sup>280</sup>

The absence or extent of prejudice to the insurer caused by the delay are factors to be considered in determining whether the insured has complied with the policy condition by giving notice within a reasonable time, or has committed a substantial breach thereof by failing to give notice as soon as practicable.<sup>281</sup> In the case of a policy condition requiring that notice of an accident be given as "soon as practicable," the burden of proof is on the insured.<sup>282</sup>

*Prejudice*

<sup>276</sup> See *supra*, note 268.

<sup>277</sup> *American Employers Ins. Co. v. Sterling*, 146 A.2d 265, 267 (N.H. 1958).

<sup>278</sup> 237 A.2d 676 (N.H. 1968).

<sup>279</sup> *Fitch Co. v. Continental Ins. Co.*, 104 A.2d 511 (N.H. 1954).

<sup>280</sup> *Lumbermens Mut. Cas. Co. v. Stamell Constr. Co.*, 192 A.2d 616 (N.H. 1975).

<sup>281</sup> *Pawtucket Mut. Ins. Co. v. Lebrecht*, 190 A.2d 420 (N.H. 1963).

<sup>282</sup> *Travelers Ins. Co. v. Greenough*, 190 A. 129 (N.H. 1937).

## NEW JERSEY

**Late Notice**

A fidelity insurer must prove "appreciable prejudice" before it can deny coverage based upon late notice of a claim.<sup>283</sup>

**Late Proof of Loss**

In *Resolution Trust Corp. v. Moskowitz*,<sup>284</sup> the district court predicted that the state's supreme court would require a fidelity insurer to demonstrate "appreciable prejudice" before denying a claim based on the late filing of a proof of loss. In *Oritani Savings & Loan Ass'n v. Fidelity & Deposit Co. of Maryland*,<sup>285</sup> the district court similarly held that an insurer must show appreciable prejudice to succeed on late proof of loss defense:

Where a technical requirement in an insurance policy is not strictly met, the New Jersey courts will nevertheless provide coverage, unless the insurer demonstrates appreciable prejudice.... Prejudice will not be presumed but must be proved, and the burden of proof is on the insurer.<sup>286</sup>

**Late Suit**

New Jersey has not yet determined whether an insurer must demonstrate "appreciable prejudice" in order to enforce the contractual limitation upon an insured's time to file suit. In *National Newark & Essex Bank v. American Insurance Co.*,<sup>287</sup> however, the court reversed a dismissal predicated upon the two-year suit limitation in a fidelity policy, holding that the time within which suit must be commenced is tolled from the date of the

<sup>283</sup> *Cooper v. G.E.I.C.O.*, 237 A.2d 870 (N.J. 1968); *see* *Resolution Trust Corp. v. Moskowitz*, 868 F. Supp. 634, 639-40 (D. N.J. 1994); *cf.* *Zuckerman v. Nat'l Union Fire Ins. Co.*, 100 N.J. 304, 323, 495 A.2d 395 (1985) ("appreciable prejudice" rule does not apply to "claims-made" policies).

<sup>284</sup> 868 F. Supp. at 640.

<sup>285</sup> 744 F. Supp. 1311, *rev'd on other grounds*, 989 F.2d 635 (3d Cir. 1993).

<sup>286</sup> *Id.* (citations omitted); *Cf.* *Brindley v. Firemen's Ins. Co. of Newark*, 113 A.2d 53 (N.J. Super. Ct. 1955) (failure to timely provide a proof of loss "is fatal to recovery in the absence of a showing of waiver or at least of substantial compliance.")

<sup>287</sup> 385 A.2d 1216 (N.J. 1978).

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insured's notice of the loss until the date of insurer's declination.<sup>288</sup>

Most policies measure the timeliness of notice, proof of loss and suit from the date a loss is discovered. In *Resolution Trust Corp. v. Fidelity & Deposit Co. of Maryland*,<sup>289</sup> the court concluded that the dishonesty of various bank employees was not discovered until after the insured bank was placed into receivership (which resulted in coverage being voided). Judge Walls provided a concise statement of New Jersey law regarding discovery:

#### **Discovery**

"Discovery" of a loss under a fidelity bond occurs when the insured learns of facts or obtains knowledge which would justify a careful and prudent person in charging another with dishonesty or fraud. Mere suspicion of dishonesty or wrongdoing does not constitute discovery. "Inefficient business procedures, or irregularities and discrepancies in accounts, if as consistent with the integrity of employees as (with) their dishonesty, does not constitute a discovery, even though dishonest acts may later be found to exist." "Discovery ... imports an awareness of the significance of known facts. In determining when discovery has taken place, the trier of fact must find the pertinent underlying facts known to the insured and must further determine subjective conclusions reasonably drawn there from."<sup>290</sup>

*Essex County State Bank v. Firemens Fund Ins. Co.*,<sup>291</sup> discusses the issue of prejudice and contains dicta indicating that the intervening bankruptcy of one of the borrowers to whom the principal had extended credit - allegedly in violation of instructions from the Bank's directors - would have constituted prejudice to the fidelity insurer(s) had they asserted late notice as a

#### **Prejudice**

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<sup>288</sup> *Id.*; accord *Impex Agric. Commodities v. Leonard Parness Trucking*, 582 F. Supp. 260 (D. N.J. 1984).

<sup>289</sup> Civ. No. 92-1003 (WHW), 1998 U.S. Dist. LEXIS 3431 (D. N.J. Jan. 29, 1998).

<sup>290</sup> *Id.* (citations omitted); see also *Nat'l Newark & Essex Bank*, 385 A.2d at 1216 (noting "serious difficulties" in "pinpointing the exact time of discovery of a loss"; in most cases involving fidelity coverage, an insured discovers a loss, such as a defaulted loan, long before it discovers that employee dishonesty is involved).

<sup>291</sup> 331 F. Supp. 931 (D. N.J. 1971).

defense. Since the court disposed of the case by finding that the loans were not dishonest, it did not find it necessary to determine whether the insurers waived their late notice defense.

## NEW MEXICO

In *Foundation Reserve Insurance Co. v. Esquibel*,<sup>292</sup> the New Mexico Supreme Court held that an insurer "must demonstrate substantial prejudice as a result of a material breach of the insurance policy by the insured before it will be relieved of its obligations under a policy."<sup>293</sup> Having found that the insurer had not been substantially prejudiced by the insured's breach, the court held it was liable to defend and indemnify the insured against a third party's claim for damages sustained in an automobile accident.<sup>294</sup>

**Late Notice &  
Late Suit**

In *Roberts Oil Co., Inc. v. Transamerica Insurance Co.*,<sup>295</sup> the Supreme Court went even further, reversing summary judgment in favor of the insurers and holding that the insured's breach of the voluntary-payment clause did not discharge the insurers, absent a showing of prejudice. The Supreme Court noted that the distinction it had drawn between late notice and late suit provisions in *Sanchez v. Kemper Insurance Co.*<sup>296</sup> was "open to serious question" by reason of its adoption of the rationale embraced by the Supreme Court of Alaska in *Estes v. Alaska Insurance Guaranty Ass'n.*<sup>297</sup> The *Roberts* court acknowledges that its holding is grounded in "the context of standard-form comprehensive general liability policies, offered to insureds like Roberts on a take it or leave it basis," noting by way of contrast: "If performance of the insured's promise is made an express condition to performance of the insurer's promise, then the insurer has a better argument that its duty is discharged upon the nonoccurrence of that express condition."<sup>298</sup>

There are also indications that the relative bargaining strength of the insured will affect the application of the prejudice requirement. Although New Mexico does

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<sup>292</sup> 607 P.2d 1150 (N.M. 1980).

<sup>293</sup> *Id.* at 1152.

<sup>294</sup> *Id.*

<sup>295</sup> 833 P.2d 222 (N.M. 1992).

<sup>296</sup> 632 P.2d 343 (N.M. 1981).

<sup>297</sup> 774 P.2d 1315, 1318 (Alaska 1989).

<sup>298</sup> 833 P.2d 222 (N.M. 1992).

not report any fidelity cases involving the late notice rule, the supreme court in *New Mexico ex rel. Udall v. Colonial Penn Ins. Co.*<sup>299</sup> considered a declination by insurers who had issued public employee bonds covering a state investment officer, who had improvidently purchased shares in a foreign corporation in violation of New Mexico law. The insurers denied coverage, arguing that the state had not complied with the time-to-sue provision contained in the policies at issue. The court refused to void the provisions on public policy grounds, and gave short shrift to the state's arguments that the policies were contracts of adhesion and that the provisions were neither bargained for nor essential to the agreement. The court held that "[t]he state has offered no evidence to demonstrate that the contract was unconscionable or one of adhesion, that it was in an unequal bargaining position with the insurers."<sup>300</sup> Remarkably, the court also held that an insurer need not demonstrate prejudice from the lack of timely filing. It must show only the breach of a time-to-sue provision.

***Discovery***

The court in *Udall* also enforced a discovery-cancellation provision as written.<sup>301</sup>

***Prejudice***

Ordinarily, an insurer must demonstrate substantial prejudice as a result of a material breach of the insurance policy by the insured before it will be relieved of its obligations under a policy.<sup>302</sup>

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<sup>299</sup> 812 P.2d 777 (N.M. 1991).

<sup>300</sup> *Id.*; cf. *Guthmann v. La Vida Llana*, 709 P.2d 675 (N.M. 1985).

<sup>301</sup> *Id.*

<sup>302</sup> *Yarbrough v. State Farm Ins. Co.*, 730 F. Supp., 1061, 1065 (D. N. Mex. 1990).

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NEW YORK

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The timely giving of notice and filing of a proof of loss are conditions precedent to coverage, and the insured's failure to comply with notice provisions is a complete defense to a fidelity bond claim. The insurer need not demonstrate that it was prejudiced in order for late notice or late proof of loss to constitute a defense to coverage,<sup>303</sup> although exceptions do exist.<sup>304</sup> In *AXA Marine and Aviation Ins. (UK) Ltd. v. Seajet Industries*,<sup>305</sup> the Second Circuit explained New York's strict approach by noting that "[u]nderlying all of these distinct rationales is the difficulty of measuring or proving the harm caused by untimely notice."<sup>306</sup>

***Late Notice &  
Proof of Loss***

In contrast to situations involving primary liability insurance policies, the breach of the prompt notice provisions in a reinsurance contract is not a ground for disclaiming coverage unless the reinsurer can show that it was actually prejudiced by the delay.<sup>307</sup> Excess insurers, however, need not show prejudice to avoid coverage on the grounds of late notice.<sup>308</sup>

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<sup>303</sup> *Commercial Union Ins. Co. v. International Flavors & Fragrances*, 822 F.2d 267, 271 (2d Cir. 1987).

<sup>304</sup> *Arch-Bilt Container Corp. v. Interboro Mut. Indem. Ins. Co.*, 119 A.D.2d 713 (N.Y. Ct. App. 1986).

<sup>305</sup> 891 F. Supp. 978 (S.D.N.Y. 1995); *aff'd* 84 F.3d 622; 1996 (2d Cir. 1996).

<sup>306</sup> *Cf. American Ins. Co. v. Fairchild Indus.*, 56 F.3d 435, 440-41 (2d Cir. 1995) (stating that "an insurer cannot be expected to show precisely what the outcome would have been had timely notice been given. This uncertainty, however, is the result of the failure of the insured to comply with the policy").

<sup>307</sup> *Unigard Security Ins. Co. v. North River Ins. Co.*, 594 N.E.2d 571 (N.Y. 1992).

<sup>308</sup> *American Home Assur. Co. v. International Ins. Co.*, No. 131, No. 132, 1997 N.Y. LEXIS 1378 (June 17, 1997).

New York courts adhere strictly to prompt notification provisions, finding delays as short as ten days to be unreasonable as a matter of law.<sup>309</sup>

**Late Suit**

New York enforces policy provisions requiring suits against the insurer to be brought within a reasonable amount of time (less than the statute of limitations) after the loss (or discovery), unless the insured can show an extension, waiver or estoppel.<sup>310</sup> Settlement negotiations between an insured and its insurer do not constitute waiver or estoppel of contractual time limitations on bringing suit.<sup>311</sup>

**Discovery**

New York requires that the time of discovery be determined "according to an objective test based on the conclusions that a reasonable person would draw from the facts known to the insured."<sup>312</sup> Reasonableness pertains both to whether the insured party should have been able to recognize that an occurrence could give rise to a claim and whether, upon such discovery, the insured notified the insurer within a reasonable time.<sup>313</sup> Irrespective of specific policy language, New York law requires notice "within a reasonable time under all the circumstances."<sup>314</sup>

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<sup>309</sup> Compare *Rushing v. Commercial Cas. Ins. Co.*, 167 N.E. 450 (N.Y. 1929) (twenty-two days); *Haas Tobacco Co. v. American Fid. Co.*, 123 N.E. 775 (N.Y. 1919) (ten days); *Pandora Indus., Inc. v. St. Paul Surplus Lines Ins. Co.*, 188 A.D.2d 277 (1st Dept. 1992) (thirty-one days); *Heydt Contracting Corp. v. American Home Ass. Co.*, 536 N.Y.S.2d 770 (N.Y. App. Div. 1989) (approximately four months); *Republic New York Corp. v. American Home*, 509 N.Y.S.2d 339 (N.Y. App. Div. 1986) (rejecting insured's attempt to excuse forty-five day delay because it was "struggling to reconcile opposing viewpoints" as to whether there was actually a loss); *Power Authority v. Westinghouse Elec. Corp.*, 117 A.D.2d 336, 502 N.Y.S.2d 420 (N.Y. App. Div. 1986) (fifty-three days); *Government Employees Ins. Co. v. Elman*, 40 A.D.2d 994, 338 N.Y.S.2d 666 (N.Y. App. Div. 1972) (twenty-nine days).

<sup>310</sup> *Helios Trading Corp. v. Great American Ins. Co.*, 92 Civ. 1071, 1993 U.S. Dist. LEXIS 2859 (S.D.N.Y. Mar. 10, 1993).

<sup>311</sup> *Fox-Knapp, Inc. v. Employers Mut. Cas. Co.*, 725 F. Supp. 706 (S.D.N.Y. 1989); *Gilbert Frank Corp. v. Federal Ins. Co.*, 520 N.E.2d 512 (N.Y. 1988).

<sup>312</sup> *Utica Mut. Ins. Co. v. Fireman's Fund Ins. Co.*, 748 F.2d 118 (2d Cir. 1984).

<sup>313</sup> *Agway, Inc. v. Travelers Indemn. Co.*, No. 93-CV-557, 1993 U.S. Dist. LEXIS 21092 (N.D.N.Y. Dec. 1993).

<sup>314</sup> *Olin Corp. v. Insurance Co. of N. Am.*, 966 F.2d 718, 722 (2d Cir. 1992).

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NORTH CAROLINA

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North Carolina reports no recent precedent relating to the Notice Prejudice Rule within the fidelity bond context. Like that of many other states, North Carolina precedent stems from the analysis of liability insurance policies. In *Great American Insurance Co. v. C. G. Tate Construction Co.*,<sup>315</sup> a case that involved a series of disconcerting remands and reversals, North Carolina abandoned its traditional contract approach in favor of the "modern trend," only to have the trial judge reaffirm, on remand, his original determination - that the insured deliberately decided not to report a dramatic and explosive automobile collision, to the material prejudice of the insurer. This finding subsequently compelled the supreme court to reverse the decision of the appellate court (which had reversed the trial court following remand), and hold that it was unnecessary to make a finding as to prejudice, when the insured has willfully refused to provide timely notice.<sup>316</sup>

*Late Notice*

The *C. G. Tate* case proves valuable, nevertheless, for two reasons: first, a stinging dissent by Judge Meyer in the 1981 case presciently forecasts the confusion that followed in North Carolina, and resonates in each of those jurisdictions that has adopted the Notice Prejudice Rule; and second, the court grounded its decision to adopt a prejudice requirement almost entirely upon precedents from other jurisdictions that emphasized the disparity in bargaining positions between insurance companies and most of their insureds<sup>317</sup> - a reason that simply does not apply to fidelity insurance provided under the standard form blanket bonds.

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<sup>315</sup> 279 S.E.2d 769 (N.C. 1981).

<sup>316</sup> *Id.* (an unexcused delay by the insured in giving notice to the insurer of an accident does not relieve the insurer of its obligation to defend and indemnify unless the delay operates materially to prejudice the insurer's ability to investigate and defend); *see* *St. Paul Fire & Marine Ins. Co. v. Vigilant Ins. Co.*, 724 F. Supp. 1173 (M.D. N.C. 1989) (late notice defense waived by liability carrier's denial on other grounds); *cf.* *Taylor v. Royal Globe Ins. Co.*, 240 S.E.2d 497 (N.C. 1978) (late notice defense preserved *ab initio* by coverage opinion asserting improper notice).

<sup>317</sup> *Great Am. Ins. Co.*, 279 S.E.2d 773-775.

**Prejudice**

The insurer has to prove that it has been materially prejudiced by any delay.<sup>318</sup> "Placing the burden of showing prejudice on the insurer encourages an adequate investigation by the qualified party at the earliest possible time."<sup>319</sup> Among the relevant factors to be considered by a jury in deciding whether the insurer has been prejudiced are "the availability of witnesses to the accident; the ability to discover other information regarding the conditions of the locale where the accident occurred; any physical changes in the location of the accident during the period of the delay; the existence of official reports concerning the occurrence; the preparation and preservation of demonstrative and illustrative evidence, such as the vehicles involved in the occurrence, or photographs and diagrams of the scene; the ability of experts to reconstruct the scene and the occurrence; and so on."<sup>320</sup>

The insurer must also show that the changed circumstance materially impairs its ability to investigate or defend. Although proof of any of the above factors is not determinative proof of the changed circumstance may give rise to an inference of prejudice.<sup>321</sup>

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<sup>318</sup> *Id.* at 776.

<sup>319</sup> *Id.*

<sup>320</sup> *Id.*

<sup>321</sup> *Id.* (proof of the unavailability of a sole independent eyewitness gives rise to an inference of prejudice).

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NORTH DAKOTA

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It is well-established in North Dakota that, because an insurance policy is a contract of adhesion, any ambiguity or reasonable doubt as to its meaning must be strictly construed against the insurer and in favor of insured.<sup>322</sup> "If the language of an insurance contract will support an interpretation which will impose liability on the insurer and one which will not, the former interpretation will be adopted."<sup>323</sup>

*General*

In *Finstad v. Steiger Tractor*,<sup>324</sup> where the insured made claim against his employers' group accident policy more than three years after sustaining work-related injuries, North Dakota's supreme court reversed summary judgment in favor of the insurer, noting that the insured was innocently ignorant of the existence of the policy. The court then adopted the Notice Prejudice Rule promulgated by the Supreme Court of New Jersey in *Cooper v. Government Employees Insurance Co.*,<sup>325</sup> which holds that an insurer is obligated to demonstrate that it was substantially prejudiced by an insured's delay in reporting the incident giving rise to a claim.

*Late Notice*

North Dakota has not reported any recent cases involving late notice under a fidelity bond.<sup>326</sup> Given the significance the supreme court attached to the "take it or leave it" nature of most insurance contracts, one may postulate that the court might reach a different conclusion if it were shown that the insurance contract at issue was the product of sophisticated negotiation.

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<sup>322</sup> *Aid Ins. Svcs, Inc. v. Geiger*, 294 N.W.2d 411 (N.D. 1980).

<sup>323</sup> *Finstad v. Steiger Tractor, Inc.*, 301 N.W.2d (N.D. 1981).

<sup>324</sup> *Id.*

<sup>325</sup> 237 A.2d 870 (N.J. 1968).

<sup>326</sup> *See Robertson Lumber Co. v. Progressive Contractors*, 160 N.W.2d 61 (N.D. 1968).

## OHIO

**Late Notice**

As a rule, Ohio has employed the condition precedent analysis in examining late notice in the context of fidelity coverage.<sup>327</sup> Despite diametrically opposing precedent in liability cases, at least one federal court has declared that Ohio law now requires fidelity insurers to demonstrate prejudice from late notice in order to be relieved of liability.<sup>328</sup> Although the Ohio Supreme Court has recognized the "modern trend" of prejudice, the state courts still do not require a demonstration of prejudice by the insurer to avoid coverage on the ground that untimely notice.<sup>329</sup> In the absence of contrary evidence, there exists a presumption of prejudice when the insured unreasonably delays in delivering notice.<sup>330</sup> The burden of proof regarding prejudice from a late claim rests upon the insured.<sup>331</sup> Although a jury usually determines the issue of late notice, the court can determine it as a matter of law when the facts are not in dispute.<sup>332</sup> In one case, without expressly discussing the question of prejudice, a United States district court applying Ohio law stated that the liability policy in question made the giving of notice a condition precedent, and that failure to comply with the terms and conditions of the policy barred recovery.<sup>333</sup>

**Late Proof of Loss**

Where a fidelity policy merely specifies a time limit for the delivery of proof of loss and does not expressly provide that failure to deliver such proof of loss shall void the policy or bar suit, compliance within the time limi-

<sup>327</sup> *City Loan & Sav. Co. v. Employers' Liability Assurance Corp.*, 249 F.Supp. 633 (N.D. Ohio 1964), *aff'd* 356 F.2d 941 (6th Cir. 1964).

<sup>328</sup> *In re Baker*, 93 Bankr. at 568.

<sup>329</sup> *Hamilton Mut. Ins. Co. v. Perry*, Court of Appeals No. 92 -OT-031, 1993 Ohio App. LEXIS 1167, at \* 17 (Ohio Ct. App. Feb. 26, 1993); *see also* *Owens-Coming Fiberglass Corp. v. American Centennial Ins. Co.*, 74, 660 N.E.2d 770 (Ohio 1995).

<sup>330</sup> *See* *Patrick v. Auto-Owners Inc. Co.*, 449 N.E.2d 790 (Ohio Ct. App. 1982).

<sup>331</sup> *Hamilton Mut. Ins. Co.*, 1997 Ohio App. LEXIS at \*10.

<sup>332</sup> *Champion*, 116 Ohio App.3d at 264.

<sup>333</sup> *National Union Fire Ins. Co. v. Fannin*, 257 F. Supp. 1017 (S.D. 1966).

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tation does not constitute a condition precedent to recovery.<sup>334</sup>

Discovery of a loss for the purpose of establishing coverage under a fidelity bond does not occur until the insured has had a reasonable amount of time to discover the extent and amount of its loss.<sup>335</sup>

***Discovery***

The insured has the burden of showing that the insurer has not been prejudiced and can still conduct an investigation that will uncover all information that could have been obtained had notice been timely.<sup>336</sup>

***Prejudice***

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<sup>334</sup> *In re Baker*, 93 Bankr. at 568, see *Central Trust & Safe Deposit Co. v. Dubuque Fire & Marine Ins. Co.*, 1 Ohio App. 447 (1913); *aff'd*, 112 N.E. 1083 (1915).

<sup>335</sup> *Russell Gasket Co. v. Phoenix of Hartford Ins. Co.*, 512 F.2d 205 (6th Cir. 1975) (applying Ohio law).

<sup>336</sup> *Hamilton Mut. Ins. Co.*, 1997 Ohio App. LEXIS at \*10.

OKLAHOMA

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**Late Notice**

In *Federal Deposit Insurance Co. v. Kansas Bankers Surety Co.*,<sup>337</sup> the court held that a fidelity insurer does not have to show prejudice when the insured fails to comply with an express notice requirement. The court based its decision upon a unique provision in the fidelity bond at issue, which provided that the insured must present proof of loss before the bond terminated in order to retain its right to make a claim against the insurer. Essentially, this provision made the fidelity bond a claims-made bond. Except for the express notice requirement provision, the fidelity bond in this case contained the standard policy language found in fidelity bonds issued to financial institutions. The court's rationale was that the insured and the insurer bargained for strict compliance with specific time requirements. Consequently, the insurer need not show any additional prejudice, as noncompliance "inherently" prejudices the insurer.

**Late Proof of Loss**

In *Alfalga Electric Cooperative, Inc. v. Travelers Indemnity Co.*,<sup>338</sup> the court held that a nine month delay in filing a notice of claim and proof of loss was not in compliance with the provisions of a fidelity policy requiring: (i) that notice of loss be given "within reasonable time after discovery;" and (ii) that proof of loss be filed within four months of discovery.

**Discovery**

Where, under the terms of a fidelity bond, discovery occurs when the insured becomes aware of facts that would cause a reasonable person to assume that a loss covered by the bond has been or will be incurred, the insured is deemed to have discovered the loss when an employee whose duty it is to report such a defalcation becomes aware of the loss within the scope of her employment.<sup>339</sup>

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<sup>337</sup> 963 F.2d 289 (10th Cir. 1992).

<sup>338</sup> 376 F. Supp. 901 (W.D. Okla. 1973).

<sup>339</sup> See *Adair State Bank v. American Cas. Co.*, 949 F.2d 1067 (10th Cir. 1991).

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 OREGON
 

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In *Lusch v. Aetna Casualty & Surety Co.*,<sup>340</sup> an automobile liability case, Oregon's highest court formally adopted the prejudice doctrine and overruled prevailing dicta supporting condition precedent analysis, found in *Hoffman v. Employer's Liability Corp.*,<sup>341</sup> *Bonney v. Jones*<sup>342</sup> and *Falk v. Sul America Terrestres*.<sup>343</sup> Where the insured fails to provide timely notice because of an unreasonable or unexcused omission or delay, a liability insurer has the burden of showing prejudice.<sup>344</sup>

**Late Notice**

When a provision of the insurance policy declares that providing proof of loss within a certain time constitutes a condition precedent, the insured must comply with this provision before it may bring an action against the insurer.<sup>345</sup>

**Late Proof of Loss**

Regarding discovery within the fidelity bond context, Oregon still adheres to the seminal case of *American Surety Co. of New York v. Pauly*.<sup>346</sup> Citing *Pauly*, a United States District Court in Oregon stated that discovery occurs when the insured has "acquired knowledge of some specific fraudulent or dishonest act which might involve the defendant in liability for the misconduct."<sup>347</sup>

**Discovery**

In determining whether the insurer has been prejudiced, the inquiry centers upon whether the insurer received notice in sufficient time to make a reasonable investigation and adequately protect both its interest and that of the insured.<sup>348</sup>

**Prejudice**


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<sup>340</sup> 538 P.2d 902 (Or. 1975).

<sup>341</sup> 29 P.2d 557 (Or. 1934).

<sup>342</sup> 439 P.2d 881 (Or. 1968).

<sup>343</sup> 465 P.2d 714 (Or. 1970).

<sup>344</sup> *Dillingham Corp. v. Employers Mut. Liab. Ins. Co.*, 503 F.2d 1181 (9th Cir. 1974); *Halsey v. Fireman's Fund Ins. Co.*, 681 P.2d 168, 170 (Or. Ct. App. 1984).

<sup>345</sup> *Grau v. Northwestern Mut. Ins. Co.*, 350 P.2d 1082 (Or. 1960).

<sup>346</sup> 170 U.S. 133 (1898).

<sup>347</sup> *Interstate Prod. Credit Ass's Fireman's fund Ins. Co.*, 788 F.Supp. 1530, 1536 (D. Or. 1992).

<sup>348</sup> *Halsey*, 681 P.2d 169-170.

## PENNSYLVANIA

**Late Notice**

The insurer has the burden of demonstrating prejudice from the insured's failure to deliver timely notice. The factors affecting the decision to relieve an insurer of liability are the length of delay and the reasons offered in excuse.<sup>349</sup> In *Northwood Nursing & Convalescent Home, Inc. v. Continental Ins. Co.*,<sup>350</sup> the court applied the Notice Prejudice Rule in a fidelity case, but granted summary judgment in favor of the insurer upon a finding that prejudice had been shown.<sup>351</sup>

**Late Proof of Loss**

In *ACF Produce, Inc. v. Chubb/Pacific Indemnity Group*,<sup>352</sup> the court concluded that Pennsylvania law, as developed in *Brakeman*, requires an insurer to show prejudice before it can compel forfeiture by invoking a proof of loss (or limitation of suit) clause. Reasoning that the purpose of the notice provision is to prevent the insurance company from being prejudiced, the court required the insurer to prove that it was prejudiced before it upheld a denial of coverage based upon the late submission of a proof of loss. Although the *Hospital Support Services Ltd. v. Kemper Group Inc.*<sup>353</sup> opinion sharply criticized *ACF Produce*, courts in other circuits have not been dissuaded from relying on that opinion.<sup>354</sup>

**Late Suit**

Several courts have held *Brakeman* to be inapplicable to late suit provisions where Pennsylvania statutes have mandated the inclusion of such clauses in insurance policies.<sup>355</sup> Other courts have held that the rationale underlying the *Brakeman* "notice" rule should not extend to limitation of suit clauses, and that *Brakeman*,

<sup>349</sup> *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193, 197 (Pa. 1977).

<sup>350</sup> 902 F. Supp. 79 (E.D. Pa. 1995).

<sup>351</sup> *Id.*; see also *Trustees of the Univ. of Pa. v. Lexington Ins. Co.*, 815 F.2d 890 (3d Cir. 1987).

<sup>352</sup> 451 F. Supp. 1095 (E.D. Pa. 1978).

<sup>353</sup> 889 F.2d 1311 (3d Cir. 1989).

<sup>354</sup> See *National Union Fire Ins. Co. v. Federal Dep. Ins. Corp.*, No. 79,825, 1998 Kan. LEXIS 97 (Kan. April 17, 1998).

<sup>355</sup> See *Laughton v. Chester County Mut. Ins. Co.*, 641 F. Supp. 40 (E.D. Pa. 1985); *Schreiber v. Pennsylvania Lumberman's Mut. Ins. Co.*, 444 A.2d 647 (Pa. 1982).

therefore, does not apply to such clauses.<sup>356</sup> At least one federal court has concluded that *Brakeman* applies to limitation of suit clauses generally, whether or not such clauses have been required by law.<sup>357</sup> The superior court has also generally applied the *Brakeman* rationale to a legislatively mandated limitation of suit clause.<sup>358</sup> Still, these cases have been sharply criticized.<sup>359</sup> In *Hospital Support Services Ltd. v. Kemper Group Inc.*,<sup>360</sup> the Court of Appeals for the Third Circuit directly addressed the issue and predicted that Pennsylvania's supreme court would not extend the Notice Prejudice Rule to require a showing of prejudice prior to enforcing a late suit provision.

Pennsylvania courts have not been reluctant to avoid coverage where they are satisfied that the insurer has been prejudiced by the insured's conduct or delay in presenting its claim.<sup>361</sup> However, the courts are not predisposed to bend the rules where conflicting statutes of limitation operate to prejudice the insurer.<sup>362</sup>

### *Prejudice*

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<sup>356</sup> See *Brandywine One Hundred Corp. v. Hartford Fire Ins. Co.*, 405 F. Supp. 147 (D. Del. 1975); *aff'd mem.*, 588 F.2d 819 (3d Cir. 1978) (applying Delaware law) (generally noting the difference between a notice provision and a limitation of suit provision, and applying a prejudice rule to the former and not to the latter).

<sup>357</sup> See *ACF Produce*, 451 F. Supp. 1095 (E.D. Pa. 1978) (concluding that Pennsylvania law, as developed in *Brakeman*, requires an insurer to show prejudice before it can compel forfeiture by involving a proof of loss or limitation of suit clause).

<sup>358</sup> See *Diamon v. Penn Mut. Life Ins. Co.*, 372 A.2d 1218 (Pa. Super. Ct. 1977).

<sup>359</sup> *Petraglia v. American Motorists Ins. Co.*, 424 F.2d 1360 (Pa. Super. Ct. 1981), *aff'd mem.*, 444 A.2d 653 (Pa. 1982); see *Pini v. Allstate Ins. Co.*, 499 F. Supp. 1003, 1005 n.4 (E.D. Pa. 1980), *aff'd mem.*, 659 F.2d 1070 (3d Cir. 1981); cf. *Leone v. Aetna Cas. & Sur. Co.*, 599 F.2d 566 (3d Cir. 1979).

<sup>360</sup> 889 F.2d 1311 (3d Cir. 1989).

<sup>361</sup> *Anselmo Torres v. Pennsylvania Financial Responsibility Assigned Claims Plan*, 645 A.2d 1322 (Pa. Super Ct. 1994).

<sup>362</sup> *American Ins. Co. v. Ford Motor Credit Co.*, 648 A.2d 576 (Sup. Ct. Pa. 1994).

RHODE ISLAND

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**Late Notice**

Rhode Island reports no cases concerning late notice in the context of fidelity insurance. The precedents relating to liability policies offer the best indication of how Rhode Island courts would deal with the issue of late notice under a fidelity bond. Prior to *Pickering v. American Employers Insurance Co.*,<sup>363</sup> Rhode Island courts held that, where the policy called for immediate written notice, delays of several months constituted unreasonable notice as a matter of law.<sup>364</sup> Absent sufficient excuse, the courts did not consider lack of prejudice material to the issue of late notice. Reasoning that modern insurance policies, as adhesion contracts, do not lend themselves to negotiation, *Pickering*, an automobile liability case, overruled *Sherwood* and imposed the burden of demonstrating prejudice upon the insurer.<sup>365</sup> Since then, Rhode Island's courts have strictly adhered to the Notice Prejudice Rule adopted in *Pickering*.<sup>366</sup>

**Late Proof of Loss**

In *Siravo v. Great American Insurance Co.*,<sup>367</sup> Rhode Island sets a higher burden for demonstrating prejudice in connection with the late submission of a proof of loss than for notice of loss. The case involved both late notice and late proof of loss under a fire insurance policy. Reasoning that adherence to the notice of loss provision provides the insurer an opportunity to investigate the loss, while adherence to the proof of loss provision only facilitates such investigation, the court determined that an untimely proof of loss only affects the adequacy, but not the existence, of an insurer's opportunity to protect its interest.<sup>368</sup> Consequently, the court obligates the insurer to show "even more forcefully" that it has been prejudiced by reason of an untimely proof of loss. The

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<sup>363</sup> 282 A.2d 584 (R.I. 1971).

<sup>364</sup> *Sherwood Ice Co. v. U.S. Cas. Co.*, 100 A. 572, 574 (R.I. 1917) (holding 142 days as unreasonable delay); *see Standard Acc. Ins. Co. v. Turgeon*, 140 F.2d 94, 95 (1st Cir. 1944).

<sup>365</sup> *Pickering*, 109 R.I. at 159-160.

<sup>366</sup> *Cooley v. John M. Anderson Co.*, 443 A.2d 435, 437 (R.I. 1982); *Siravo v. Great Am. Ins. Co.*, 410 A.2d 116, 117 (R.I. 1980); *Donahue v. Hartford Fire Ins. Co.*, 295 A.2d 693 (R.I. 1972).

<sup>367</sup> 410 A.2d 116.

<sup>368</sup> *Siravo*, 410 A.2d 118.

court did not hesitate to extend the Late Notice Rule promulgated in *Pickering* from notice of loss to proof of loss, and from automobile liability policies to fire insurance policies.<sup>369</sup>

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<sup>369</sup> *Id.* at 118-120.

## SOUTH CAROLINA

**Late Notice**

Although South Carolina recognizes the modern trend of relaxing the notice requirement, it strictly adheres to the condition precedent analysis in determining the rights of the insured and the insurer under commercial insurance policies.<sup>370</sup> South Carolina has consistently maintained its well-established rule of strictly enforcing late notice provisions in liability policies since the 1930s.<sup>371</sup> However, it took the infamous real estate and savings and loans scandals of recent years for South Carolina to confront the issue of late notice within the fidelity bond context. In *First Savings Bank v. American Casualty Co.*,<sup>372</sup> the insured's predecessor bought mortgages from a fraudulent equity corporation that later incurred millions of dollars in losses. The insured tried to recoup these losses by making an untimely claim upon its own fidelity bond. The United States Court of Appeals for the Fourth Circuit held that the insurer need not demonstrate prejudice to avoid liability under a fidelity bond.<sup>373</sup> Reasoning that compliance with notice requirements would minimize losses and benefit both the insured and the insurer, the court affirmatively restated the established law of strictly enforcing time limits in commercial insurance contracts, including fidelity bonds.<sup>374</sup>

**Discovery**

South Carolina discussed the issue of discovery in the fidelity bond context in *C. Douglas Wilson & Co. v. Insurance Co. of North America*.<sup>375</sup> The insurer issued a discovery bond which covered acts of employee dishonesty at any time so long as the insured discovered the loss within the bond's applicable time period. The court used an objective test to determine when the insured had discovered that its employee was dishonest: whether the insured possessed "knowledge, which

<sup>370</sup> See *Humana Hospital-Bayside v. Lightle*, 407 S.E.2d 637, 639 (S.C. 1991).

<sup>371</sup> *Lee v. Metropolitan Life Ins. Co.*, 186 S.E. 376, 381 (S.C. 1936).

<sup>372</sup> No. 92-1320, 1993 U.S. App. LEXIS 2049 (4th Cir. Feb. 8, 1993).

<sup>373</sup> *First Sav. Bank*, 1993 U.S. App. LEXIS at \*12-\*13.

<sup>374</sup> *Id.* at \*12-\*14.

<sup>375</sup> 464 F. Supp. 1 (1977), *aff'd*, 590 F.2d 1275 (1979).

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would justify a careful and prudent man in charging another with fraud or dishonesty."<sup>376</sup>

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<sup>376</sup> *C. Douglas Wilson & Co.*, 464 F. Supp. at 14 \*(citing *Hidden Splendor Mining Co. v. General Ins. Co. of Am.*, 370 F.2d 515, 517 (10th Cir. 1966)).

SOUTH DAKOTA

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**Late Notice**

South Dakota has not had occasion to rule upon the issue of late notice or late proof of loss in the context of a fidelity bond. The only indication as to the manner in which South Dakota courts may rule comes from Justice Sabers' dissent in *City of Fort Pierre v. United Fire & Casualty Co.*<sup>377</sup> In that case, the majority never broached the issue of late notice, basing its decision to allow the insurer to avoid the duty to defend upon the specialized coverage provided by the errors and omissions policy at issue.<sup>378</sup> In his dissent, Justice Sabers addressed the issue of late notice, justifying his argument in favor of imposing a duty to defend. Justice Sabers favored the "better and more modern view" embodied in the Notice Prejudice Rule,<sup>379</sup> arguing that an eighteen month delay in receiving notice of a third party's suit against the insured did not prejudice the insurer.

**Discovery**

In *First Dakota National Bank v. St. Paul Fire & Marine Insurance Co.*,<sup>380</sup> the Court of Appeals for the Eighth Circuit discussed the issue of discovery of a loss under a fidelity bond. The court deemed the time of discovery to be the point at which the insured actually became aware of sufficient facts to lead a reasonable person to believe that an insured loss had occurred.<sup>381</sup>

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<sup>377</sup> 463 N.W.2d 845 (S.D. 1990).

<sup>378</sup> *Id.*

<sup>379</sup> *Id.* at 851.

<sup>380</sup> 2 F.3d 801 (8th Cir. 1993).

<sup>381</sup> *Id.* at 807-808.

## TENNESSEE

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*Griffith Motors, Inc. v. Compass Insurance Co.*<sup>382</sup> sets forth Tennessee's analysis of late notice in the context of a fidelity bond. There the insured suffered fidelity losses arising from a check kiting scheme. The insured failed to comply with relevant provisions of the fidelity bond requiring it to give notice "as soon as practicable" and to file a detailed proof of loss within four months of discovery.

*Late Notice*

The *Griffith Motors* court applied Tennessee's well-settled case law providing that notice provisions within liability policies act as conditions precedent to coverage.<sup>383</sup> Failure to deliver notice will justify a denial of coverage even where the fidelity bond or liability policy does not contain a forfeiture clause, and irrespective of whether the insurer has been prejudiced by the delay.<sup>384</sup> Within a fidelity bond or liability policy, the language "as soon as practicable" imposes a duty upon the insured to deliver notice upon discovery of the loss.<sup>385</sup> Applying this reasoning, the *Griffith Motors* court held that delivering notice nine months after the discovery of the loss did not comply with the "as soon as practicable" provision.<sup>386</sup>

The *Griffith Motors* court also found that the insured's failure to submit a proof of loss within the four month time limit set forth as a condition precedent in the fidelity bond barred recovery, regardless of the insurer's ability to demonstrate that it was prejudiced by the delay.<sup>387</sup>

*Late Proof of Loss*

Even with Tennessee's strong policy of enforcing notice provisions, some Tennessee courts have excused delays in giving notice where the liability policies at issue did not condition recovery upon proper delivery

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<sup>382</sup> 676 S.W.2d 555 (Tenn. Ct. App. 1983).

<sup>383</sup> McKimm v. Bell, 790 S.W.2d 526, 538 (Ten. 1990).

<sup>384</sup> Hartford Acc. & Indem. Co. v. Creasy, 530 S.W.2d 778 (Tenn. 1975).

<sup>385</sup> Transamerica Ins. Co. v. Parrott, 531 S.W.2d 306 (Tenn. Ct. App. 1975).

<sup>386</sup> *Griffith Motors*, 676 S.W.2d at 558.

<sup>387</sup> *Id.*

of notice.<sup>388</sup> In addition, Tennessee has found prejudice relevant in determining the promptness of the notice and the reasonableness of the delay.<sup>389</sup>

**Late Suit**

In *Federal Savings & Loan Insurance Corp. v. Burdette*,<sup>390</sup> the federal district court, applying Tennessee law, held in a liability policy context that a contractual limitation upon the insured's time to bring suit would be tolled for the time period between the insured's delivery of a notice of claim (or tender of defense) and the insurer's denial of coverage. The *Burdette* court determined that a literal reading of the bond in conjunction with a tolling until the insurer had declined coverage would best protect the interests of both the insured and the insurer.<sup>391</sup>

**Discovery**

Within the context of fidelity bonds, discovery means that the insured has knowledge of facts and circumstances sufficient to satisfy reasonable persons that a loss has occurred.<sup>392</sup> Knowledge that a loss has occurred is sufficient to constitute discovery, even if all the specific facts concerning the loss are not known.<sup>393</sup>

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<sup>388</sup> *Creasy*, 530 S.W.2d at 779.

<sup>389</sup> *McKimm*, 790 S.W.2d at 527, *Bush v. Exchange Mut. Ins. Co.*, 866 S.W.2d 575, 577 (Tenn. Ct. App. 1993).

<sup>390</sup> 701 F. Supp. 1357 (E.D. Tenn. 1988).

<sup>391</sup> *Id.* at 1361.

<sup>392</sup> *World Secret Serv. Ass'n, Inc. v. Travelers Indemn. Co.*, 396 S.W.2d 848 (Tenn. Ct. App. 1965).

<sup>393</sup> *Griffith Motors*, 676 S.W.2d at 558.

## TEXAS

In Texas, the courts have a long history of enforcing conditions precedent to coverage in insurance policies irrespective of whether the insurer suffers any harm or prejudice.<sup>394</sup> Texas courts interpret the language "as soon as practicable" and "immediately" alike within fidelity bonds and liability policies - as requiring notice to be given within a reasonable time in light of the circumstances involved.<sup>395</sup> Texas courts have held that a delay as little as thirty-two days may constitute untimely notice.<sup>396</sup>

*Late Notice*

In *Members Mutual Ins. Co. v. Cutaia*, the Texas Supreme Court expressly noted the arguments favoring a prejudice requirement in insurance contracts, as well as the authorities from other jurisdictions favoring such a rule, but held that any such limitation was a matter to be considered by the legislature or the State Board of Insurance.<sup>397</sup> Following this ruling, the Texas Board of Insurance issued a rule requiring all general liability policies issued or delivered in Texas to include an amendatory endorsement providing that lack of notice only constitutes a defense where the insurer has established prejudice from the insured's failure to forward suit papers.<sup>398</sup> Even with this amendatory endorsement, Texas courts have remained reluctant to utilize the prejudice analysis. In *American States Insurance Co. v. Hanson Industries*, the court held that the amendatory endorsement did not apply because the policies in question were issued in New York and not issued or deliv-

<sup>394</sup> *American States Ins. Co. v. Hanson Industries*, 873 F. Supp. 17, 27 (E.D. Tex. 1995); *McPherson v. St. Paul Fire & Marine Ins. Co.*, 350 F.2d 563, 566 (5th Cir. 1965); *Members Mutual Ins. Co. v. Cutaia*, 476 S.W.2d 278, 281 (Tex. 1972); *Chiles v. Chubb Lloyds Ins. Co.*, 858 S.W.2d 633 (Tex. Ct. App. 1993); *Podelewski v. Government Employees Ins. Co.*, 616 S.W.2d 298, 299-300 (Tex. Ct. App. 1981).

<sup>395</sup> *Continental Sav. Ass'n v. U.S. Fid. & Guar. Co.*, 762 F.2d 1239, 1243 (5th Cir. 1985); *McPherson*, 350 F.2d at 566; *American States*, 873 F. Supp. at 27; *Pioneer Cas. Co. v. Blackwell*, 383 S.W.2d 216, 219 (Tex. Civ. App. 1964).

<sup>396</sup> *American States*, 873 F. Supp. at 28.

<sup>397</sup> *Cutaia*, 476 S.W.2d at 281.

<sup>398</sup> State Bd. of Ins., Revision of Texas Standard Provision of General Liability Policies – Amendatory Endorsement – Notice, Order No. 23080 (March 13, 1973).

ered in Texas.<sup>399</sup> In *Chiles*, the court held that an insurer did not need to show prejudice, because the insured did not establish that a homeowner's policy constituted a general liability policy.<sup>400</sup> In view of these cases, Texas courts will probably remain loyal to the traditional analysis within the fidelity bond context.

***Late Proof of Loss***

In *Abilene Savings Assn v. Westchester Fire Insurance Co.*,<sup>401</sup> the U.S. Court of Appeals for the Fifth Circuit applied Texas law to analyze the effect of a late proof of loss upon fidelity bond coverage. The insured had sustained losses from the misappropriation of funds by its employees. Although the fidelity bond contained an express provision requiring proof of loss to be submitted within one hundred days, the insured did not submit a proof of loss until two years after discovery. Citing *Cutaia*, the court held that under Texas law, where the fidelity bond mandates timely submission of the proof of loss as an express requirement, such timely proof of loss constitutes a condition precedent to recovery in the absence of waiver or estoppel.<sup>402</sup> The court declined to discuss whether a state statute which voids any provision limiting the notice of suit to less than ninety days applied to the late proof of loss, because the fidelity bond at issue provided one hundred days for notice, and thus fell outside the purview of the statute.<sup>403</sup>

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<sup>399</sup> *American States*, 873 F. Supp. at 28.

<sup>400</sup> *Chiles v. Chubb Lloyds Ins. Co.*, 858 S.W.2d 633 (Tex. Ct. App. 1993).

<sup>401</sup> 461 F.2d 557 (5th Cir. 1972).

<sup>402</sup> *Id.* at 559; *General Am. Life Ins. Co. v. Rodriguez*, 641 S.W.2d 264, 269 (Tex. Ct. App. 1982); *U.S. Fid. & Guar. Co. v. Bimco Iron & Metal Corp.*, 464 S.W.2d 353 (Tex. 1971).

<sup>403</sup> *Abilene Sav. Ass'n*, 461 F.2d at 561.

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UTAH

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The Utah legislature has enacted into law a statute that maintains "failure to give notice or file proof of loss ... does not bar recovery under the policy if the insurer fails to show that it was prejudiced by the failure."<sup>404</sup> Utah's courts had not addressed the issue of late notice within the context of fidelity bonds prior to *Federal Deposit Insurance Corp. v. Oldenburg*.<sup>405</sup> Thus, *Oldenburg* states current Utah law regarding late notice arising under fidelity bonds, and is repeatedly cited as authority in the Tenth Circuit and other jurisdictions favoring the Notice Prejudice Rule.

*General*

The *Oldenburg* court looked to the law of other jurisdictions for guidance in rendering a decision upon the case's particular facts,<sup>406</sup> and determined that the bond provisions in question - which did not expressly state that notice within a specified time was a condition precedent to recovery - were distinguishable from the bond provisions at issue in other cases where the courts held that late notice automatically relieved the insurer of liability. The *Oldenburg* court focused on the fact that the bonds before it did not contain an express forfeiture or cancellation clause in the event of noncompliance with notice provisions. As such, the *Oldenburg* court found no reason not to require that the fidelity insurer demonstrate prejudice.

*Late Notice*

The court reasoned that the Utah rule of strictly construing insurance provisions against the insurer supported a ruling requiring a fidelity insurer to show it had suffered substantial prejudice from late notice. Although the *Oldenburg* court did not apply UTAH

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<sup>404</sup> UTAH CODE ANN. §31a-21-312(2) (1985).

<sup>405</sup> 34 F.3d 1529 (1994). *See also* AOK Lands, Inc. v. Shand Morahan & Co., 743 P.2d 94, 928 (Utah 1993) (upholding in dicta trial court's finding of prejudice but refusing to directly decide if a demonstration of prejudice was required where the insured failed to comply with notice requirements contained in a claims-made policy).

<sup>406</sup> The *Oldenburg* case involved fraudulent misrepresentations by the officers of the insured.

CODE ANN. § 31 A-21-312(2), it cited the statute in support of its decision.

***Late Proof of Loss***

Utah's courts have not specifically determined whether prejudice is a factor to be considered in ruling upon the effect of a late proof of loss upon coverage. However, considering the rationale of the *Oldenburg* court and UTAH CODE ANN. § 31-A-21-312(2), it is likely that Utah would require the insurer to demonstrate prejudice in order to prevail on a late notice defense.

***Discovery***

In the *Oldenburg* case, the fidelity bond provided that discovery occurred when the insured became aware of facts that would cause a reasonable person to assume that a loss has been or will be incurred. Noting *Home Savings & Loan v. Aetna Casualty & Surety*,<sup>407</sup> the *Oldenburg* court stated that the language of the bond tied coverage to the discovery of "possible loss," and did not require an "actual loss." Following precedents from other jurisdictions, the *Oldenburg* court adopted the "objectively reasonable person" test in determining the time of discovery. Based upon these precedents, the *Oldenburg* court determined that the insured discovered its loss when non-complicit employees learned of the issuance of formal cease and desist orders addressing the defalcations at issue.

***Prejudice***

The *Oldenburg* court held that the purpose of notice requirements should dictate what constitutes prejudice. Citing *Federal Deposit Insurance Corp. v. Aetna Casualty & Surety Co.*,<sup>408</sup> the *Oldenburg* court reasoned that the drafters of insurance policies intended late notice provisions to prevent further losses by the insurer. Following the earlier district court decision, the *Oldenburg* decision concluded that the question of whether an insurer has been prejudiced by an insured's delay in giving notice should be resolved by determining whether the insurer's "ability to investigate, settle or defend the claims at issue" has been frustrated.

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<sup>407</sup> 817 P.2d 341 (Utah Ct. App. 199i).

<sup>408</sup> 744 F. Supp. 729, 734 (E.D. La. 1990).

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 VERMONT
 

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Vermont has not reported recent precedent relating to late notice in the fidelity bond context.<sup>409</sup> However, Vermont does have extensive case law addressing late notice under liability policies. Until recently, Vermont followed a traditional condition precedent analysis set forth in *Houran v. Preferred Accident Insurance Co.*<sup>410</sup> However, in *Cooperative Fire Insurance Assn of Vermont v. White Caps, Inc.*,<sup>411</sup> Vermont's supreme court overruled all of its prior precedents concerning late notice.

*General*

The *Cooperative Fire* court viewed "condition precedent" notice provisions as unreasonable forfeitures because modern insurance contracts essentially are nonnegotiated adhesion contracts.<sup>412</sup> The court concluded that such a forfeiture could harm both the insured and the innocent victim.<sup>413</sup> Reasoning that the modern view of prejudice does not undermine the purpose of the notice requirement, which is to allow the insurer an opportunity to protect its rights, but simultaneously protects the rights of the insured and the innocent victim, the court concluded that the "modern rule represents the better reasoned approach."<sup>414</sup> The court held that an insured may not forfeit coverage unless the insurer demonstrates that the insured breached the notice provision, and that the insurer was "substantial prejudiced" thereby.<sup>415</sup> In a footnote, the *Cooperative Fire* opinion declined to discuss whether different rules should apply to a claims-made policy and an occurrence policy.<sup>416</sup>

*Late Notice*


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<sup>409</sup> See *Brown v. Maryland Casualty Co.*, 11 A.2d 222, (Vt. 1940).

<sup>410</sup> 195 A. 253 (Vt. 1937); see *Ziman v. Employers Fire Ins. Co.*, 493 F.2d 196, 199 (2d Cir. 1964); see *Boyer v. American Cas. Co.*, 332 F.2d 708, 710-711 (2d Cir. 1964); see also *Town of Windsor v. Hartford Acc. & Indem. Co.*, 885 F. Supp. 666, 670 (D. Ct. 1995).

<sup>411</sup> 694 A.3d 34, 35 (Vt. 1997).

<sup>412</sup> *Id.* at 37.

<sup>413</sup> *Id.* at 38.

<sup>414</sup> *Id.*

<sup>415</sup> *Id.*

<sup>416</sup> *Id.* at 39.

**Late Proof of Loss**

Vermont does not distinguish between late notice of loss and late proof of loss. Generally, Vermont courts will liberally construe late notice of loss and proof of loss provisions in favor of the insured, and substantial compliance therewith, as opposed to strict compliance, will suffice.<sup>417</sup> In light of the *Cooperative Fire*, decision, however, Vermont may readily extend the Notice Prejudice Rule to include late proof of loss.

**Prejudice**

The court in *Cooperative Fire* declined to define what constitutes prejudice, noting that the insurer in the case at bar could not assert that it had been prejudiced because it had not attempted to conduct an investigation.<sup>418</sup>

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<sup>417</sup> *Stonewall Ins. Co. v. Moorby*, 298 A.2d 826 (Vt. 1972).

<sup>418</sup> *Cooperative Fire*, 694 A.2d at 39.

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**VIRGINIA**

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Virginia has not reported any recent precedent relating to late notice within the fidelity bond context.

*General*

Virginia has historically viewed notice provisions as reasonable contractual terms, and consequently has enforced them as conditions precedent to recovery.<sup>419</sup> In determining compliance with the notice provisions, the materiality of the information that an insured should have given may be assessed under a lack of prejudice standard.<sup>420</sup> However, when the insured has given no notice at all, the insurer need not demonstrate prejudice.<sup>421</sup> Although the fact-finder usually determines the issue of whether the insured has given notice "as soon as practicable," the Supreme Court of Virginia has held as a matter of law that a two year delay in reporting constituted a substantial and material violation of the notice provision.<sup>422</sup> Virginia's courts do not distinguish between occurrence and claims-made policies, considering the performance of notice provisions to be conditions precedent to recovery irrespective of the type of coverage afforded.<sup>423</sup>

*Late Notice*

In *Maryland Casualty Co. v. Clintwood Bank*,<sup>424</sup> where a fidelity bond required notice within ten days after the insured became aware of any act of dishonesty by an employee, the court held that the question of whether or not the bank's officers provided notice as soon as they discovered dishonesty on the part of the bank's cashier was a question of fact properly left to the jury, and affirmed a judgment permitting recovery by the insured.

*Discovery*

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<sup>419</sup> *Liberty Mut. Ins. Co. v. Safeco Ins. Co. of Am.*, 288 S.E.2d 469, 473 (Va. 1982); *Erie Ins. Exch. v. Meeks*, 288 S.E.2d 454 (Va. 1982).

<sup>420</sup> *State Farm Fire & Cas. Co. v. Walton*, 423 S.E.2d 188, 192 (Va. 1992).

<sup>421</sup> *Walton*, 423 S.E.2d at 192.

<sup>422</sup> *Harmon v. Farm Bureau Auto Ins. Co.*, 200 S.E. 616, 618 (Va. 1939).

<sup>423</sup> *Porter*, 211 Va. at 599, *State Farm Mut. v. Douglas*, 267, 148 S.E.2d 775, 777 (Va. 1966).

<sup>424</sup> 154 S.E. 492 (1930).

WASHINGTON

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**Late Notice**

During the 1970's, Washington's courts adopted the prejudice analysis. As it did in many states, precedent concerning late notice evolved from the analysis of liability policies. Whenever an insured has raised prejudice to counter the defense of late notice, Washington courts have obliged the insured and undertaken a prejudice analysis.<sup>425</sup> Even where an insured breaches the notice provision, the insurer will not escape liability or coverage unless it can demonstrate "actual and substantial prejudice" from the breach.<sup>426</sup> Reasoning that notice provisions are designed to prevent the insurer from suffering prejudice, Washington courts have held that releasing an insurer from its obligations without the demonstration of actual prejudice would authorize a possible windfall.<sup>427</sup>

**Discovery**

*Tradewell Stores, Inc. v. Fidelity & Casualty Co. of New York*<sup>428</sup> sets the standard for determining when discovery occurs under a fidelity bond. In *Tradewell*, an employee whom the insured considered "unimpeachable in honesty and integrity" misappropriated funds while depositing daily cash receipts. Under the discovery bond at issue in that case, the insured was obligated to give notice after acquiring "actual knowledge" of the loss. The *Tradewell* court stated that the discovery of loss usually requires analyzing a long train of events or examining extended accounts.<sup>429</sup> The court held that mere knowledge that funds were not being promptly

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<sup>425</sup> Pilgrim v. State Farm Fire & Cas. Ins. Co., 950 P.2d 479, 484 (Wash. Ct. App. 1997).

<sup>426</sup> Olds-Olympic, Inc. v. Commercial Union Ins. Co., 918 P.2d 923 (Wash. 1996).

<sup>427</sup> Public Utility Dist. No. 1 of Klickitat County v. International Ins. Co. of N. Am., 881 P.2d 1020 (Wash. 1994).

<sup>428</sup> 410 P.2d 782 (Wash. 1966).

<sup>429</sup> *Id.* at 785 (citing Perpetual Bldg. & Loan Ass'n v. U.S. Fid. & Guar. Co., 92 N.W. 686 (Iowa 1902)).

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deposited did not constitute "discovery" of a loss, requiring notice to the insurer.<sup>430</sup>

The issue of prejudice resulting from breach of a notice provision presents a question of fact for the jury.<sup>431</sup> Washington courts will presume prejudice only in extreme cases.<sup>432</sup> To establish prejudice, the insurer must demonstrate "concrete detriment" and "specific harm" to the insurer's preparation or presentation of defenses to coverage or liability resulting from the delay.<sup>433</sup> Excepting an impending or resolved trial, Washington courts rarely find prejudice as a matter of law.<sup>434</sup>

*Prejudice*

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<sup>430</sup> *Id.* at 785-786; *see also* National Sur. Co. v. Western Pac. Ry., 200 F. 675 (9th Cir. 1912).

<sup>431</sup> *Salzberg*, 535 P.2d at 819.

<sup>432</sup> *Twin City Fire Ins. Co. v. King County*, 749 F. Supp. 230, 233 (W.D. Wash. 1990).

<sup>433</sup> *Pilgrim*, 950 P.2d 485-486, *Pederson's Fryer Farms*, 922 P.2d at 133; *Canron, Inc. v. Federal Ins. Co.*, 918 P.2d 937 (Wash. Ct. App. 1996).

<sup>434</sup> *Pederson's Fryer Farms*, 922 P.2d at 131.

WEST VIRGINIA

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**Late Notice**

West Virginia law concerning late notice stems from liability policies. A provision in a liability policy requiring "prompt" notice, notice "as soon as practicable," or other language of similar import means that the insured must deliver notice within a reasonable period of time.<sup>435</sup> Generally, whether the insured has delivered notice within a reasonable period of time presents a fact issue for the jury.<sup>436</sup>

In *State Automobile Mutual Insurance Co. v. Youler*,<sup>437</sup> an uninsured motorist case, the state supreme court held that West Virginia courts should consider the prejudice factor in correlation to the insurer's investigative interests. In a typical case, the insured must present its reason for delay. The insurer then has the burden of demonstrating prejudice. If the insurer fails to present evidence as to prejudice, then the insured's failure to give timely notice will not bar recovery.<sup>438</sup>

**Prejudice**

The test of prejudice is whether the insurer would be in a better position to investigate the loss had the insured furnished notice within a reasonable time.<sup>439</sup>

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<sup>435</sup> *State Auto. Mut. Ins. Co. v. Youler*, 396 S.W.2d 737 (W. Va. 1990); *Ragland v. Nationwide Mut. Ins. Co.*, 120 S.E.2d 482 (W. Va. 1961).

<sup>436</sup> *Youler*, 396 S.W.2d at 742; *State Farm. Mut. Auto. ins. Co. v. Milam*, 438 F. Supp. 227, 232 (S.D. W. Va. 1977).

<sup>437</sup> 396 S.E.2d 737.

<sup>438</sup> *Id.*

<sup>439</sup> *Milam*, 438 F. Supp. at 232-233.

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WISCONSIN

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Prior to 1975, Wisconsin courts held that prejudice was immaterial to late notice in the context of fidelity bonds.<sup>440</sup> However, Wisconsin enacted its version of the Notice Prejudice Rule by statute in 1975.<sup>441</sup> Under the Wisconsin statute, an insurer must demonstrate prejudice if the insured delivers notice or proof of loss within one year after the time required by the policy and "as soon as reasonably possible."<sup>442</sup> Should the insured fail to comply with the statutory requirement,<sup>443</sup> such failure still does not bar recovery if the insurer has incurred no prejudice.<sup>444</sup> The effect of the Wisconsin statute is to allow the insured an additional grace period "beyond the time set by the policy" to give notice to the insurer.<sup>445</sup> Where the insured delivers notice more than one year after the time required by the policy, a rebuttable presumption of prejudice arises in favor of the insurer and the burden of proving the absence of prejudice shifts to the insured.<sup>446</sup> All insurance contracts are deemed to incorporate the statute.<sup>447</sup>

***Late Notice &  
Proof of Loss***

Generally, the issue of prejudice from untimely notice presents a question of fact for the jury.<sup>448</sup> Prejudice occurs when failure to deliver timely notice damages the insurer's position relative to case strategy or its interests.<sup>449</sup> In *Bradley Corp. v. Zurich Insurance*

***Prejudice***

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<sup>440</sup> *Viroqua v. Capitol Indem. Corp.*, 214 N.W.2d 42 (Wis. 1974).

<sup>441</sup> WIS. STAT. ANN. §§ 631.81, 632.26(2) (1997).

<sup>442</sup> Section 631.81.

<sup>443</sup> *Id.*

<sup>444</sup> § 632.26(2).

<sup>445</sup> *Persinger v. Chubb Group of Insurers*, 549 N.W.2d 286 (Wis. 1996).

<sup>446</sup> *Persinger*, 549 N.W.2d at 287-288; *Gerrard Realty Corp. v. American States Ins. Co.*, 277 N.W.2d 863 (Wis. 1979).

<sup>447</sup> *Garcia v. Regent Ins. Co.*, 481 N.W.2d 660 (Wis. Ct. App. 1993).

<sup>448</sup> *See City of Edgerton v. General Cas. Co.*, 493 N.W.2d 768 (Wis. Ct. App. 1992), *rev'd on other grounds*, 517 N.W.2d 463 (1994).

<sup>449</sup> In *Maryland Casualty Co. v. Northern Ins. Co. of N.Y.*, 809 F. Supp. 680, 694-695 (D. Wis. 1992), the insured carried the burden of establishing that the insurer had not been prejudiced by showing that the insurer made no effort to conduct an investigation of the loss during the eight years after the insured had delivered (late) notice.

*Co.*,<sup>450</sup> the court declined to find prejudice where the insurer suggested that it "could have" pursued a certain course of action, but presented no evidence as to how the late notice prevented or hindered such a course.<sup>451</sup> The court also held that higher litigation costs do not constitute prejudice to the insurer.<sup>452</sup>

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<sup>450</sup> 984 F. Supp. 1193.

<sup>451</sup> *Id.* at 1204.

<sup>452</sup> *Id.*

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WYOMING

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Wyoming has not reported any recent precedent that specifically discusses late notice or the Notice Prejudice Rule in the context of fidelity insurance. In *Phelan v. New Amsterdam Casualty Co.*,<sup>453</sup> the court held that failure to deliver notice within a reasonable time breached the liability policy provision requiring "immediate notice" and prohibited the insured from any recovery.<sup>454</sup> Although *Phelan* has not been directly criticized in other opinions, this case is inherently unreliable because it is based upon out-of-state precedents that have since been reversed by the courts that rendered them.<sup>455</sup> In recent years, Wyoming has held that a delay of three years would not satisfy the "immediate notice of loss" provision within a liability policy, as such a delay deprives the insurer of an effective opportunity to examine the claim.<sup>456</sup>

***Late Notice***

As a general rule, Wyoming courts will construe the proof of loss requirement as a valid condition precedent to recovery.<sup>457</sup>

***Late Proof of Loss***

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<sup>453</sup> 5 F. Supp. 810 (Wy. 1934).

<sup>454</sup> *Id.* at 814.

<sup>455</sup> *See* *Sherwood Ice Co. v. U.S. Cas. Co.*, 100 A. 572 (R.I. 1917).

<sup>456</sup> *Pacheco v. Continental Cas. Co.*, 476 P.2d 166, 168 (Wy. 1970).

<sup>457</sup> *Connecticut Fire Ins. Co. v. Fox*, 361 F.2d 1, 6 (10th Cir. 1966).

PUERTO RICO

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***Late Notice &  
Proof of Loss***

In *Federal Deposit Insurance Corp. v. CNA Casualty of Puerto Rico*,<sup>458</sup> the district court addressed the provisions governing late notice and proof of loss under a fidelity bond, and held that the issue of whether the insured provided timely notice presents a question of fact for the jury.<sup>459</sup>

***Discovery***

The determination of when an insured will be deemed to have "discovered" a fidelity loss is also considered a question of fact for the jury.<sup>460</sup> The insured need not provide notice until it possesses "actual knowledge" of the dishonest act.<sup>461</sup> Mere suspicion of wrongdoing does not constitute discovery.<sup>462</sup>

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<sup>458</sup> 786 F. Supp. 1082 (P.R. 1991).

<sup>459</sup> *Id.* at 1088.

<sup>460</sup> *Id.* at 1089.

<sup>461</sup> *Id.* at 1088-1089.

<sup>462</sup> *Id.* at 1089.