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Substantial Compliance: Substantially Erroneous Doctrine

by Jack Leyhane

I. INTRODUCTION

The insurance business is a multi-billion dollar industry. The agreements between policyholders¹ and insurers affect every aspect of a policyholder's life, including health, housing, cars, and employment. Most consumers never think about their insurance policies until a loss occurs, such as a theft or the destruction of their home or business by fire. Only then do policyholders typically consult their policies to determine what steps they must take to obtain indemnification under the policies.

Few consumers realize that an insurance policy, in essence, is simply a contract between a policyholder and an insurance company. Like any contract, an insurance contract is construed strictly against its drafter, the insurer. "[T]he purpose of an insurance contract is indemnity and therefore the policy should be liberally construed with uncertainty resolved in favor of the insured. However, the general rules which favor the insured must yield to the paramount rule of reasonable construction which guides all contract interpretations."² It is how a court strikes this balance — between liberal construction with a view toward fulfilling the purpose of indemnification and the paramount rule of reasonable construction — that determines the outcome in many insurance cases.

In this article, we consider the situation where a policyholder presents a claim on his or her own policy. Insurance policies

frequently list detailed steps that a policyholder must follow in order to recover on the claim. If a court interprets the contract language literally, consumers can be denied coverage by failing to fulfill a condition precedent in the insurance contract that may seem, to some, like a technicality. When courts do this, they are requiring "strict compliance" on the part of the policyholder with all of the terms and conditions of the policy in order for the policyholder to recover on an insurance claim. Many courts do not require strict compliance. Instead, a growing number require "substantial compliance" with the terms and conditions of the policy in order for a policyholder to recover on an insurance claim.

The definition of "substantial compliance" varies greatly with the jurisdiction. Some courts, as will be discussed below, require policyholders to make a good-faith attempt to comply with the provisions of the policy. Others require almost nothing of policyholders, and allow policyholders to refuse to provide the insurance company with the information needed to complete its investigation.

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This article examines how courts in Illinois and across the nation have interpreted insurance contracts in the context of litigation between a policyholder and insurance company. Each of these approaches has pronounced effects on the likelihood that fraud will occur, directly affecting the cost of insurance premiums. For those states that have adopted a "substantial compliance" approach, this article recommends an approach that courts in those states should take in applying this doctrine. This approach will enable courts to balance the interests of individual policyholders attempting to recover on particular claims with the interests of premium-paying consumers as a whole.

II. BACKGROUND

A. *The Process of Recovering on an Insurance Policy*

Generally, insurance policies require policyholders who want to recover on insurance claims to do four things. First, policyholders must notify the insurer of a loss within a relatively short period of time. Second, they may be asked to submit a "proof of loss" to the insurer. This is a form used in the insurance business which requires the insured to provide specific factual information about the loss, such as the cause and origin of the loss and the amount claimed under the policy. The form is signed by the insured and notarized. Third, if the insurance company requests it, policyholders must submit to an examination under oath ("EUO"). An EUO has some similarities to a deposition, in that, as the name suggests, the policyholder gives testimony under oath, usually before a court reporter. Also like a deposition, the policyholder has a right to have counsel present, but counsel's role is more circumscribed than in a deposition. Finally, policyholders must produce all related financial documents.

These provisions are found in virtually every insurance policy providing property coverage,

from an individual renter's policy, to complex commercial forms covering skyscrapers or multi-site industrial risks. In many jurisdictions, these provisions have been considered conditions precedent to recovering under the policy.

Consumers should realize, however, that this "formal" claim handling is not required every time a policy claim is presented. As a practical matter, with the exception of the notification requirement, insurers do not seek compliance with these requirements unless fraud by the policyholder is suspected. (Detailed investigation of every single claim would be prohibitively expensive.) The cooperation provisions of the insurance policy exist for the purpose of allowing an insurer to identify and resist suspected fraudulent claims. As the United States Supreme Court explained in *Clafin v. Commonwealth Insurance Co.*:

The object of the provisions in the policies of insurance, requiring the assured to submit himself to an examination under oath, to be reduced to writing, was to enable the company to possess itself of all knowledge, and all information as to other sources and means of knowledge, in regard to the facts, material to their rights, to enable them to decide upon their obligations, and to protect them against false claims.³

Based on information gleaned from its investigation, the insurance company must either pay the claim or deny payment. If the insurance company denies the claim, a policyholder can sue the insurance company for a breach of the policy. This is known as a "first-party claim." In deciding first-party claims, courts must frequently examine whether the policyholder cooperated with the insurance company in conducting its claim investigation. However, to the detriment of consumers generally, the requisite level of policyholder cooperation is eroding in many jurisdictions.

B. *Why Insurance Companies Need Policyholders to Cooperate (and Why Consumers Want Policyholders to Do So).*

As a private entity, an insurer's ability to obtain information following a loss from third parties, even public agencies, is quite limited. An insurer's only protection against fraudulent claims is the limited investigative procedures authorized by its policies. Different jurisdictions take different approaches in requiring policyholder cooperation. In those jurisdictions that deem an insured's obligations following a loss to be conditions precedent to recovery under the policy, a policyholder's failure to cooperate is fatal to recovery on a first party claim. Though the term is not used in the cases, we can refer to these as "strict compliance" jurisdictions to distinguish these from states which hold that a policyholder must only "substantially comply" with these traditional conditions precedent. In states where courts require other than "strict compliance" from policyholders, the courts, in essence, are requiring less than full cooperation from policyholders. Whether the courts of a particular jurisdiction will require strict compliance or allow "substantial compliance" can thus significantly affect the quantity and quality of information that an insurance company will be able to collect from its policyholders.

As applied, particularly in Illinois, this "substantial compliance" doctrine has the undesirable effect of eviscerating the obligations created by the policy, if not actually encouraging non-compliance by the policy-

holder, at the direct expense of the insurer's ability to investigate claims promptly and thoroughly. While there are no figures specifically addressing the financial impact of Illinois' substantial compliance doctrine, any policy that discourages the investigation of insurance fraud can be presumed to have a significant effect on the wallets of premium-paying consumers.

Consumers feel this effect primarily through the fallout of insurance fraud. A dishonest

policyholder, perpetrating a fraud, can, in some states, make only minimal efforts at policy compliance and still be in "substantial compliance" with the conditions of the policy. The policyholder can thereby avoid summary judgment and guarantee himself a jury trial. Faced with the expense of a trial, an insurer may opt to settle claims in these circumstances, allowing the policyholder to complete the perpetration of the fraud.

In this country, insurance fraud is widespread and extremely detrimental to consumers. The National Insurance Crime Bureau ("NICB") calls insurance fraud the second most costly white collar crime in the United States, second only to tax evasion. The NICB estimates that as many as 10% of all property/casualty claims are fraudulent and cost Americans as much as \$20 billion a year.⁴ Consumers ultimately absorb this \$20 billion cost through higher insurance premiums. The NICB contrasts its \$20 billion estimate of the annual cost of insurance fraud with the \$17 billion in damage done by Hurricane Andrew, to date the costliest natural disaster in United States history. In order to help prevent insurance fraud and, ultimately, the increase in

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consumers' premiums, courts should require policyholders to cooperate with insurance companies' investigations.

Not only do consumers as a whole need policyholders to comply with insurance companies' investigations, insurance companies themselves also need policyholder cooperation so that they can comply with state regulatory requirements. For example, Illinois, like most states, imposes a statutory obligation on insurers not to engage in the "unfair claims practice" of refusing "to pay claims without conducting a reasonable investigation based on all available information."⁵ Under current Illinois common law, an Illinois insurer is not entitled to deny claims without conducting a reasonable investigation; however, an insurer has no right to compel a policyholder's meaningful cooperation in a post-loss investigation. This leaves insurance companies with the responsibility to investigate claims and little power to conduct such investigations.

Courts can empower insurance companies by requiring policyholders to comply with the policy's terms and conditions and cooperate in claim investigation. This cooperation would enable insurance companies to fulfill their statutory duty of conducting reasonable investigations. Although claim investigations are initiated because of a suspicion of fraud, not all investigations result in declination (the refusal to pay the claim). Often, where the insured willingly cooperates in the insurer's investigation, those initial questions which gave rise to the request for formal claim handling are resolved in favor of the policyholder.

In the absence of policyholder cooperation, and without meaningful enforcement of policy cooperation provisions, the insurance company has two choices when faced with a policyholder's claim that raises a suspicion of fraud. First, it can deny the questionable claim and face the expense of litigation if a policyholder decides to sue. Second, it can pay the questionable claim, even though the claim appears to be fraudulent. Both of these options result in substantially increased costs to the

insurance company — costs which are passed to the policyholder in the form of increased premiums.

III. THE TRADITIONAL APPROACH: STRICT COMPLIANCE WITH THE COOPERATION PROVISIONS OF THE INSURANCE CONTRACT

Some jurisdictions continue to require policyholders' strict compliance with all conditions in insurance contracts. North Carolina's *Fineberg v. State Farm Fire and Casualty Co.*⁶ illustrates this approach. In this case, after a fire at his home, Mr. Fineberg's insurance company sent him several letters demanding an EUO. Fineberg failed to appear for an EUO, citing poor health. He had suffered five heart attacks, and he feared that the stress of an EUO might trigger a sixth one. Fineberg did provide a statement to his insurance company and later submitted a proof of loss. Furthermore, he was willing to answer questions if submitted to him in writing.⁷ The insurance company refused to accommodate him and denied his claim. Fineberg filed suit.

The insurer moved for summary judgment on the basis of Fineberg's failure to submit to an EUO. Fineberg responded by producing an affidavit which attested to his troubled medical history. His cardiologist submitted an affidavit verifying the policyholder's health problems and noting the link between stress and heart attacks.

The *Fineberg* court held that compliance with the EUO requirement was a condition precedent to bringing suit against the insurer.⁸ "A 'condition precedent' is defined as an event which must occur, or an act which must be performed by one party to an existing contract before the other party is obligated to perform."⁹ A condition precedent must be performed before the contractual obligation becomes binding on the parties. Where the condition precedent is not satisfied, the obligations of the parties end. The court stated,

“[W]e are not persuaded by plaintiff’s arguments that the [statement given to the insurance company] constituted an examination under oath for purposes of compliance.”¹⁰ As in any contract, a party failing to comply with a condition precedent in the contract cannot recover in a suit on that contract. Under this strict-compliance approach, a policyholder must comply with the policy requirements or the insurance company has no obligation to pay the claim. There is no in-between level of policyholder cooperation where the policyholder can “substantially comply” with policy requirements and still obtain coverage.

Florida also continues to require strict compliance as demonstrated in *Goldman v. State Farm Fire General Ins. Co.*¹¹ In this case, Richard and Patricia Goldman obtained a homeowners/tenants policy from State Farm Fire General Insurance Company in June of 1992. Four months later, the Goldmans reported a burglary and submitted a proof of loss. State Farm requested the Goldmans’ EUOs. The Goldmans’ attorney asked that the examinations be rescheduled from their original date. The Goldmans then filed suit against the insurance company, alleging breach of contract and claiming to have complied with all conditions precedent to recovery on the policy. When he filed the complaint, the Goldmans’ attorney suggested that the EUOs be renounced as depositions. State Farm refused, and again requested EUOs.

State Farm moved for summary judgment, arguing that the policyholders’ filing suit without submitting to examinations was a material breach of the policy and a failure to satisfy a condition precedent to filing suit on the policy. In response, the Goldmans argued that they never actually *refused* to submit to their examinations under oath, they only wanted them rescheduled. In addition, the Goldmans filed affidavits stating that they had complied with State Farm’s requests “to the best of their ability.”¹²

The trial court granted summary judgment, and the appellate court affirmed, finding that

State Farm was not required to show that it was prejudiced by the policyholders’ noncompliance in order to obtain summary judgment.¹³ The *Goldman* court analyzed numerous cases from Florida and other jurisdictions before concluding that the policy provisions requiring the policyholders to submit to EUOs were conditions precedent to coverage, and that prejudice was unnecessary where a violation of a condition precedent was at issue.¹⁴

Like North Carolina and Florida, Illinois has required strict compliance of the terms of an insurance contract. Strict compliance was the rule in Illinois in 1897 when the Illinois Supreme Court held that production of a policyholder’s books and records, when requested, is a reasonable condition precedent to recovery in a first party claim.¹⁵ This rule held firm in Illinois for almost ninety years.

Perhaps the last Illinois case to require strict compliance was *Horton v. Allstate Insurance Co.*¹⁶ In that case, Horton’s home was damaged by a fire which both parties agreed may have been intentionally set.¹⁷ Horton submitted a proof of loss, and Allstate rejected it. Allstate asked Horton to file an amended proof and submit related documentation. These documents included “books of account, bills, [and] invoices [as well as] tax returns, utility bills, and pleadings pertaining to his bankruptcy petition.”¹⁸ Rather than comply, Horton filed suit. The trial court granted summary judgment to Allstate based on Horton’s noncompliance. On appeal, the court affirmed the trial court’s holding and stated:

[P]laintiff was under a contractual obligation to produce those documents expressly specified in the policy . . . Because the [P]laintiff did not fulfill this condition precedent *or attempt to excuse his noncompliance*, we find that his suit against Allstate was barred under the policy for failure to comply with a condition precedent to which the parties had both agreed.¹⁹

Even though the court refused to allow Horton to recover, the court's language opened the door to recovery to those policyholders who admitted that they had not fully complied with the conditions of the insurance policy. The Illinois court suggested that if policyholders could make an excuse for their noncompliance, they might be allowed to recover. With this, the court started to erode the traditional doctrine of strict compliance in Illinois.

IV. A BROAD VIEW OF SUBSTANTIAL COMPLIANCE IN ILLINOIS: *Piro v. Pekin Insurance*

Only three years after *Horton*, in *Piro v. Pekin Insurance Co.*,²⁰ the substantial compliance doctrine made its Illinois debut. In this case, Charles Piro owned Piro T.V., Heating & Air Conditioning, Inc. A fire destroyed the corporate premises, and he filed a claim with his insurance company. After submitting his proof of loss, Piro submitted to an EUO five months after the fire. However, Piro failed to produce financial records and information relevant to his financial motive to stage a fire or inflate his losses resulting from an accidental fire. The insurance company rejected the claim, insisting on "strict compliance with all policy provisions."²¹ Instead of complying with the insurance company's request for information, Piro filed suit. The insurer moved for summary judgment. The trial court granted summary judgment to the insurance company. The appellate court reversed, stating:

The question whether [P]laintiffs' disclosures after defendant's motion for summary judgment came too late to comply with the disclosure provisions of the policy is not an appropriate question to decide on motion for summary judgment. Whether a party has committed a breach of contract is generally a question of fact.

* * *

We express no opinion as to whether the instant [D]efendant can demonstrate on remand that it would be inequitable to permit plaintiffs to comply with the policy at such a late date. If [D]efendant can demonstrate the existence of a question of fact as to whether it was prejudiced, the issue becomes one of substantial compliance and is for the jury.²²

Thus, the Fifth District of the Illinois Appellate Court created a requirement that the insurance company show prejudice resulting from the policyholder's failure to comply with the policy provisions. By imposing a prejudice requirement on the policy, a court essentially excuses a policyholder's non-cooperation. Consider the prejudice to the insurer in this circumstance. The insurer is prejudiced by having to pay a fraudulent claim — but it can not know whether a particular suspicious claim is really an attempted fraud unless it is allowed to complete its investigation — with the insured's cooperation. The insurer becomes trapped in a vicious circle, left to hope that it can develop a basis upon which to prove fraud during the discovery phase of litigation on the policy — long after any possible investigative trail suggested by the facts of the loss has grown cold.

This rule enables a policyholder to sue an insurance company for failure to pay a claim even if the policyholder himself has not complied with any of the cooperation provisions of the policy. By forcing insurance companies either to pay claims they strongly suspect to be fraudulent or risk lawsuits on every claim they deny, the Illinois courts have increased the incentives for dishonest policyholders to attempt fraud and increased premium costs for honest consumers.

A. *First District Follows the Fifth District in Adopting Substantial Compliance*

The First District of the Illinois Appellate Court subsequently adopted this prejudice-based test in *Pick v. Associated Indemnity Corp.*²³ In this case, Harold Pick, reported to his homeowners' insurance company a theft of personal property valued at over a quarter-million dollars. Four months later, the insurer required Pick to produce various financial documents relating to the purchase of the property allegedly stolen or other proof of ownership, prior claim information, and property settlement agreements from the Pick's previous divorces.

Pick did not comply, and the insurer denied his claim. The insurer withdrew its decision, however, when Pick agreed to produce the requested documents and submit to an EUO. Over a year after the fire, the parties began an EUO; however, Pick's attorney terminated the examination mid-stream, and Pick failed to produce the documents that he had agreed to submit.²⁴ The insurance company attempted to reschedule the EUO several times and persisted in its document request.²⁵ The parties never resumed the examination because either the policyholder or his attorney canceled each scheduled date.²⁶ The insurer continued in its unsuccessful demand for financial documents and eventually declined the claim due to Pick's policy non-compliance.

In response, Pick filed suit, and the insurance company filed a motion for summary judgment relying on *Horton*.²⁷ The *Pick* court chose to follow the Fifth District's *Piro* instead of its own *Horton*. The *Pick* court noted:

In *Horton*, plaintiff failed to resubmit a proof of loss and failed to produce any documents requested. Here, plaintiff has arguably made some attempt to comply with the policy. Although plaintiff may not have been as cooperative as the insured in

Piro, he did produce certain documents and eventually appeared for an examination under oath, although it was not completed. These facts show [P]laintiff made some attempt to comply with the policy provisions which is [sic] similar to the situation presented in *Piro*. Whether [P]laintiff's actions amounted to substantial compliance with the policy is a question of fact and therefore, summary judgment in [D]efendant's favor was improper.²⁸

With this decision, a second Illinois court adopted an extremely broad view of substantial compliance. Although the Illinois Supreme Court had not spoken on the issue (and still has not), with the adoption of the substantial compliance doctrine, the Fifth and First District Illinois Appellate Courts fundamentally changed the way insurance contracts are read in Illinois to the detriment of honest Illinois consumers.

B. *The First District Again Uses Substantial Compliance to Eviscerate the Provisions of an Insurance Contract*

The First District of the Illinois Appellate Court reaffirmed the view that any tenuous stab at compliance was sufficient to raise a question of "substantial compliance" in *Patel v. Allstate Insurance Co.*²⁹ In that case, an apartment building insured by Allstate suffered a fire, and the policyholder, Babu Patel, submitted a proof of loss claiming \$118,942.00. Patel appeared for an EUO but did not produce any of the financial documents Allstate requested.³⁰ The insurance company likely requested the documents to determine if Patel had a motive to burn the building. Patel stated that these documents were either in the possession of a bankruptcy trustee or that all debts relating to the building had been paid by the mortgage company since it had assumed

management of the building.³¹

But Patel stated that he could not have been involved in the fire because, at the time of the fire, he was out of the country.³² There are many ways to corroborate such an alibi: a stamped passport, for example, or a used airline ticket. Even Patel's disclosure of his flight number might have given Allstate enough information to investigate the truth of Patel's assertion. Although Patel's attorney promised full cooperation, neither Patel nor his attorney ever provided the requested information to corroborate Patel's alibi or financial position. Subsequently, Allstate rejected Patel's claim due, in part, to Patel's failure to cooperate with its investigation. Patel, like Pick and Piro before him, filed suit. The district court granted summary judgment to Allstate, holding that plaintiff's failure to produce the requested documents precluded recovery under the insurance policy. The appellate court reversed, again distinguishing the facts of this case from *Horton*.³³ In noting that Patel had stated that certain documents were either inaccessible or in control of third parties, the court held that:

In the present case, unlike *Horton*, [P]laintiff made some attempt to comply with the provisions of the policy. As in *Pick* and *Piro*, Patel appeared for an examination under oath and provided some of the requested information. In addition, Patel provided explanations for his failure to fully comply with defendant's requests. Thus, the actions of the [P]laintiffs in the present case can be distinguished from those of *Horton*, where the insured filed suit without responding to, or attempting to excuse his failure to respond to, Allstate's request for records and documentation.

We believe the facts in this case are sufficient to raise the issue of whether [P]laintiffs substantially complied with the terms of the policy

and, therefore, summary judgment was improper.³⁴

Although Patel and his attorney made repeated promises of cooperation, they disclosed nothing.³⁵ Nonetheless, the appellate court still reversed the granting of summary judgment in favor of the insurance company. A close reading of *Patel* suggests an Illinois court may be willing to find "substantial compliance" if an insured makes *any* effort to create the mere appearance of cooperation. The policyholder intent on committing insurance fraud is thus well advised to repeatedly promise cooperation; empty promises alone may be sufficient to create a triable issue of fact regarding whether the insured has sufficiently cooperated.

C. Illinois Eviscerates Virtually All Obligations of Policyholders: *Crowell v. State Farm*

Crowell v. State Farm Fire and Casualty Co.,³⁶ the most recent Illinois case considering the substantial compliance doctrine, reinforces this impression. The facts of *Crowell* should be particularly troublesome to consumers worried about the costs of insurance fraud.

Crowell was the subject of a criminal arson investigation because of the loss for which he made a claim. Crowell showed up for an EUO but failed to answer relevant and material questions concerning his financial status and walked out of the examination before it was concluded.³⁷ He refused to produce Paula Hunter, who had been living with Crowell at the time of the fire, for examination despite the carrier's demands.³⁸

State Farm denied coverage; Crowell sued. As in the other cases, the insurer moved for summary judgment. Crowell responded to the motion by noting that he was not represented by counsel at his examination, and that many questions seemed irrelevant and immaterial to him. Now that the criminal arson charges against Crowell had been dropped, he was

willing to give a deposition and "answer all material questions with the guidance of his attorney."³⁹

As in the other cases, the trial court granted summary judgment; the Appellate Court reversed, holding:

[P]laintiff's conduct does not demonstrate the type of consistent, obstinate, and permanent refusal to cooperate present in those cases in which summary judgment was allowed based on breach of the cooperation clause of the policy. Plaintiff should have been given the opportunity by the trial court to cure his noncompliance upon his offer to do so prior to the entry of summary judgment.⁴⁰

The *Crowell* court stated that the insurance company must demonstrate some prejudice before the question of plaintiff's "late compliance . . . becomes one of substantial compliance . . . for the jury."⁴¹ This holding prompted a vigorous dissent from Presiding Justice William A. Lewis:

[T]his was not a case of the plaintiff failing to understand the terms of the policy. He simply refused to comply with his agreement. The majority has now written a new clause into the insurance policy that says that the insured can refuse to submit to an oral examination, refuse to produce members of his household, and refuse to submit requested documents until ordered by the court. This ruling abrogates the duties of the insured under the policy for no discernible reason. There are not even public policy reasons suggested for doing so.⁴²

Thus, according to *Crowell*, a policyholder can refuse to cooperate with the insurance

company's investigation, wait for a claim to be denied, and sue the insurance company for its alleged noncompliance with the insurance contract. The insurance company must then prove how the information it has not received affected its rights. This requires an insurer to prove a negative. Such an approach can only encourage insurance fraud. It gives license to dishonest policyholders to stonewall investigations and greatly increases the chances that a "fraud attempted" will be successful.

V. NEW YORK, NEW JERSEY, AND IOWA: A RATIONAL COMPROMISE

Between Illinois' overly broad version of substantial compliance and the rigid North Carolina and Florida strict compliance approach, there is a middle ground. New York, New Jersey, and Iowa have adopted an approach which sometimes allows a policyholder the opportunity to cure his or her noncompliance but also allows courts to evaluate the degree of willfulness of an insured's noncompliance on summary judgment.⁴³

In these states, as in all American jurisdictions, the courts do not resolve fact questions on summary judgment. Rather, courts address the substance of a policyholder's compliance as a contract construction issue, which is a traditional question of law. To illustrate why this approach does not grant the power to resolve fact questions to courts reviewing summary judgment motions, consider the following cases in which this approach has been adopted. For example, in *Davis v. Allstate Insurance Co.*, the Appellate Division of the New York Supreme Court granted the insurer's summary judgment motion based on the policyholder's noncooperation.⁴⁴ The policyholder alleged that he was the victim of two fires at the insured property on different dates. He submitted his proof of loss to Allstate five months after the fires. A consultant hired by the insurance company determined that one or both of the fires had been intentionally set.⁴⁵

Allstate then requested that the policyholder submit to an EUO.

Although the policyholder appeared with counsel on the appointed date, the examination did not proceed because the policyholder insisted on tape recording the proceedings and Allstate's attorney refused to be taped.⁴⁶ The parties volleyed letters back and forth concerning the proposed taping of the examination. Additionally, the policyholder did not comply with Allstate's demand for the production of certain financial documents because he believed that these documents were beyond the scope of Allstate's "permissible inquiry."⁴⁷

Davis filed suit, and Allstate moved for summary judgment. The trial court denied the motion. The appellate court reversed, looking at the totality of the circumstances surrounding Davis's refusal to cooperate and finding that Davis's "failure to cooperate was willful" and "a material breach of the policy." Thus, the New York appellate court required the policyholder to cooperate significantly with the insurance company's investigation in order to maintain a suit against his insurance company. The court's refusal to eviscerate the policyholder's obligations under the contract protected both the insurance company and consumers from fraud.⁴⁸

One might not ordinarily consider a determination of "willfulness" to be a matter of law. However, a New Jersey case, *DiFrancisco v. Chubb Insurance Co.*,⁴⁹ clarifies that courts following this approach are not making inappropriate factual determinations. The policyholder, Robert DiFrancisco, controlled corporations that owned two restaurants. He made an \$87,253 claim to his homeowner's carrier for two burglaries that allegedly took place at his home. The insurance company sought personal financial information from DiFrancisco, and demanded his tax returns and records pertaining to the two restaurants. DiFrancisco refused to produce corporate records but did submit to three EUOs.⁵⁰

The insurance company questioned the validity of the policyholder's claim for several

reasons. First, DiFrancisco did not report the first burglary for over a month. The court noted that between the first burglary and DiFrancisco's report to the insurance company, DiFrancisco experienced serious financial problems.⁵¹ Additionally, he did not report the second burglary for 10 months after it allegedly occurred — after the insurance company had already closed its file on the first claim. Moreover, the insured's ex-wife was apprehended by police at the policyholder's premises during the second "burglary." She "allegedly admitted removing bedroom furniture from the house[,] claiming it was her[s]." The policyholder did not press charges against his ex-wife, however, out of consideration, he said, for their children.⁵²

When DiFrancisco advised his carrier of the first burglary loss, he indicated that the total amount of his claim was \$25,000, even though the initial police report on this incident put the value of the items stolen at only \$10,020.⁵³ Later, the value of his claim skyrocketed to the \$87,253 figure mentioned above.⁵⁴ He denied ever telling the police that his claim was only for \$10,000; he likewise denied ever telling his insurance agent that this claim was only for \$25,000.⁵⁵ Finally, the insurance company also doubted the validity of DiFrancisco's claim because he suffered heavy business losses during this period.⁵⁶

The insurance company denied the claim because the policyholder failed to produce requested documents and misrepresented and concealed material facts. DiFrancisco sued. The insurance company moved for summary judgment, citing DiFrancisco's failure to produce documents and his misrepresentations. The trial court granted summary judgment, and the appellate court affirmed on the basis of DiFrancisco's failure to produce the requested corporate records. The appellate court cited a line of New York cases which "have recognized that delays in obtaining requested information frequently result in 'a material dilution of the insurer's rights.'"⁵⁷ In addition, the court concluded that the demand for corporate

records was “highly relevant to the insurer’s inquiry concerning plaintiff’s financial ability to have acquired the items and his potential motive for committing fraud by arranging the loss or exaggerating its magnitude.”⁵⁸ The particular categories of records requested were “reasonable and specific in light of these concerns.”⁵⁹ The policyholder’s failure to produce the requested documentation could only be seen as “constituting a willful refusal to comply with the terms of his insurance contract.” This failure “materially diluted” the insurer’s rights.⁶⁰

“Thus, no legal or equitable basis exists in these circumstances for giving the insured ‘another chance’ to produce the records withheld.”⁶¹

The New York and New Jersey cases validate the policy cooperation clauses without insisting on “strict compliance.” They recognize that there must be an element of substance in order for the policyholder to reasonably assert “substantial compliance.”

This is not a wholly subjective determination, nor one foreign to contract law. For example, the term “substantial compliance” is frequently used in the context of construction contracts. As the Illinois Supreme Court stated in *W.E. Erickson Construction, Inc. v. Congress-Kenilworth Corp.*, “a purchaser who receives substantial performance of a building contract must pay the price bargained for, less an offset for defects in what he received as compared to what strict performance would have given

him.”⁶² Citing a 1919 case,⁶³ the *Erickson* court defined “substantial” in this context as meaning “in substance; in the main; essential, including material or essential parts.”⁶⁴ In *A.W. Wendell & Sons, Inc. v. Qazi*, the Illinois Appellate Court read *Erickson* to mean that: “[s]ubstantial performance of a contract means performance of all necessary to accomplish the purpose of the contract.”⁶⁵ In *Wilmette Partners v. Hamel*, the Illinois Appellate Court found that the “doctrine of substantial performance is relevant only where the contractor is in *technical* breach of contract.”⁶⁶

A home builder might expend thousands of dollars and hundreds of labor-hours without creating a habitable structure. That, however, would not constitute “substantial performance” because “[an] important factor in determining whether a builder has rendered substantial performance is the actual receipt of benefits by the purchaser/owner.”⁶⁷ The *Erickson* court stated, “[t]he

question of whether there has been substantial performance of the terms and conditions of a contract sufficient to justify a judgment in favor of the builder for the contract price is always a question of fact.”⁶⁸ A contractor can not just scratch a vacant lot with a bulldozer, walk off the job and then sue on the construction contract and claim that there is a question of fact regarding whether the contractor has “substantially complied” with a contract to build a house.⁶⁹

The New York and New Jersey cases validate the policy cooperation clauses without insisting on “strict compliance.” They recognize that there must be an element of substance in order for the policyholder to reasonably assert “substantial compliance.”

Because a building contractor's performance under a construction contract is ordinarily a question of fact, it can be only imperfectly analogized to a policyholder's cooperation obligations following a loss. However, as the building cases make clear, an important factor in the latter situation would be whether the insurer has actually received the "benefits" of the policyholder's partial compliance, specifically, information with which it can complete a good-faith investigation into the merits of the policyholder's claim. Delay alone operates to deny the insurer the benefits to which it is entitled under the cooperation provisions.

Why substantial compliance might be a question of fact in a building case, but not in an insurance case, is explained by realizing that, in the building contract situation, the entire contract is being evaluated; in the insurance context, it is the policyholder's own compliance with conditions precedent that is at issue.⁷⁰ In other words, the courts in a first party insurance case are being asked to determine whether there has been a failure of a condition precedent to recovery under the policy; if the condition has not been met, there can be no question of the insurer's breach. In this context, a court's willingness to allow "substantial" as opposed to "strict" compliance with the condition may be seen as consistent with the law's traditional reluctance to enforce contract provisions that result in forfeitures.

It is fairly easy to see that in *Piro, Pekin, Patel, Crowell, Davis, and DiFrancisco*, the insureds could not reasonably be said to have substantially complied with their policy obligations notwithstanding the varying results in these cases. It is likewise easy to construct situations where a court could rule, as a matter of law, that the insured had indeed substantially complied with his policy obligations. If the policyholder is requested to produce 12 months worth of checking account statements to show financial wherewithal to acquire recently purchased goods allegedly stolen in a home burglary, but can only find 10 or 11 statements and readily signs an authorization

for the bank to provide those that are missing, it *might* be possible to argue that the insured has not *strictly* complied with the insurer's request for information. On the other hand, could anyone doubt that such a "failure" should be deemed merely technical or that the policyholder's compliance with this request was substantial? Enforcement of the policy condition precedent under these circumstances would impose a forfeiture on merely technical grounds, and no jurisdiction, even the so-called strict compliance jurisdictions likely would conclude that such a claim would be denied for failure of a condition precedent in that case.

The author's object is to formulate a general rule regarding how courts should treat questions of an insured's substantial compliance and still honor policy conditions precedent. *Brown v. Danish Mutual Insurance Ass'n*,⁷¹ provides a workable blueprint for such a rule. Duane Brown reported a theft of \$13,820 in antique articles from the basement of his farmhouse.⁷² Within a month of this loss, Brown provided his insurance company a proof of loss and inventory forms. In the meantime, however, the local sheriff's office had informed the insurance company that the theft seemed suspicious.⁷³

Danish elected to require Brown to submit to an EUO. Brown refused and told Danish that he had no intention of submitting at any time in the near future.⁷⁴ Danish sent a second notice, advising him specifically that such refusal was a breach of the insurance contract and would cause Danish to deny the claim. Brown again declined to appear.⁷⁵ Danish denied his claim. In response, Brown sued, alleging breach of the insurance contract and bad faith. Danish moved for summary judgment, and the trial court granted the motion.

On appeal, Brown argued that the trial court erred in determining that his refusal to submit to an EUO "amounted to a failure to substantially comply with the terms of the insurance policy."⁷⁶ Citing *Watson v. National Surety Corp.*,⁷⁷ the *Brown* court noted that the Iowa Supreme Court had found that submission to

an EUO is a condition precedent to a policyholder's recovery on a policy, but that *strict compliance* with this provision is not required. It is, however, the policyholder who bears the burden of proving that he or she has substantially complied with the policy requirement.⁷⁸ The insurer might have to justify the reasonableness of requirements (as the insurer persuaded the courts in *DiFrancisco* that the requests for business records were germane to the homeowner's claims), but it is the insured who must carry the burden of showing that his or her compliance with these requests was reasonable in the circumstances.⁷⁹ This construction is reasonable because any party to a contract containing conditions precedent must demonstrate that these conditions were fulfilled in order to enforce the contract. Moreover, this approach benefits individual policyholders because they are not unduly burdened by overly technical requirements, and consumers benefit because fraud-fighting policy provisions can be meaningfully enforced.

The *Brown* court recognizes that policy cooperation obligations are conditions precedent to recovery. These cooperation provisions help insurers prevent fraud and help policyholders know that they fail to comply with these provisions at their own risk. Yet the *Brown* court would not *strictly* enforce these provisions; it would not permit a claim to be forfeited because the insured made some technical or unimportant misstep in presenting a claim. Upholding policy cooperation provisions helps everyone involved. The policyholder must explain why he or she could not fully comply, and the insurer is not obliged to demonstrate that it was prejudiced because it could not act on information it does not have and which the insured refused to provide.

VI. RECOMMENDED GUIDELINES

In the author's view, it is unlikely that any jurisdiction that has abandoned strict compliance can be persuaded to return that standard. Harsh as it may seem in some applications,

"strict compliance" has the virtue of predictability and provides the strongest disincentive to commit fraud. Moreover, in those instances where a policyholder really believed that the carrier's request for particular documents was overbroad or unduly intrusive, the policyholder could always seek a declaration of his or her rights under the insurance contract.

For those states that have shifted to a "substantial compliance" approach, however, the Iowa, New Jersey, and New York cases discussed herein suggest a reasonable way to apply the doctrine. What constitutes "substantial compliance" must be a question of law for the court to decide on a summary judgment motion, rather than a question of fact, because the issue of whether the condition precedent to recovery has been sufficiently fulfilled, is in essence, an issue of contract construction appropriate for judicial determination. There may be a factual dispute concerning what the policyholder produced in response to the insurer's requests, but if the facts of the policyholder's partial compliance are established, the court should be able to determine whether the policyholder's partial compliance sufficiently fulfills the condition precedent and rises to the level of "substantial compliance."

VII. CONCLUSION

In sum, the insurer has bargained in the contract for tools to protect itself against false claims; these tools are essential to effectuate the purpose of the insurance policy — indemnification — unless, of course, one wants to seriously argue that an insurer should not care whether a given claim is valid or fraudulent. Surely an insurer owes an obligation to promptly pay all valid claims; just as surely, however, an insurer owes its stockholders and the consumers who pay its premiums, a duty not to pay fraudulent claims. Where a policyholder denies the insurer the effective or meaningful use of the tools designed to ferret out fraud, the policyholder has not "substantially complied" with its policy obligations.

E N D N O T E S

¹ "Policyholder" and "consumer" will be used interchangeably throughout this article because policyholders are consumers of insurance services.

² *Travelers Ins. Co. v. P.C. Quote, Inc.*, 570 N.E.2d 614, 617 (Ill. App. Ct. 1991) (citation omitted).

³ 110 U.S. 81, 94-95 (1884).

⁴ NATIONAL INS. CRIME BUREAU, "INSURANCE FRAUD: THE \$20 BILLION DISASTER" 1 (1995).

⁵ 215 ILL. COMP. STAT. § 5/154.6(n) (West 1997). While an insurer's commission of an improper claim practice does not give rise to a private right of action, see *Van Vleck v. Ohio Casualty Insurance Co.*, 471 N.E.2d 925, 926 (Ill. App. Ct. 1984), the commission of any improper claims practice may subject the carrier to penalties imposed by the Illinois Department of Insurance, see 215 ILL. COMP. STAT. § 5/154.6 (West 1997).

⁶ 438 S.E.2d 754, 755 (N.C. Ct. App. 1994).

⁷ An Examination Under Oath ("EUO") on written questions does not satisfy the policy requirements. In *Boston Insurance Co. v. Mars*, 148 So. 2d 718, 720 (Miss. 1963), the court stated, "[We] are of the opinion that the provision in the policy of insurance for an examination . . . under oath contemplated an examination by the question and answer method, wherein the answer to one question may suggest the next question to be asked by the examiner." The offer by the insured's attorney to provide "all available information, including copies of insurance policies and mortgage papers" and "have his clients answer any list of written questions that the insurance company may care to furnish" did not make the insurer's request for EUO "unreasonable." *Id.* Refusal to submit to an EUO was therefore "a violation of the express provisions of the insurance policy, and resulted in a forfeiture of their right to recover under the policy." *Id.*

⁸ See *Fineberg*, 438 S.E.2d at 755.

⁹ *Fineberg*, 438 S.E.2d at 756

¹⁰ See *id.*

¹¹ 660 So. 2d 300, 303 (Fla. Dist. Ct. App. 1995).

¹² *Id.* at 302.

¹³ See *id.*

¹⁴ *Id.* at 303-04.

¹⁵ See *Niagara Fire Ins. Co. v. Forehand*, 48 N.E. 830, 831 (Ill. 1897).

¹⁶ 467 N.E.2d 284, 285 (Ill. App. Ct. 1984).

¹⁷ See *id.* at 284.

¹⁸ *Id.*

¹⁹ *Id.* at 286 (emphasis added).

²⁰ 514 N.E.2d 1231 (Ill. App. Ct. 1987).

²¹ *Id.* at 1233.

²² *Id.* at 1234-35 (citations omitted).

²³ 547 N.E.2d 555, 560 (Ill. App. Ct. 1989).

²⁴ See *id.* at 558.

²⁵ See *id.*

²⁶ See *id.*

²⁷ See *Horton*, 467 N.E.2d at 285.

²⁸ 547 N.E.2d at 560.

²⁹ 570 N.E.2d 357, 360 (Ill. App. Ct. 1991).

³⁰ *See id.* at 359.

³¹ *See id.*

³² *See id.*

³³ *See id.* at 361.

³⁴ *See id.*

³⁵ *See id.* at 359.

³⁶ 631 N.E.2d 418 (Ill. App. Ct. 1994).

³⁷ *See id.* at 419.

³⁸ *See id.*

³⁹ *Id.* at 419.

⁴⁰ *Id.* at 421.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Lentini Brothers Moving & Storage Co. v. New York Property Insurance Underwriting Association* is an early example of this phenomenon. 422 N.E.2d 819, 820 (N.Y. 1981). In *Lentini*, Plaintiff stipulated that it filed suit rather than comply with the insurer's requests for submission of a proof of loss and for examination under oath. In affirming summary judgment for the insurer, the New York Court of Appeals found that the policyholder's mistaken belief that it had only two months to file suit after the insurer's requests did not excuse the policyholder's failure to respond to the insurer's requests. *See id.* at 820.

⁴⁴ 612 N.Y.S.2d 195, 196 (N.Y. App. Div. 1994).

⁴⁵ *See id.* at 195-96.

⁴⁶ Unlike a court reporter's transcript, there is no guarantee of integrity or accuracy in an easily edited tape recording.

⁴⁷ *See Davis*, 612 N.Y.S. 2d at 196.

⁴⁸ *Id.* (citations omitted); *see also*, *Antao & Chuang v. St. Paul Fire & Marine Ins. Co.*, 639 N.Y.S.2d 322, 323 (N.Y. App. Div. 1996) (affirming dismissal of plaintiff's punitive damage claims but finding "plaintiff's substantial compliance warrants a final opportunity to seek relief pursuant to the policy").

⁴⁹ 662 A.2d 1027 (N.J. Super. Ct. App. Div. 1995).

⁵⁰ *See id.* at 1030.

⁵¹ *See id.* at 1029-30.

⁵² *See id.*

⁵³ *See id.* at 1029-30.

⁵⁴ *See id.* at 1030.

⁵⁵ *See id.*

⁵⁶ *See id.* For example, just before the first burglary allegedly occurred, the managers of one of the policyholder's restaurants stole \$100,000. *See id.* at 1029. The policyholder then put \$80,000 into the other restaurant but was never able to draw an income from it. *See id.*

⁵⁷ *DiFrancisco*, 662 A.2d at 1032 (quoting *Evans v. International Ins. Co.*, 562 N.Y.S.2d 692, 694 (N.Y. App. Div. 1990)).

⁵⁸ *Id.*

⁵⁹ *Id.* at 1033

⁶⁰ *See id.*

⁶¹ *Id.*

⁶² 503 N.E.2d 233, 237 (Ill. 1986).

⁶³ People ex rel. Peterson v. Omen, 124 N.E. 860, 863 (Ill. 1919).

⁶⁴ *W.E. Erickson*, 503 N.E.2d at 237.

⁶⁵ 626 N.E.2d 280, 289 (Ill. App. Ct. 1993).

⁶⁶ 594 N.E.2d 1177, 1187 (Ill. App. Ct. 1992) (emphasis added).

⁶⁷ Weidner v. Szostek, 614 N.E.2d 879, 882 (Ill. App. Ct. 1993).

⁶⁸ *W.E. Erickson*, 503 N.E.2d at 236 (quoting Petersen v. Hubschman Constr. Co., 389 N.E.2d 1154, 1160 (Ill. 1979)).

⁶⁹ In *M.J. Oldenstedt Plumbing Co. v. K-Mart*, 629 N.E.2d 214, 220 (Ill. App. Ct. 1994) (citations omitted) the court explained:

A builder who fails to substantially perform a contract is not entitled to the contract price. Rather, the “builder’s right is, under a theory of *quantum meruit*, a right to recover only reasonable compensation for value received by the purchaser over and above the injury suffered by the builder’s breach.”

⁷⁰ See *Vuagniaux v. Korte*, 652 N.E.2d 840, 842 (Ill. App. Ct. 1995).

⁷¹ 550 N.W.2d 171 (Iowa Ct. App. 1996).

⁷² See *id.* at 173.

⁷³ See *id.*

⁷⁴ See *id.*

⁷⁵ See *id.*

⁷⁶ *Id.* at 173-74.

⁷⁷ 468 N.W.2d 448 (Iowa 1991).

⁷⁸ *Brown*, 550 N.W.2d at 174.

⁷⁹ See *id.*

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