Pace Law Review

Volume 16
Issue 3 *Summer 1996*

Article 4

June 1996

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Book Review

Commercial Litigation in New York State Courts (Robert L. Haig, Editor-in-Chief)

Reviewed by Hon. Joseph P. Sullivan

Nary the litigation attorney who, faced with a daunting legal problem, has not at one time or other asked, "Where do I start?" Now, however, if that attorney practices in the field of insurance litigation, a valuable resource and starting point has emerged in the form of "Commercial Litigation in New York State Courts," edited by Robert Haig.[1] The chapter on Insurance Law,[2] written by Kevin J. Walsh, Jennifer B. Bernheim and Kevin C. Walker, is one of sixteen chapters devoted to litigation issues arising in particular areas of substantive law. The authors, and Mr. Haig, must be commended as their work will no doubt become indispensable to those practicing in the insurance litigation field.

That this work is intended to be utilized as an aid to the every day practitioner, rather than being an academic treatise on insurance law, is immediately apparent after reviewing its table of sections. The chapter is organized into sections which address both the procedural and substantive aspects of insurance litigation. For example, as a procedural guide to the practitioner, there are sections devoted solely to certain preliminary considerations that must be addressed in analyzing the potential liability of the insured and insurer;[3] to the threshold prob-

1. 4 COMMERCIAL LITIGATION IN NEW YORK STATE COURTS (Robert L. Haig ed., 1995).

2. Kevin J. Walsh et al., *Insurance*, *in* 4 COMMERCIAL LITIGATION IN NEW YORK STATE COURTS 83 (Robert L. Haig ed., 1995).

3. *Id.* at 85-92.

lem of lost or destroyed insurance policies;[4] and four particularly useful sections providing "Checklists" of the essential allegations, as well as the sources of proof, for the most frequently asserted types of claims and defenses in the more common type of insurance actions.[5] Additionally, the final three sections, which include specimen pleadings,[6] jury instructions[7] and forms pertinent to these common claims and defenses,[8] present the reader with a broad framework for developing an effective insurance claim or defense.

The inclusion of these procedural aids does not, however, diminish the authors' discussion of the substantive issues arising during the course of insurance litigation. Sections are also devoted to the "non-coverage defenses" asserted by insurers to avoid coverage such as untimely notice,[9] misrepresentation in the application and failure to cooperate;[10] to the burden of proof and rules of policy construction in determining the issue of coverage;[11] to bad faith actions against insurers;[12] and to particular issues regarding coverage in mass tort, product liability and hazardous waste litigation.[13] Current federal and New York state law are effectively cited to support the authors' propositions, and unsettled areas, or conflicts between the jurisdictions, are studiously noted. In short, although the authors note at the outset that the scope of the chapter was not intended to extend to all of the substantive areas of insurance law,[14] the essential areas are comprehensively covered.

Section 52.2, which discusses the preliminary considerations, will be especially useful to the new insurance practitioner, as it may help to avoid costly mistakes or wasted hours in preparation for litigation. The section focuses on the information that must be amassed before any litigation strategy can be developed. Identification of other potential defendants, the

4. *Id.* at 92-96.
5. *Id.* at 129-36.
6. *Id.* at 136-40.
7. Walsh et al., *supra* note 2, at 140-48.
8. *Id.* at 148-49.
9. *Id.* at 97-99.
10. *Id.* at 99-102.
11. *Id.* at 103-12.
12. Walsh et al., *supra* note 2, at 120-27.
13. *Id.* at 112-20.
14. *Id.* at 85.

policies of insurance which may cover the particular loss, and the time periods these policies were in effect are essential first steps.

The section goes into some detail in its listing of the potential sources of information as to the insurance policies available for coverage, including the files and employees of the insured, the records of the insured's legal, insurance and finance departments, the insured's past and present insurance brokers, and even other insurance companies. The sheer multitude of these sources reinforces the authors' suggestion that an exhaustive search may be necessary to determine all possible sources of insurance coverage.[15]

Appropriately, the section next addresses the cardinal rule for any holder of an insurance policy in New York state: notify all your insurers as soon as you become aware that you *might* have a claim under their policies. The authors note that New York favors the insurer with respect to the issue of timeliness of notice, a requirement being considered a condition precedent to coverage.[16] Generally, the timeliness of an insured's notice is measured by what is reasonable under the circumstances, a standard which, in the usual case, presents an issue of fact as to the insured's compliance with the notice provision. Included, as a practical aid, is a list of what should be included in a notification letter to an insurer where the policy itself makes no provision for the form of the notification.

The last preliminary consideration discussed in this section is the useful tool of the declaratory action, and its availability under both federal and state law to resolve coverage issues. The basic points addressed are the fact that a declaratory action is the mechanism to resolve disputes between an insurer and an insured, and that it is available only to those parties.[17] Additionally, it is noted, at least under a liability policy, that an insurer will be accountable for attorneys fees if it brings a declaratory judgment action to absolve it of its policy obligations and a determination adverse to it is reached.[18]

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15. *Id.* at 86.

16. *Id.* at 88.

17. Walsh et al., *supra* note 2, at 91.

18. *Id.*

One entire section (section 52.3) is devoted to a discussion of what an inexperienced practitioner might consider to be an insurmountable obstacle to insurance coverage: a lost insurance policy. However, the authors succinctly outline the methods by which an insured may prove the existence and terms of a lost insurance policy.[19] Initially, they advise that a lost policy does not preclude a claim; rather its existence may be proven by secondary evidence of any kind, including affidavits and records of brokers and claims adjusters.[20]

The authors note that the more difficult problem is proving the *terms* of the policy once its existence is established.[21] Notwithstanding these difficulties, evidence such as the insurer's use of a standard policy form, proof of premium payments and their method of computation, or evidence of custom and practice may be sufficient to establish the policy's terms. The reader is reminded, however, that the insured bears a heavy burden of proof, by clear and convincing evidence, of demonstrating the existence, delivery, execution and contents of the lost insurance policy.[22]

Having identified the preliminary considerations, the authors delve into a discussion of the three non-coverage defenses commonly asserted by the insurers: the failure to provide timely notice of an occurrence; material misrepresentations by the policyholder in the insurance application; and a breach of the insured's duty to cooperate with the insurer following the assertion of a claim (section 52.4). The requirements for each defense are stated with brevity and clarity, and any practitioner interested in a quick study of potential defenses that would relieve an insurer of liability would be wise to consult this section.

Although an in-depth discussion of each defense is beyond the scope of this review, it should be noted that the essential elements of each defense are included. For example, on the issue of the timeliness of notice, the authors inform us that, unlike many jurisdictions where prejudice must be shown in order to justify a disclaimer of coverage due to lack of timely notice, under New York law, as noted, timely notice to the insurer is

19. *Id.* at 93-96.
20. *Id.* at 93.
21. *Id.*
22. Walsh et al., *supra* note 2, at 95.

considered a *condition precedent* to an insurer's liability under the policy.[23] Only in those circumstances where an insured can demonstrate that it did not discover an occurrence despite exercising diligence in keeping itself informed, or where the insured possessed a good faith belief of non-liability, would untimely notice be excused.[24]

Regarding judicial acceptance of excusing late notice of claim, the authors observe that while the courts have consistently recognized that untimely notice may be excused, they rarely excuse it.[25] It should be noted, however, that several recent appellate cases have upheld excuses by an insured, especially on the grounds that the insured possessed a good faith belief of non-liability.[26] Such is the case, for example, where the loss occurred as a result of an intentional tort or criminal act by a third party, and a claim is subsequently asserted against the insured for failing to provide adequate security.

The authors set forth in comprehensive fashion the requirements of a defense based on misrepresentation in an insurance application.[27] In order to establish that the policy was void ab initio, the insurer must show that the misrepresentation was material and was relied upon by the insurer, but it need not show that the misrepresentation was intentional. Materiality, we are told, is judged by whether the insurer, absent the misrepresentation, would have refused to issue the policy on the same terms. The authors note that this standard is codified in Insurance Law section 3105(b).

While the authors make clear what materiality means in this context, it would also have been helpful to touch on the issue of what in fact constitutes a "misrepresentation." Some courts have held that in order to find that a statement on an insurance application is a misstatement, the questions posed must be so plain and intelligible that any applicant could readily comprehend them.[28] Thus, while an insurer asserting the defense of misrepresentation need not prove an intent to

23. *Id.* at 97.
24. *Id.* at 98.
25. *Id.*
26. *Id.* at 98-99.
27. Walsh et al., *supra* note 2, at 99-100.
28. *See, e.g.,* Nadel v. Manhatten Life Ins. Co., 211 A.D.2d 900, 621 N.Y.S.2d 180 (3d Dep't 1995).

deceive, courts have recognized that an insured should not forfeit coverage due to poorly worded questions on the insurance application.

The third non-coverage defense, non-cooperation with the insurer subsequent to the filing of a claim, also functions as a condition precedent, voiding coverage if the insured's non-cooperation is intentional, substantial and material. The authors also point out that the insurer must itself exercise due diligence in communicating its requirements to the insured, making clear the nature of the cooperation upon which it insists.

The last section regarding non-coverage defenses pertains to the insurer's obligations to assert its defenses in a timely fashion. As the authors demonstrate, the untimely assertion of a defense by an insurer may result in a waiver, or an estoppel, regarding that defense. A significant distinction between the two is indicated, whereby a waiver requires no showing of prejudice to the insured, while estoppel will operate only where, as in a liability policy, the insured can show that it prejudicially relied on the insurer's initial undertaking to defend or indemnify it.

Section 52.5, pertaining to the burden of proof and rules of policy construction in coverage actions, is perhaps the cornerstone of the entire chapter. It focuses on the situation where the policyholder has already made a prima facie showing of a loss that falls within the general coverage provisions of the insurance contract; once such a showing has been made, the burden shifts to the insurer to demonstrate the applicability of a coverage exclusion.

The authors make it eminently clear that the burden on the insurer of proving that an exclusion applies is a heavy one, which may also entail proving that an exemption to that exclusion is inapplicable. Thus, the burden is met only where the insurer shows that the insured's reading of the policy exclusion is objectively unreasonable, *and* that its own construction is the only one that could fairly be placed on the policy.[29]

One observation arises in light of the insurer's burden of proving an exclusion. While at many points in the chapter the authors note that New York is a "pro-insurer" state, it would

29. Walsh et al., *supra* note 2, at 104.

seem that in this aspect of insurance litigation, the rules are heavily weighted in favor of the insured. Given the authors' characterization of New York as a pro-insurer state, some discussion as to how these pro-insured rules regarding exclusions square with the pro-insurer reputation would have been enlightening.

The section also discusses the issue of contract construction in determining whether the terms of the insurance contract are unambiguous on their face, a determination which is to be made as a matter of law by the court. If the terms are unambiguous, the court must, as with any contract, enforce the plain meaning of those words. The pivotal definition of ambiguity in the context of insurance policies is then provided: when words or phrases are capable of more than a single meaning when viewed objectively by a person who has examined the entire agreement, and who is familiar with the customs, practices, and terminology as understood in the insured's trade or business. The tradition in New York, it is noted, is that in cases of ambiguity as to coverage, any doubt must be resolved in favor of the insured and against the insurer. This principle is known as "contra proferentum."

The authors point out that even though the courts should be restricted to the words of the policy alone in determining whether ambiguity exists, in fact they frequently rely on "pro-insured" rules of construction to resolve this question.[30] They cite the principle that courts should attempt to interpret policies in a manner which would provide coverage since that is the very purpose of insurance, as well as the fundamental axiom that policy exclusions should be given an interpretation most beneficial to the insured.[31] Again, while it is noted that these principles all run in favor of the insured, especially on a motion for summary judgment, no analysis is offered as to how this fits in with the authors' characterization of New York as a pro-insurer state.

The section also discusses the judicial approach if the policy wording is ambiguous. Only then may the courts rely on extrinsic evidence to determine the intent of the parties. Extrinsic

30. *Id.* at 106.
31. *Id.*

evidence may include testimony regarding the circumstances surrounding the execution of the agreement, as well as evidence of custom and usage, to help demonstrate the intended meaning of a particular term. It is noted that while the evaluation of this extrinsic evidence to determine the parties' intent is generally a question of fact for the jury, the issue may be determined as a matter of law when the evidence unequivocally resolves the ambiguity and does not raise questions of credibility.

The authors perform a useful service in placing the doctrine of contra proferentum in its proper perspective. They note that the dominant approach taken by New York courts is to apply the doctrine only where the policy is ambiguous, and extrinsic evidence fails to resolve the ambiguity. Furthermore, the authors identify what may be seen as an exception, the "sophisticated policyholder" concept, to the doctrine.[32] Under the exception, the courts will not apply contra proferentum where the insured is a "sophisticated" purchaser of insurance, that is, one who contributed to the drafting of the policy or had bargaining power comparable to that of the insurer. The reader is advised, however, that this exception has not gained full acceptance, and even if applied, will be construed narrowly so that only those policyholders who participate in negotiating the *terms* of coverage, regardless of size, will be deemed sophisticated.

The "reasonable expectations" doctrine is characterized as an analog to the contra proferentum rule, and broadly states that if a policy can reasonably be construed in favor of the position asserted by the insured, he or she is entitled to recover on the policy. The term "reasonable expectations" is defined as those of an ordinary businessman in the insured's line of business.[33]

In these sections the authors perform a valuable service in bringing to the reader's attention considerations such as which party has the burden of proof and which, if any, rules of policy construction may be utilized by the court, factors which will likely have great significance on the ultimate coverage determi-

32. *Id.* at 110-11.
33. *Id.* at 111-12.

nation, be it on a motion for summary judgment, or after a trial of the action.

Section 52.6 of the chapter is addressed to particular issues regarding coverage in mass tort, product liability and hazardous waste litigation, and is too narrow in scope to warrant a detailed review here. However, the section does provide a useful analysis of what constitutes an accident or occurrence within the meaning of the insurance policies; of the "pollution exclusion" and the "sudden and accidental" exemption to that exclusion; and the "injury-in-fact" test for determining when coverage is triggered under a policy.

The last section discussing a substantive topic, section 52.7, is addressed to the area of bad faith actions against insurers. The authors describe how the insurer's contractual duty to defend and indemnify also implies a duty of good faith and fair dealing on the part of the insurer.[34] When an insurer breaches that duty by refusing in bad faith to defend or indemnify, the insured can bring an action for compensatory damages in excess of the policy limits. Different types of bad faith actions are identified, the most common of which is based on an insurer's bad faith refusal to settle a claim within policy limits.

The authors also note that aside from the implied duties of good faith and fair dealing, two statutory provisions take on relevance in any bad faith assessment. First, Insurance Law section 2601 prohibits unfair claim settlement practices, and requires a showing that the insurer failed to attempt to obtain a fair settlement for a claim where liability has become reasonably clear, *and* that such conduct is frequently engaged in by the insurer. This statute, the authors note, does not afford a private right of action. However, the second statute, General Business Law section 349, does afford a private right of action to those who can demonstrate that the insurer's bad faith refusal to settle in violation of Insurance Law section 2601 constituted a deceptive act or practice.

The standard for establishing a bad faith refusal to settle a claim is conduct by the insurer which constitutes a "gross disregard" of the insured's interest, i.e., a deliberate or reckless failure to place the interests of the insured on an equal footing with

34. Walsh et al., *supra* note 2, at 120-21.

its own. For a bad faith recovery, however, it must be shown that liability is clear, and that the potential recovery far exceeded the policy limit.

As the authors point out, only in rare circumstances in New York will punitive damages be allowed in first-party actions involving the breach of an insurance contract. Only where there is a showing that the breach is so egregious so as to involve tortious conduct, *and* that such conduct was part of a pattern aimed at the public generally, will punitive damages be allowed.[35]

If a practitioner is curious as to the circumstances that will permit the recovery of attorneys' fees in insurance actions, a quick answer is provided. An insured may recover such fees from the insurer only in two circumstances: where a liability insurer unsuccessfully brings a declaratory action to escape its coverage obligations and where there has been an unreasonable, bad faith denial of coverage.

The authors have included a short section (section 52.8) regarding discovery in insurance cases. They note that all the normal discovery devices are, of course, applicable in insurance actions, but they further draw attention to certain types of documents which might be particularly useful, especially to the insured. For example, documents regarding the drafting history of the policy and the underwriting and claims handling manuals of the insurer would be useful in providing information as to what was originally intended by certain policy provisions, and how the insurer interprets its own policy. Additionally, communications with the insurer's reinsurer, claims filed by other insureds, and information regarding the insurance companies' reserves would also provide a genuine assessment of the insurer's own expectations as to its own liability exposure. Obviously, this type of information would be extremely useful in cases involving ambiguity in the policy wording.

The remainder of the chapter (sections 52.9 to 52.15) includes several aids, in the form of checklists, sample pleadings, sample jury instructions and a model coverage chart and notification letter, which incorporate the substantive legal principles discussed throughout the chapter. For example, there are

35. *Id.* at 124.

checklists for the essential allegations that must be made in an insured's declaratory judgment action and those required to support a complaint alleging a bad faith refusal to settle.[36] The sources of proof necessary to support such allegations are also listed.[37] Sample pleadings are included to indicate how the allegations should be structured to achieve a proper format.[38]

The sample jury instructions are particularly useful given their necessary focus on the burden of proof as to the crucial issues at trial. Sample jury instructions regarding ambiguities in the insurance contract, proof of lost policies, misrepresentations in an insurance application, timeliness of notice to an insurer, failure to cooperate with the insurer, estoppel from denying coverage, and a bad faith refusal to settle are included.[39]

The chapter on Insurance Law will, as indicated, provide a useful tool for the practitioner confronted with a legal problem in the field of insurance law. The authors provide a valuable insight into many of the more common problems in insurance litigation. After reading the chapter the reader might find it difficult, as I did, to accept their characterization of New York as a pro-insurer state, although its jurisprudence does not, to be sure, reflect the anti-insurer bias of some states. The authors might also have relied more on New York state court precedents, which provide ample support for the propositions advanced. Generally, the authors' focus is on federal cases.

36. *Id.* at 130-32.
37. *Id.* at 132-34.
38. *Id.* at 136-40.
39. Walsh et al., *supra* note 2, at 140-47.

Notes and Comments