

EDITOR'S NOTE

NEW YORK COURT OF APPEALS EVISCERATES KINNEY, CHANGING CONSEQUENCES FOR FAILURE TO PROCURE INSURANCE

For the past decade, New York law has been well-established concerning the contractual duty to procure insurance: a party who was found to have breached its obligation to procure insurance for the benefit of a third-party was liable for all of the third-party's "resulting damages," including all defense and identification costs arising from any losses that would have been covered under the insurance policy that should have been procured. Courts routinely have granted summary judgment motions on "Kinney" claims (as they have been called because they were based on the seminal 1990 case *Kinney v. G. W. Lisk Co.*, 76 N.Y.2d 215, 556 N.E. 2d 1090, 557 N.Y.S. 2d 283 (1990)). The *Kinney* line of case law has benefitted insurers providing coverage to commercial landlords, real estate owners and general contractors, who often are the implicit beneficiaries of contractual insurance procurement provisions.

On April 26, 2001, the New York Court of Appeals reversed this 10-year rule of law. In *Inchaustegui v. 666 5th Avenue Ltd. Partnership*, 96 N.Y.2d 111, 749 N.E.2d 196, 725 N.Y.S.2d 627(2001), New York's high court ruled that where a promisor (i.e., a subcontractor or lessee) fails to procure required insurance for the benefit of a promisee (i.e., a general contractor or lessor), the promisee is not entitled to collect its full defense and indemnification costs from the promisor if the promisee has procured its own separate policy of insurance. Instead, the promisee is only entitled to collect "out-of-pocket" expenses, such as the cost of the policy premium, any co-insurance obligation or deductible under the policy, and any increased policy premium as a result of filing the claim under the promisee's policy.

Promisees are still entitled under New York law to pursue claims for contractual indemnification against promisors, if the contract contains a separate indemnification provision. However, if the contractual indemnification clause is inapplicable to the facts

of the particular case or is voided for any reason (i.e., under New York General Obligations Law § 5-322.1), neither the promisee nor its own insurer is entitled to seek contribution from the promisor even though it breached its contractual obligation to procure insurance in the first place. The Court of Appeals ruling in *Inchaustegui* may have serious consequences for insurance carriers who, until recently, were able to seek contribution/subrogation rights against parties who violated their contractual obligations.

We will be monitoring cases that are decided in the wake of the *Inchaustegui* decision, and exploring other options that might be available to promisees and their insurers to protect their bargained-for contractual rights. We will be reporting on these developments in future issues. Moreover, our attorneys are available to discuss our findings to date and explain in greater detail the impact of the recent shift in New York law. ☺

—*Ian Chesir-Teran was instrumental in the preparation of this note.*

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COURT OF APPEALS RESOLVES CONFLICT ON WHO ARE PROFESSIONALS FOR MALPRACTICE PURPOSES, HOLDING INSURANCE BROKERS ARE NOT

The New York Court of Appeals has denied insurance agents and brokers status as professionals within the meaning of CPLR 214(6). Reversing the decision of the Appellate Division, Second Department decision in *Chase Scientific Research, Inc. v NIA Group, Inc.*, 268 A.D.2d 115, 708 N.Y.S.2d 128 (2nd Dep't 2000) (see Appellate Divisions Split on Limitations Periods for Suits Against Insurance Brokers, OHRENSTEIN & BROWN INS. NEWSLETTER, Fall 2000 at 1) and in effect adopting the Appellate Division, First Department's approach in *Santiago v 1370 Broadway Assoc., L.P.*, 264 A.D.2d 624, 695 N.Y.S.2d 326 (1st Dep't 1999) (see Insurance Brokering Does Not Qualify as a Learned Profession for Statute of Limitations Purposes, OHRENSTEIN & BROWN INS. NEWSLETTER, Winter 2000 at 3), the Court in *Chase Scientific Research, Inc. v NIA Group, Inc.*, 96 N.Y.2d 20, 749 N.E.2d 161, 725 N.Y.S.2d 592 (2001), declared that insurance agents and brokers are not governed by the three year non-medical malpractice limitations period of CPLR 214(6), but by the six year limitations period of CPLR 213 (2).

The issue before the Court of Appeals arose in the context of two actions which were dismissed as a result of the trial courts' application of the three year statute of limitations embodied in CPLR 214(6) and affirmed by the Appellate Division, Second Department. Despite the Legislature's recent amendment to CPLR 214(6), establishing a three year limitations period to non-medical malpractice actions based either in tort or contract, the issue of who qualified as a "professional" remained unsettled. In holding that insurance agents and brokers are not "professionals" within the meaning of CPLR 214(6), the Court examined the requirements of education, work experience, and discipline imposed on insurance agents and brokers, and compared this criteria to that imposed on lawyers, accountants, architects, and engineers. While acknowledging that agents and brokers are held to high standards of education and qualification, the Court concluded that the criteria imposed on them was "not as rigorous as those embraced by what we conclude are the professionals within CPLR 214(6)."

The Court, however, did not address the effect of the "continuous treatment doctrine" which in certain malpractice actions tolls the start of the limitations period until the professional relationship between the parties has terminated. As a result, a plaintiff might actually have a shorter period of time to sue under CPLR 213(2) (providing for a six year period) than he or she would have under the CPLR 214(6) (providing for a three year time period) a result clearly contrary to legislative intent. The Court of Appeals may well be asked to address this issue in the future. ☺

—Stephanie Hatzakos

APPELLATE DIVISION ALLOWS A CLAIM FOR DAMAGES BEYOND LIMITS OF INSURANCE POLICY

New York's Appellate Division, First Department has allowed a claim for consequential damages beyond the limits of a disputed policy for an insurer's unreasonable delays in paying claims. A sharply divided court did so while declining to recognize an independent tort claim for bad faith conduct against an insurer.

Acquista v. New York Life Insurance Co., N.Y.S.2d, 2001 WL 752640, 2001 N.Y. Slip Op. 06087 (1st Dep't 2001), arose from a denial by New York Life Insurance Company of a disability claim made by plaintiff, Dr. Angelo Acquista. New York Life had taken the position that Dr. Acquista was not totally disabled because he could still perform some of the duties of his job. Dr. Acquista alleged that New York Life had undertaken "a conscious campaign calculated to delay and avoid payment on his claims, while having determined at the outset that it would deny coverage." The trial court dismissed all but one of Dr. Acquista's claims.

The First Department unanimously modified the trial court's determination by reinstating a number of the contract-based claims citing issues of fact regarding whether plaintiff could still perform "the substantial and material duties" of his regular jobs as they existed before he became ill. The appellate panel was, however, sharply divided as to whether Dr. Acquista's tort claims for bad faith and unfair practices should be reinstated.

Recognizing that “an insured should have an adequate remedy to redress an insurer’s bad faith refusal of benefits,” but unwilling to recognize a cause of action for bad faith in the context of a first-party claim, since to do would “constitute an extreme change in the law,” the court instead decided to adopt a more “conservative approach,” adopted by a minority of jurisdictions, which:

have instead expanded the scope of contract remedies to encompass more than just the policy limits. These courts have instead held that the contract damages available, where an insurer fails to pay benefits to which the insured was entitled may include foreseeable money damages beyond the policy limits.

The dissenting judges would not have allowed either a tort claim or a contract-based claim of consequential damages. To them, this would amount to a kind of forced settlement. Quoting from *Pavia v. State Farm Mut. Automobile Ins. Co.*, 82 N.Y.2d 445, 626 N.E.2d 24, 605 N.Y.S.2d 208 (1993), they said that this would in essence coerce premature settlements, undermining the insurer’s “contractual right and obligation of thorough investigation.”

—*Stephanie Hatzakos*

COURT OF APPEALS HOLDS THAT CPLR 1602 (2) (iv) DOES NOT PROHIBIT APPORTIONMENT IN CASES OF NON-DELEGABLE DUTY

In *Rangolan v. County of Nassau*, 96 N.Y.2d 42, 749 N.E.2d 178, 725 N.Y.S. 2d 611 (2001), the New York Court of Appeals answered the following question, certified to it by the U.S. Court of Appeals for the Second Circuit: “Whether a tortfeasor such as the County can, in the facts and circumstances of this case, seek to apportion its liability with another tortfeasor such as King pursuant to CPLR 1601, or whether CPLR 1602(2)(iv) precludes such a defendant from seeking apportionment.” The Court of Appeals held that “CPLR 1602(2)(iv) does not preclude a tortfeasor such as the County, in the facts and circumstances of this case, from seeking apportionment.”

While incarcerated at the Nassau County Correctional Center, plaintiff Neville Rangolan was housed in a dormitory with another inmate, Steven

King, against whom Rangolan had acted as a confidential informant. The fact that Rangolan had informed on King was noted in Rangolan’s inmate file, which cautioned that Rangolan was not to be housed with King. However, the corrections officers at the Correctional Center failed to notice the warning, resulting in the housing of Rangolan and King in the same dormitory and the subsequent assault by King upon Rangolan, during which Rangolan was “seriously beaten.”

Plaintiffs Neville and Shirley Rangolan commenced an action in the United States District Court against defendant Nassau County based upon Nassau County’s alleged negligence in failing to protect plaintiff Neville Rangolan while he was incarcerated at the Nassau County Correctional Center, as well as for violating his rights under 42 U.S.C. 1983. Prior to trial, the District Court dismissed the 1983 claim but granted Rangolan’s motion for judgment as a matter of law on Rangolan’s negligence claim and ordered a trial to determine damages. During the course of the damages trial, the County sought a jury instruction on apportionment of damages between the County and King pursuant to CPLR 1601, which the District Court denied on the basis that CPLR 1602(2)(iv) rendered apportionment unavailable where the County’s liability arose from a breach of a non-delegable duty. After the jury awarded Rangolan damages for past and future pain and suffering, as well as to Rangolan’s wife for loss of services, the Court ordered a new trial on damages unless the Rangolans accepted a reduced award, which they subsequently did. On appeal by both parties to the United States Court of Appeals for the Second Circuit, the Second Circuit affirmed the dismissal of Rangolan’s 1983 claim and certified the aforementioned question to the New York Court of Appeals.

In reaching its conclusion that apportionment was not precluded by CPLR 1602(2)(iv), the Court addressed the basis behind the enactment of CPLR Article 16, which modified the common law rule of joint and several liability by limiting a joint tortfeasor’s liability for noneconomic losses to the joint tortfeasor’s proportionate share, provided that the joint tortfeasor is 50% or less at fault. The Court noted that while Article 16 was intended to remedy the inequities created by joint and several liability on low-fault, “deep pocket” defendants, Article 16

was still subject to various exceptions which preserve the common law rule. The Court then examined the various exceptions contained in CPLR 1602 and, upon comparing the language contained in each and the statutory rules of construction, determined that CPLR 1602(2)(iv) was not a limitation on apportionment, but a “savings provision” designed to preserve principles of vicarious liability.

The Court first examined the statutory scheme of CPLR 1602 and noted that the section includes several exceptions to the apportionment rule, to wit CPLR 1602(3)-(11), each of which specifically state that Article 16 shall not apply in certain circumstances. CPLR 1602(2)(iv), however, does not state that apportionment shall not apply, but rather that the limitations on liability shall not be construed to impair, limit or modify any liability arising from a non-delegable duty or respondent superior. This distinction indicated to the Court that in enacting CPLR 1602(2)(iv), the New York Legislature did not intend to establish a free-standing exception to the apportionment rule, but rather intended to insure that the courts did not interpret Article 16 as altering the pre-existing law regarding respondent superior or non-delegable duties. Concluding this initial analysis, the Court determined that the absence of the “shall not apply” language referenced in the other provisions of section 1602 indicates the Legislature never intended to include an exception to apportionment based upon the breach of a non-delegable duty.

In further support of its conclusion, the Court noted that section 1602 contains a separate, non-delegable duty exception in subdivision 8. CPLR 1602(8) specifically provides that Article 16 shall not apply to any person held liable for violating Article 10 of the Labor Law, which imposes on owners and contractors a non-delegable duty to maintain a safe workplace. The Court held that were it to interpret section 1602(2)(iv) as a general exception to apportionment in the event of a breach of a non-delegable duty, section 1602(8) would be meaningless and redundant. Furthermore, such a construction would result in the impermissible nullification of one part of the statute by another and violate the rule that all parts of a statute are to be harmonized with each other, as well as with the general intent of the statute. *See Matter of Albano v. Kirby*, 36 N.Y.2d 526, 330 N.E.2d 615, 369 N.Y.S.2d 655

(1975); *Matter of Society of N.Y. Hosp. v. Del Vecchio*, 70 N.Y.2d 634, 512 N.E.2d 302, 518 N.Y.S.2d 781 (1987).

The Court also considered the effect of interpreting section 1602(2)(iv) as an exception to apportionment upon Article 16 as a whole, and determined that the *Rangolan* holding was fully consistent with the purpose of Article 16. Inasmuch as Article 16 was intended to limit those occasions in which joint and several liability was imposed upon low-fault, deep pocket defendants, allowing an exception that would prohibit apportionment against all defendants whom are vicariously liable for the acts of others would not only vitiate that intent but would also serve to impose, in direct contradiction of that intent, joint and several liability in all cases based upon a non-delegable duty or respondent superior. Furthermore, the Court noted that there is no general rule regarding what constitutes a non-delegable duty, and that the determination of such a duty ultimately rests on policy considerations. *See Kleeman v. Rheingold*, 81 N.Y.2d 270, 614 N.E.2d 712, 598 N.Y.S.2d 149 (1993). The Court then concluded that the Legislature did not intend to exclude the breach of every non-delegable duty from Article 16.

Finally, the Court specifically rejected the interpretations of the appellate courts which held that section 1602(2)(iv) creates a non-delegable duty exception to Article 16, noting that those cases did not involve any meaningful analysis of section 1602(2)(iv), but merely assumed, without explanation, that section 1602(2)(iv) precludes application of Article 16. *See Nwaru v. Leeds Mgmt. Co.*, 236 A.D.2d 252, 654 N.Y.S.2d 338 (1st Dep’t 1997). *See also Cortes v. Riverbridge Realty Co.*, 227 A.D.2d 430, 642 N.Y.S.2d 692 (2nd Dep’t 1996). In addition, the Court noted that in two of its recent decisions recognizing a non-delegable duty exception to apportionment under Article 16, the issue of whether a non-delegable duty exception applied was unreviewable by the Court because the plaintiff failed to plead it. *See Morales v. County of Nassau*, 94 N.Y.2d 218, 724 N.E.2d 756, 703 N.Y.S.2d 61 (1999); *Cole v. Mandell Food Stores*, 93 N.Y.2d 34, 710 N.E.2d 244, 687 N.Y.S.2d 598 (1999). Accordingly, both the *Morales* and *Cole* appeals were resolved without the Court resolving the effect of section 1602(2)(iv). 🍷

—Michael O’Malley

FEDERAL JUDGE SETS ASIDE JURY VERDICT OF BAD FAITH

Judge Arthur D. Spatt, sitting in the U.S. District Court for the Eastern District of New York has set aside a jury verdict of bad faith, which had been based on a primary insurer's failure to settle within policy limits. In *New England Ins. Co. v. Healthcare Underwriters Mut. Ins.*, 146 F. Supp. 2d 280 (E.D.N.Y. 2001), the jury had awarded \$1.1 million to an excess insurer, which had alleged that the primary carrier's rejection of a settlement offer in a medical malpractice action amounted to bad faith.

The jury found that Healthcare Underwriters, the primary insurer for a hospital which was a defendant in a medical malpractice case, was liable for bad faith for refusing to settle a case in which the injuries were severe enough to expose the carrier to substantial damages well in excess of its coverage, but where the liability of the hospital was disputed. The court stated:

This case of original impression, presents the question of whether a bad faith claim in New York State requires the plaintiff to prove, as an element of the cause of action, that the insured's liability was clear - that is "all serious doubts about the insured's liability were removed" - at a time when an offer to settle within the policy limits was refused by the carrier.

Following the jury verdict, Healthcare filed a motion for judgment as a matter of law under Federal Rule of Civil Procedure 50, contending that New England failed to establish the required element of "clear liability."

The underlying claim arose out of the birth in 1985 of David Weinstock with severe brain damage. David's parents commenced a medical malpractice action against the attending obstetrician and hospital in which he was born. Healthcare was the primary liability carrier for the hospital, covering the first \$1 million in claims. New England provided excess insurance coverage in the amount of \$3 million. Prior to trial, David's parents settled with the doctor for \$1.2 million, leaving the hospital as the only defendant. David's parents and the hospital engaged in settlement discussions, but the matter was not resolved. Ultimately, a jury returned a verdict against the hospital and awarded David's

parents \$9.6 million, 2.5 per cent of which (\$2.4 million) was attributed to the hospital. In post-verdict settlement discussions, David's parents accepted \$2.1 million from the hospital. Healthcare paid its \$1 million limit and New England paid the remaining \$1.1 million. New England then commenced an action for bad faith against Healthcare alleging that Healthcare had the opportunity to settle the case within its policy limits prior to and during the underlying trial, but refused to do so, and thus, engaged in bad faith.

Although Healthcare never made a settlement offer prior to the verdict, Judge Spatt cited to evidence that established that the hospital had an arguably viable defense on the liability issue throughout the underlying trial, specifically that David's injuries were suffered either in utero or during delivery and that the hospital had no vicarious responsibility for the actions of the attending obstetrician.

Prior to giving the case to the jury, Judge Spatt advised the attorneys of his intention to charge the jury that, in accordance with *Pavia v. State Farm Mut. Automobile Ins. Co.*, 82 N.Y.2d 445, 626 N.E.2d 24, 605 N.Y.S.2d 208 (1993), New England had the burden of proving that (i) Healthcare had the opportunity to settle the case within its limits, (ii) the hospital would have consented to the settlement, and (iii) the hospital's liability was "clear" at that time. New England objected and stated that Pavia also provided a multi-factor balancing test which required the jury to consider the likelihood of success on the liability issue in the underlying action. Judge Spatt thereafter charged the jury that the third element to be considered was the probability of success on the merits.

In deciding the motion for judgment as a matter of law, Judge Spatt opined that the crucial issue before the court was whether clear liability in the underlying action is an indispensable element in a bad faith claim under New York law, or whether the correct standard is a multi-factor test weighing, among other things, the probability of success on the merits in the underlying action. Judge Spatt opined that the language of *Pavia* appeared to be somewhat inconsistent:

Bad faith is established only "where the liability is clear and the potential recovery far exceeds

the insurance coverage.” (citation omitted.) However, it does not follow that whenever an injury is severe and the policy limits are significantly lower than a potential recovery the insurer is obliged to accept a settlement offer. The bad faith equation must include consideration of all of the facts and circumstances relating to whether the insurer’s investigatory efforts prevented it from making an informed evaluation of the risks of refusing settlement. In making this determination, courts must assess the plaintiff’s likelihood of success on the liability issue in the underlying action, the potential magnitude of damages and the financial burden each party may be exposed to as a result of a refusal to settle. Additional considerations include the insurer’s failure to properly investigate the claim and any potential defenses thereto, the information available to the insurer at the time the demand for settlement is made, and any other evidence which tends to establish or negate the insurer’s bad faith in refusing to settle. The insured’s fault in delaying or ceasing settlement negotiations by misrepresenting the facts also factors into the analysis. (citation omitted.)

Reviewing the differences between the clear liability and the multi-factor analyses, Judge Spatt opined that the decision in *Pinto v. Allstate Ins. Co.*, 221 F.3d 394 (2d Cir. 2000) “best harmonizes the two competing provisions into a workable and practical framework” by requiring the fact finder to first determine whether the carrier acted in bad faith by weighing the factors listed in *Pavia*. Next, a fact finder must determine if settlement was possible at the moment all of the carrier’s good faith defenses to liability were exhausted. Therefore, given these two elements, the court found that while an insurer’s refusal to settle in a medical malpractice claim such as the one at bar may have been foolish, it did not amount to bad faith. Judge Spatt found that clear liability on the part of the hospital was not present until after a damaging admission from the hospital’s expert witness well into the underlying trial. By that time, however, there was no settlement offer on the table which was at or within Healthcare’s limits. Therefore, Healthcare’s rejection of the settlement at a time when a viable defense still existed was not in bad faith. 🍷

—Melissa Shea

JUDGE ALLOWS TORT CLAIM FOR SPOILIATION OF EVIDENCE

Justice Patricia P. Satterfield of the New York Supreme Court, Queens County (a trial level court) has held that an insurance carrier can be held liable for damages because of its negligent destruction of evidence (spoliation) that its policyholder needed to mount a legal defense. In *Fada Industries, Inc. v. Falchi Bldg. Co., L.P.*, 2001 WL 826700, 2001 N.Y. Slip Op. 21311 (2001), Justice Satterfield refused to dismiss a third party action by a business against its liability insurer for negligent spoliation of evidence.

Fada Industries was initially commenced as an action for property damage against Koolwear, a tenant in a Long Island city building, by Fada Industries, a co-tenant. Koolwear’s water heater allegedly leaked and caused \$60,000 in damage to Fada Industries’ premises. Koolwear’s liability insurer, General Accident Insurance Company took possession of the water heater after the leak occurred and apparently lost it.

Koolwear, in turn, brought a third-party action against General Accident seeking recovery based on the failure to preserve evidence. Not only did the loss of the water heater impair Koolwear’s ability to defend itself from the property damage claim, but it made it impossible to identify the manufacturers of the water heater, effectively eliminating any possibility of a breach of warranty action. General Accident moved to dismiss the third-party complaint on the ground that it failed to state a cause of action.

The question of whether spoliation of evidence is an actionable tort in New York was again brought to the forefront with General Accident’s motion. Two other trial courts in *Pharr v. Cortese*, 147 Misc.2d 1078, 559 N.Y.S.2d 780 (N.Y. Sup. Ct. 1990) and *Weigel v. Quincy Specialties Co.*, 158 Misc.2d 753, 601 N.Y.S.2d 774 (N.Y. Sup. Ct. 1993) -- had earlier rejected spoliation of evidence as a cognizable tort action.

Nevertheless, New York trial courts have often relied upon spoliation claims to dismiss claims or impose trial sanctions. Justice Satterfield stated that these remedies were not available to Koolwear because “here, Koolwear is stripped of its ability to defend in the main action because of the conduct of General Accident, its own insurer. None of the sanctions traditionally available to a party apply in this case.” The only other remedy was to allow a damage

claim against the party that destroyed or lost the water heater, General Accident.

Justice Satterfield's based her decision both on the facts presented and public policy. The relationship between the insurer and its insured, Justice Satterfield reasoned, argued in favor of the spoliation claim. She stated that "from a policy perspective, the obligation of the insurer to defend must carry with it the obligation to preserve key evidence relied upon by its insured to defend against property damage claims."

A motion for reargument is pending. 🗨️

—*Victor Guzman*