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QUARTERLY INSURANCE COVERAGE NEWSLETTER: NEW YORK

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CASES OF INTEREST BY TOPIC

PRIVILEGE/DISCOVERABILITY

Melworm v. Encompass Indem. Co., 2013 WL 6642679 (2d Dept. Dec. 18, 2013). Michael Melworm, who had procured an insurance policy which provided coverage for his boat from Encompass Indemnity Company, made a claim under the policy asserting that the boat had been vandalized. After Encompass denied the claim, Melworm commenced an action seeking to recover, *inter alia*, damages for breach of the insurance policy and moved to compel Encompass to produce an unredacted copy of an electronic claims diary prepared by an Encompass adjuster, as well as certain reports from coverage counsel to Encompass. The materials sought by Melworm had been created prior to Encompass' denial of the claim and counsel drafted the letters while conducting an investigation of the claim on behalf of Encompass. In opposition, Encompass argued that the material was protected by attorney-client privilege. In rendering its decision, the Second Department noted that the payment or rejection of claims is part of the regular business of an insurance company; consequently, reports which aid it in the process of deciding whether to pay or reject a claim are made in the regular course of its business. The Court further stated that "[r]eports prepared by insurance investigators, adjusters, or attorneys before the decision is made to pay or reject a claim are thus not privileged and are discoverable, even when those reports are mixed/multi-purpose reports, motivated in part by the potential for litigation with the insured." In affirming the decision of the trial court, the Second Department held that, as the materials sought by Melworm were prepared as part of Encompass' investigation into the claim and were not predominately of legal character, Encompass did not meet its burden of establishing that the subject materials were protected by the attorney-client privilege. It is unclear if the discoverable information prepared by counsel encompassed coverage opinions or simply reports on the factual circumstances surrounding the claim.

DUTY TO DEFEND

Certain Underwriters At Lloyd's of London Subscribing To Policy No. SYN-1000263 v. Lacher & Lovell-Taylor, P.C., 2013 WL 6284081 (1st Dept. Dec. 5, 2013). Certain Underwriters at Lloyd's of London commenced a declaratory judgment action against Lacher & Lovell-Taylor, P.C., which Lloyd's insured under a professional liability insurance policy, seeking, *inter alia*, a declaration that it had no duty to defend and indemnify Lacher in connection with an underlying legal malpractice action where it was alleged that Lacher overbilled its client by $6 million. In affirming the decision of the trial court, which granted Lloyd's motion for summary judgment and awarded it the sum of $166,968.90 as reimbursement of defense costs incurred in the underlying malpractice action from Lacher, the First Department stated that the claim by Lacher's client for the return of fees is not a claim for "damages" in a legal malpractice action, as defined in the professional liability insurance policy Lloyd's issued to Lacher. Moreover, the Court noted that in support of each of the causes of action, the malpractice Complaint alleges only that Lacher overbilled its client; it did not allege facts tending to show that, but for Lacher's negligence, the client could have achieved a better result. Accordingly, the First Department held that Lloyd's had no duty to defend Lacher in connection with the malpractice action and that Lloyd's was entitled to reimbursement of the defense costs it had previously expended in connection with the same.

Herbert L. MacDonell v. OneBeacon American Ins. Co., 2013 WL 6181867 (W.D.N.Y. Nov. 25, 2013). By way of a Complaint dated November 7, 2005, Rodney D. Englert, a forensic consultant and director, accused Herbert L. MacDonell, among others, of publishing defamatory statements about Englert's professional conduct. After service of the Complaint, MacDonell tendered his defense and indemnification to, *inter alia*, OneBeacon Insurance Group under his homeowners policy. Thereafter, OneBeacon disclaimed coverage to MacDonell citing the policy's exclusion for injury that is "expected or intended by the 'insured'" and the business pursuits exclusion which barred coverage for injury "[a]rising out of or connected with a 'business' engaged in by an 'insured'". MacDonell then commenced a declaratory judgment action against OneBeacon and both parties cross-

moved for summary judgment. Specifically, MacDonell argued that the exclusions were not applicable because the Complaint did not specifically allege that he was pursuing any business interest when he allegedly made the statements and that the circumstances leading to the emotional distress alleged in the Complaint was an "accident" within the definition of "occurrence" under the policy. In finding for OneBeacon, the United States District Court for the Western District of New York noted that under New York law, where an insurance policy contains an expected or intended acts exclusion, an insurer is not required to defend or indemnify an insured from a lawsuit which alleges that defamatory words were uttered intentionally, as in the underlying action. In regard to the business pursuit exclusion, the Court noted that the Complaint alleged that MacDonell made defamatory statements about Englert's conduct as a forensic consultant. These statements, which related directly to the business profession in which Englert was engaged, did not suggest that MacDonell would have made such statements but for his professional relationship with Englert. Accordingly, the Western District held that the allegations fell squarely within both exclusions and, therefore, OneBeacon had no duty to defend or indemnify MacDonell relative to the *Englert* action.

LATE NOTICE

Richard J. Vale v. Vermont Mut. Ins. Grp., 2013 WL 6283963 (3d Dept. Dec. 5, 2013). On June 27, 2008, a guest staying at Richard J. Vale's motel in Saratoga Springs, New York, allegedly sustained various injuries after he tripped and fell on a rug located in his room. At the time of the incident, the motel was covered by a liability insurance policy issued by Vermont Mutual Insurance Group. In August 2008, the guest commenced a personal injury action in Bronx County, in response to which Vale wrote a letter to the guest's attorney contending, among other things, that the lawsuit was fraudulent. A supplemental Summons and Complaint followed in December 2008, and the plaintiff again responded with a *pro se* letter. On January 23, 2009, Vale notified Vermont Mutual of the lawsuit and provided it with copies of the pleadings. In a letter dated January 27, 2009, Vermont Mutual disclaimed coverage based upon Vale's failure to provide timely notice and his failure to immediately provide Vermont Mutual with copies of the pleadings in the lawsuit, as required by the terms of the policy. Thereafter, Vale commenced a declaratory judgment action against Vermont Mutual seeking, *inter alia*, a declaration that Vermont Mutual was required to provide a defense and indemnity in connection with the underlying action. Following joinder of issue, Vale moved for summary judgment and Vermont Mutual cross moved for the same relief (under New York's prior "no prejudice" law). In affirming the ruling of the trial court, the Third Department held that Vermont Mutual made a *prima facie* showing of its entitlement to judgment as a matter of law based upon Vale's nearly five month delay in notifying it of the underlying action and his failure to tender sufficient proof to raise a question of fact as to the reasonableness of such delay. The Court noted that Vale's personal belief that the guest's lawsuit was fraudulent was not the equivalent of a good faith belief of non-liability. The Third Department further noted that, even assuming a question of fact existed as to whether Vale provided Vermont Mutual with notice of the occurrence as soon as practicable, Vale's corresponding failure to immediately send Vermont Mutual copies of the pleadings without any reasonable excuse offered for the delay, provided an independent basis upon which to absolve Vermont Mutual of its coverage obligations. Accordingly, the Court held that Vermont Mutual had no duty to defend or indemnify Vale in connection with the underlying action.

Property & Cas. Ins. Co. of Hartford v. Levitsky, 973 N.Y.S.2d 78 (1st Dept. Oct. 15, 2013). Steven Levitsky and Handelman Witkowicz & Levitsky (collectively referred to as "Levitsky") represented Paul Rowland as a plaintiff for personal injuries sustained on October 24, 2003 while Rowland was performing construction work at a mall. On August 29, 2006, less than two months before the statute of limitations would expire, Levitsky commenced an action on Rowland's behalf against Wilmorite, Inc., the entity Levitsky believed owned the mall where Rowland was injured. On October 19, 2006, five days before the statute of limitations expired, Wilmorite answered Rowland's Complaint denying ownership of the mall. Almost fourteen months later, Levitsky learned the correct identity of the owner of the mall and unsuccessfully sought to join that entity as a defendant. On August 19, 2008 Rowland's new attorney informed Levitsky that he had been retained for purposes of a possible malpractice claim. Thereafter, on August 29, 2008, Levitsky notified its professional liability insurer, Property & Casualty Insurance Company of Hartford, of the potential claim. By way of a letter dated September 18, 2008, Property & Casualty reserved its right to deny coverage due to Levitsky's failure to provide timely notice. The professional liability policy at issue contained a notice provision which required, *inter alia*, that notice of "any" circumstances which "may" give rise to a claim. In affirming the trial court's decision, the First Department held that Levitsky failed to comply with the notice provision in a timely fashion. In this regard, the Court noted that Levitsky became aware of circumstances which

may give rise to a claim in October 2006, either when Wilmorite answered the Complaint denying ownership of the premises or six days later when the statute of limitations expired and Levitsky failed to join the correct owner. Moreover, even if the Answer denying ownership was ambiguous, Levitsky was aware of circumstances which may have given rise to a claim no later than December 2007 when the identity of the current owner was ascertained. The Court stated that despite these circumstances, notice was not provided to Property & Casualty until August 2008. As such, it was held that Property & Casualty had no duty to defend or indemnify Levitsky relative to the malpractice action.

APPLICABILITY OF EXCLUSIONS

Conley & Tibbitts Properties, LLC v. Leatherstocking Cooperative Ins. Co., 109 A.D.3d 1198, 971 N.Y.S.2d 776 (4th Dept. Sept. 27, 2013). Conley & Tibbitts Properties, LLC procured a property insurance policy from Leatherstocking Cooperative Insurance Company to cover a property it owned in Oneida County. Although the policy provided coverage for losses caused by fire, it contained an exclusion for losses or increased costs resulting directly or indirectly from "enforcement of any code, ordinance or law regulating the…repair…of a building," regardless of "any other cause or event that contributes concurrently or in any sequence to the loss." While the policy was in effect, a fire damaged the insured property and plaster had been disturbed while the fire was being extinguished. A state code required under such circumstances that an asbestos survey be completed before any further repairs could be undertaken at the premises. The survey indicated that asbestos was present, and Conley obtained an estimate for the cost of the asbestos abatement. Although Leatherstocking reimbursed Conley for all other aspects of its claim, coverage was denied for the cost of the asbestos remediation. As a result, Conley commenced a declaratory judgment action. The Fourth Department noted that where, as here, the provisions of an insurance contract are clear and unambiguous, they must be enforced as written. The Court held that pursuant to the plain and ordinary meaning of the terms of the exclusion, the policy did not provide coverage for increased costs caused by the enforcement of the state code "irrespective of any other concurrent or subsequent contributing cause or event". Accordingly, Leatherstocking had no duty to indemnify Conley for the cost of the asbestos remediation.

EXCESS INSURANCE

Ragins v. Hospitals Ins. Co., 2013 WL 6588738 (Ct. of App. Dec. 17, 2013). Herzel Ragins commenced a breach of contract action against the plaintiff's excess professional liability insurer, Hospitals Insurance Company, for failing to pay interest on a $1.1 million judgment against the insured arising out of an underlying medical malpractice action. Ragins' primary insurer, which went into liquidation, paid the $1 million liability limit of the primary policy toward the judgment and Hospitals Insurance paid the remaining $100,000. It was undisputed that the terms of that policy did not include a clause obligating the primary insurer to pay interest on a judgment where it exhausted the policy. Moreover, under the terms of the excess policy, Hospitals Insurance was required to pay "all sums" in excess of $1 million that Ragins became "legally obligated to pay as damages." The Second Department held that Hospitals Insurance was not obligated to indemnify Ragins for the amount of unpaid interest incurred in connection with the underlying action. The Court of Appeals (New York's highest court) reversed and remitted the matter to the Second Department for consideration of the issues raised, but not determined. In that regard, the Court of Appeals noted that the Hospitals Insurance policy did not define "sums" and, thus, assigned the term its widely used meaning of "indefinite amount[s] of money…." Similarly, the Court of Appeals reasoned that the parties evidently intended that "damages" would retain its most common meaning, namely "[t]he sum of money which the law awards or imposes as pecuniary compensation, recompense, or satisfaction for an injury done or a wrong sustained as a consequence either of a breach of a contractual obligation or a tortious act…." The Court of Appeals held that, by those definitions, interest included in any judgment against Ragins constituted a "sum" of money that is traceable to the judgment against him for "damages" in satisfaction of the wrong caused and, therefore, if the subject pre-judgment interest is in excess of the primary policy's limits, Hospitals Insurance must pay it. Lastly, the Court of Appeals noted that there are no state regulations mandating that the primary insurer cover additional damages or interest beyond the primary policy's limit, nor do any regulations exempt Hospitals Insurance from its responsibility to pay all amounts in excess of the primary policy's limit. The Second Department has not yet considered the issues raised by the Court of Appeals.

HOMEOWNERS INSURANCE

Wangerin v. New York Cent. Mut. Fire Ins. Co., 2013 WL 5942376 (3d Dept. Nov. 7, 2013). In March 2003, after discovering that the floors in their home had dropped approximately four inches, Karen and Alex Herrera submitted a claim under their homeowners' insurance policy issued by New York Central Mutual Fire Insurance Company. New York Central denied the claim contending that the damage to the home was not a covered loss under the policy. Thereafter, the Herreras commenced a declaratory judgment action seeking a declaration that the loss was covered under the terms of the policy. The policy at issue provided coverage for "physical loss to covered property involving [the] collapse of a building or any part of a building", but only if such collapse was caused by, *inter alia*, "hidden insect or vermin damage." While the New York Central policy did not define what constitutes a collapse, it provided that a "[c]ollapse does not include settling, cracking, shrinking, bulging or expansion." The parties agreed that an infestation of insects caused damage to the home's sill plate. However, New York Central disputed the claims that there was a collapse of the subject building, instead asserting that the building had merely settled. Following a non-jury trial, the Supreme Court ruled in favor of the Herreras and New York Central appealed. On appeal, the Third Department noted that it had previously held that the term collapse "involves an element of suddenness, a falling in, and total or near total destruction…." However, the Court recognized that the clear modern trend is to hold that collapse coverage provisions, which define collapse as not including cracking and settling, provide coverage if there is substantial impairment of the structural integrity of the building or any part of a building. The Third Department ruled that although the Herreras had acknowledged that no part of the floor or ceiling actually fell completely, the damage to their home was nonetheless consistent with a collapse as the term has been interpreted by the Court. Accordingly, it was held that the loss was, in fact, covered under the New York Central policy.

Estate of Courtney v. Dryden Mut. Ins. Co., 971 N.Y.S.2d 695 (Cortland Co. Sup. Ct. Sept. 24, 2013). On September 18, 2011, Randall and Margaret Courtney died when a farm tractor that Randall was operating and on which Margaret was a passenger flipped over in a wooded area on their property. Prior to the accident, the Courtneys had procured a homeowners' insurance policy from Dryden Mutual Insurance Company on which both were named as insureds. The administrators of the Estate of Margaret Courtney commenced a wrongful death action against the administrator for the Estate of Randall Courtney which, in turn, sought a defense and indemnification from Dryden. Dryden disclaimed coverage on the basis that the policy excluded coverage for liability arising from bodily injuries sustained by Margaret Courtney, as a named insured. Subsequently, the administrators for the Estate of Randall Courtney commenced an action against Dryden and both parties moved for summary judgment. The Estate of Randall Courtney argued that the exclusion relied upon by Dryden applies only to injuries directly suffered by an insured, and that it does not preclude coverage for a wrongful death claim, which constitutes an independent injury directly sustained by a decedent's distributees. In granting Dryden's motion, the Courtland County Supreme Court was persuaded by the Supreme Court of Ohio's decision in *Cincinnati Indem. Co. v. Martin*, 85 Ohio St.3d 604, 710 N.E.2d 667 (1999). In considering similar policy language, the Ohio Supreme Court stated: "…that an insurer has no duty to defend or indemnify its insured in a wrongful death lawsuit brought by a noninsured based on the death of an insured where the policy excludes liability coverage for claims based on bodily injury to an insured. Since appellant's wrongful death claim stems solely from an insured's bodily injury, 'we hold that appellant's wrongful death claim is excluded from coverage and that [the insurer] has no duty to defend or indemnify its insured." As such, the Court held that Dryden did not have a duty to defend or indemnify the Estate of Randall Courtney relative to the wrongful death action.

MISCELLANEOUS.

Georgitsi Realty, LLC v. Penn-Star Ins. Co., 2013 WL 5637757 (Ct. of App. Oct. 17, 2013). Georgitsi Realty, LLC, the owner of a four-story apartment building in Brooklyn, procured a "named perils" property insurance policy from Penn-Star Insurance Company, covering "direct physical loss or damage…caused by or resulting from…[v]andalism", which was defined as "willful and malicious damage to, or destruction of, the described property." Armory Plaza, Inc., the owner of the lot next to Georgitsi's building decided to construct a new building that would include an underground parking garage. Georgitsi claimed that the excavation of the adjacent lot caused cracks in the walls and foundation to its building. As a result, the New York City Department of Buildings issued a series of violations and "stop work" orders and Georgitsi obtained a temporary restraining order directing Armory to cease all construction and excavation work. Georgitsi alleged that Armory ignored the same. Georgitsi then made a

claim under its policy, which Penn-Star denied, and Georgitsi commenced a declaratory judgment action. The United States District Court for the Eastern District of New York ultimately granted summary judgment to Penn-Star finding that the alleged conduct was not "vandalism" within the meaning of the policy. Georgitsi appealed to the Second Circuit Court of Appeals, which certified to the New York Court of Appeals the following questions: (i) For purposes of construing a property insurance policy covering acts of vandalism, may malicious damage be found to result from an act not directed specifically at the covered property?; (ii) If so, what state of mind is required? In answering the first certified question in the affirmative, the Court of Appeals stated that it saw "no reason why the term 'vandalism' should be limited to acts 'directed specifically at the covered property.'" The Court of Appeals reasoned that the term vandalism, as ordinarily understood, need not imply a specific intent to accomplish any particular result. It was further noted that it did not seem relevant that the alleged act of vandalism in the present matter did not bring the alleged vandals into direct contact with the covered property. The Court of Appeals found that where damage naturally and foreseeably results from an act of vandalism, a vandalism clause in an insurance policy should cover it. In regard to the state of mind required for "malice", the Court of Appeals adopted the same standard used in reviewing awards of punitive damages. In this regard, conduct is "malicious" for these purposes when it reflects "such a conscious and deliberate disregard of the interests of others that [it] may be called willful or wanton." The Court of Appeals reasoned that this test will serve to distinguish between acts of vandalism and ordinary tortious conduct.

Universal American Corp. v. National Union Fire Ins. Co. of Pittsburgh, PA, 972 N.Y.S.2d 241 (1st Dept. Oct. 1, 2013). Universal American Corp. is a health insurance company which provides, among other things, Medicare managed-care plans. Under the plans provided by Universal, health care providers submit claims for services provided to plan members, many of which are "auto adjudicated" through Universal's computer system, with payments rendered without any manual review. Universal obtained a Financial Institution Bond from National Union Fire Insurance Company of Pittsburgh, PA which contained a Rider entitled "Computer Systems Fraud" that provided coverage for "[l]oss resulting directly from a fraudulent…entry of Electronic Data…into…[Universal's] proprietary Computer System…." Universal contended that in late 2008 it suffered approximately $18,321,296 in losses from fraudulent claims made against some of its health plans. Most of these claims were submitted by providers directly into Universal's computer system and subsequently processed through the system. Thereafter, Universal commenced a declaratory judgment action against National Union seeking an order that it was entitled to indemnification under the National Union policy for the loss suffered. Universal subsequently moved for summary judgment arguing that the Computer Systems Fraud Rider covered the entry of fraudulent information, *e.g.*, fraudulent claims, even by an authorized user (such as a provider). National Union cross-moved asserting that the policy only provides coverage for situations in which an unauthorized user accessed the system and caused money to be paid out, *i.e.*, computer hackers. After the trial court found that Universal was not entitled to coverage for the loss as the terms of the policy did not provide coverage for fraudulent claims entered into the system by authorized users, Universal appealed. In affirming the ruling of the trial court, the First Department found that the unambiguous plain meaning reading of the Computer Systems Fraud Rider indicated that it was intended to apply to wrongful acts in manipulation of the computer system by computer hackers, and did not provide coverage for fraudulent content consisting of claims by bona fide doctors or other health care providers authorized to use the system seeking reimbursement for health care services that were not provided. Accordingly, the Court held that Universal was not entitled to indemnification relative to the loss it sustained.

Olin Corp. v. Century Indem. Co., 522 Fed.Appx. 78 (2d Cir. June 18, 2013). Century Indemnity Company, the successor to Insurance Company of North America ("INA"), appealed from a partial final judgment entered by the United States District Court for the Southern District of New York in favor of Olin Corporation for litigation costs and prejudgment interest in connection with actions by California homeowners and residents alleging environmental contamination from a facility in Morgan Hill formerly operated by Olin. On appeal, INA first argued that it had no duty to reimburse Olin's costs in defending the Morgan Hill actions because the homes at issue were constructed after the policy expired. The Second Circuit noted that the Complaints against Olin alleged careless disposal of contaminates in the area's water supply and affected real property "situated above a highly toxic groundwater plume of potassium perchlorate, created as a result of forty years [1956-1996]" of Olin's operations. The Court indicated that while on their face, the Complaints did not specify when injury to the individual homes or wells occurred, they did allege ongoing contamination of the groundwater plume beginning in 1956. (Olin's policies with INA were in effect from 1956 to 1970). As such, the Second Circuit affirmed the Southern District's decision

which held that the allegations contained in the Complaints were sufficient to establish a reasonable possibility of coverage and, therefore, INA had a duty to defend Olin relative to the Morgan Hill actions. INA then challenged the District Court's conclusion that it had a duty to reimburse Olin for 100% of its defense costs, asserting that instead the costs should be allocated between INA and Olin. In this regard, the District Court concluded as a matter of law that the allocation of defense costs between insurer and insured for periods of self-insurance in which the harm occurred is unavailable, although the matter had not been definitively established as a matter of law in New York. In this regard, the Second Circuit noted that it would not reach the issue of whether defense costs may be allocated between an insurer and insured for periods of self-insurance because, after reviewing the evidence, the Court found that there were no reasonably means available of prorating the costs between the covered and non-covered items. Accordingly, the Second Circuit found that INA was obligated to reimburse Olin for the entirety of the defense costs incurred in connection with the Morgan Hill lawsuits.

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