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NEW YORK COVERAGE PROTOCOLS

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1. What statutes or regulations, if any, govern the drafting of a reservation of rights letter?

Under New York law, reservations of rights letters are of limited value in most situations, as a result of New York Insurance Law § 3420, which imposes onerous standards on insurers seeking to disclaim coverage where the statute is applicable. The law identifies several requirements necessary for proper disclaimer and denial of coverage letters. Unlike most jurisdictions, where insurers are able to protect themselves by sending out reservation of rights letters, New York generally finds such communications to be ineffective to protect carrier rights to later deny coverage and are not generally favored by the courts.

New York Insurance Law § 3420(d)(2) is the operative statutory provision. A "deeming statute," it imposes requirements that are grafted onto casualty policies issued in New York and requires strict compliance to avoid dire consequences.

Liability insurance carriers that fail to issue disclaimer letters promptly and properly, where claim is made under a policy issued or delivered in New York State involving an accident that occurs in New York and seeking recovery for bodily injury or wrongful death, will lose their right to rely on exclusions and breaches of policy conditions.

In New York, use of the term "reservation of rights letter" is not recommended as a general rule. Instead, the term "partial disclaimer letter" more appropriate comports with the statutory mandates set forth in Insurance Law Section 3420(d)(2).

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***Statutory scheme*:**

Insurance Law § 3420(d)(2) provides, with important terms highlighted, what we call the *statutory scheme* for coverage denials:

> If under a liability policy **issued or delivered in this state**, an insurer shall **disclaim liability or deny coverage** for **death or bodily injury** arising out of a motor vehicle accident or **any other type of accident occurring within this state**, it shall give **written notice as soon as is reasonably possible** of such **disclaimer of liability or denial of coverage** to the **insured and the injured person or any other claimant**.

That section creates a *statutory scheme* that applies to disclaimers when all of the following circumstances exist:

- The policy was issued or delivered in the State of New York;
- The accident occurred in the State of New York; and
- The claim involves bodily injury or wrongful death.

The purpose is to "protect the insured, the injured party, and 'any other interested party who has a real stake in the outcome' from prejudice resulting from a belated denial of coverage." *Admiral Ins. Co. v. State Farm Fire*, 86 A.D.3d 486, 488 (N.Y. App. Div. 2011).

If the *statutory scheme* does not apply, the courts resort to common law and require insurers to deny coverage in a *reasonable time* under the circumstances.

The *statutory scheme* does not apply to property damage claims. Likewise, it does not apply to "personal or advertising" injury claims (e.g., libel, slander, defamation), unless there is a bodily injury component alleged. Under New York law, "emotional distress," even with physical injury, is considered bodily injury so the statute may apply where such a claim is made.

What the statute does not instruct, but the case law clearly teaches, is that a failure to strictly comply with these requirements renders a disclaimer invalid and ineffective and results in a loss of most coverage defenses, assuming the claim would otherwise fall within the coverage grant. The statute does not speak of "reservations of rights" and the courts have held that a reservation of rights letter is not a substitute for a disclaimer letter. *Hartford Ins. Co. v. Cnty. of Nassau*, 46 N.Y.2d 1028 (1979). A reservation of rights does not toll the time which an insurer would otherwise be obligated to issue a statutory compliant disclaimer of coverage.

As noted above, the claim must initially fall within the grant of coverage before adherence with the strict requirements of the statute will apply, i.e., the statute does not create coverage where none existed. For example, if an insurer is placed on notice of an accident or claim, but there was no policy in force for the purported insured at the time – or there was no occurrence – the failure to disclaim will not create coverage. However, if the claim falls within the grant of coverage and the basis for disclaimer or denial of coverage is the applicability of an

exclusion or a breach of policy condition (notice or cooperation, for example), a failure to deny coverage "as soon as reasonably possible" by sending out a letter to the insured, the injured person and those who may be "other claimants" (e.g., potential cross-claimants), will invalidate the denial.

While a failure to provide notice of the carrier's coverage position to the injured party and others who qualify as "any other claimant" as soon as reasonably possible will also result in nullification of the denial, only those who do not receive proper notice of a coverage denial have standing to challenge and potentially overturn that denial. Under Insurance Law § 3420(d)(2), "written notice as soon as is reasonably possible of such disclaimer of liability or denial of coverage" has been interpreted as obligating an insurer to issue an otherwise compliant disclaimer within 30 days of the date the insurer knew or should have known of the grounds to deny. Although the timeliness of such a disclaimer generally presents a question of fact, where the basis for the disclaimer was, or should have been, readily apparent before the onset of the delay, any explanation by the insurer for its delay will be insufficient as a matter of law. If an investigation is necessary before a denial of coverage is concluded, insurers have a duty to "expedite" the disclaimer process and the courts will evaluate whether the insurer acted promptly. It is the burden of the insurer to explain or justify the reasonableness of the delay. *Felice v. Chubb & Son Inc.*, 67 A.D.3d 861 (N.Y. App. Div. 2009).

Carlson v. American Insurance Group, decided by the Court of Appeals on November 20, 2017, expanded the conventional understanding of "issued or delivered." The Court held that the term "issued or delivered" in New York under Insurance Law § 3420 refers both to a policy issued for delivery in New York, and could refer to a policy issued for delivery outside of New York, where there is a New York accident and the insured has a substantial business presence and creates risks in New York. Accordingly, even policies sent by out-of-state carriers to out-of-state insureds, may be subject to the statutory scheme if the insured has a "presence" in New York.

2. What events necessitate an insurer to issue a reservation of rights/partial disclaimer letter?

Notice of an accident, occurrence or suit necessitate the insurer's obligation to consider and advise of their position, whether notice is received from the insured, a claimant or a potential cross-claimant. Under New York law, specifically Insurance Law § 3420(a)(3), written notice given by or on behalf of the injured party or any other claimant is deemed to be notice by the insured.

3. What are the timing requirements for issuing a reservation of rights/partial disclaimer letter?

Under the *statutory scheme*, the statute requires that the insurer must "give written notice as soon as is reasonably possible of such disclaimer of liability or denial of coverage to not only the insured, but the injured person or any other claimant." The term "as soon as reasonably possible" is generally considered to be no more than 30 days from the time the insurer learns, or should have learned after diligent investigation, of the ground for disclaimer.

When an insurer fails to timely disclaim, it is precluded from disclaiming coverage based upon breaches of policy conditions and the insurer generally waives its right to rely upon policy exclusions. Again, a reservation of rights letter is not considered a substitute for a disclaimer. A reservation of rights letter has no relevance to the question whether the insurer has timely sent a notice of disclaimer of liability or denial of coverage. *See Allstate Ins. Co. v. Gross*, 27 N.Y.2d 263 (1970); *Hartford Ins. Co. v. Nassau Cnty.*, 46 N.Y.2d 1028 (1979).

The insurer bears the burden to explain the reasonableness of any delay in disclaiming coverage. *See Moore v. Ewing*, 9 A.D.3d 484, 488 (N.Y. App. Div. 2004). The reasonableness of any delay is computed from the time that the insurer becomes sufficiently aware, or should have become so aware, of the facts which would support a disclaimer. *See Pawley Interior Contr., Inc. v. Harleysville Ins. Cos.*, 11 A.D.3d 595 (N.Y. App. Div. 2004). Although the timeliness of such a disclaimer generally presents a question of fact, *see Continental Cas. Co. v. Stradford,* 11 N.Y.3d 443, 449 (2008), where the basis for the disclaimer was, or should have been, readily apparent before the onset of the delay, any explanation by the insurer for its delay will be insufficient as a matter of law. *See First Fin. Ins. Co. v. Jetco Contr. Corp.,* 1 N.Y.3d 64, 69 (2003); *West 16th St. Tenants Corp. v. Public Serv. Mut. Ins. Co.,* 290 A.D.2d 278, 279 (N.Y. App. Div. 2002), *lv. denied*, 98 N.Y.2d 605 (2002).

Where the basis is not readily apparent, an unsatisfactory explanation will render the delay unreasonable as a matter of law. *See Bovis Lend Lease LMB, Inc. v. Royal Surplus Lines Ins. Co.,* 27 A.D.3d 84, 88 (N.Y. App. Div. 2005) (citing *First Fin. Ins. Co. v. Jetco Contr. Corp.*, 1 N.Y.3d at 69 (2003)). If the delay allegedly results from a need to investigate the facts underlying the proposed disclaimer, the insurer must demonstrate the necessity of conducting a thorough and diligent investigation. *See Quincy Mut. Fire Ins. Co. v. Uribe*, 45 A.D.3d 661 (N.Y. App. Div. 2007); *Schulman v. Indian Harbor Ins. Co.,* 40 A.D.3d 957 (N.Y. App. Div. 2007). However, as noted, where no coverage is available in the first instance, a delayed disclaimer will not create coverage. See, for example*, Hunter Roberts Const. Group, LLC v. Arch Ins. Co.*, 75 A.D.3d 404, 408-09 (N.Y. App. Div. 2010) (where the court noted: "Insofar as Arch's denial of coverage was based upon lack of coverage as an additional insured pursuant to the additional insured endorsement, a timely disclaimer was unnecessary (*see Markevics v. Liberty Mut. Ins. Co.*, 97 N.Y.2d 646, 648, 735 N.Y.S.2d 865, 761 N.E.2d 557 [2001]; *Perkins v. Allstate Ins. Co.*, 51 A.D.3d 647, 649, 858 N.Y.S.2d 238 [2008])").

4. What information must be included in a reservation of rights/partial disclaimer letter (*e.g.*, is a generally stated reservation of rights sufficient, must all potentially applicable policy language be quoted, must a summary of the underlying facts or pleadings be included and, if so, must the reservation of rights explain how each fact or pleading may apply to the policy language, must the right to independent counsel be included)?

Under the *statutory scheme,* specificity for grounds for disclaimer must be included, particularly if the reason for denial is a breach of policy condition or policy exclusion. See further discussion at Question 6*, infra*. It is preferable to include the policy language upon which the insurer is relying in the disclaimer letter.

In *Elacqua v. Physician's Reciprocal Insurers*, 21 A.D.3d 702 (N.Y. App. Div. 2005), *lv dismissed*, 6 N.Y.3d 844 (2006), an intermediate appellate court, the Third Judicial Department, held that, where an insurer may face liability based upon some of the grounds for recovery asserted but not upon others, the insurer has an obligation to inform the insured of its right to be represented by an attorney of his or her own choosing at the expense of the insurer. In a second decision, three years later, the same intermediate court held *that an insurer's failure to meet its "affirmative obligation" to so inform the insured is further a deceptive trade practice under New York's General Business Law, § 349. Elacqua v. Physicians' Reciprocal Insurers*, 52 A.D.3d 886 (N.Y. App. Div. 2008) (emphasis added). No other courts have yet so held. Many insurers have decided to so advise insureds, even in parts of the state outside of the Third Department.

5. What specific statutory or regulatory language must be included in a reservation of rights/partial disclaimer letter?

There is no special language that need be included either by statute or regulation. Often, carriers include Fair Claims Settlement language that is required in first party property damage denials by regulation (11 NYCRR Part 216), but that language is not necessary in third party disclaimers.

> "Should you wish to take this matter up with the New York State Department of Financial Services, you may file with the department either on its website at http://www.dfs.ny.gov/consumer/fileacomplaint.htm or you may write to or visit the Consumer Assistance Unit, Financial Frauds and Consumer Protection Division, New York State Department of Financial Services, at: One State Street, New York, NY 10004; One Commerce Plaza, Albany, NY 12257; 1399 Franklin Avenue, Garden City, NY 11530; or Walter J. Mahoney Office Building, 65 Court Street, Buffalo, NY 14202."

6. May an insurer reserve the right to seek reimbursement of defense or indemnity payments (and, if so, must this right be expressly stated in the reservation of rights/partial disclaimer letter)?

While this issue has not reached the highest state court, generally, federal courts interpreting New York law have opined that where "coverage is disputed and a liability policy includes the payment of defense costs, 'insurers are required to make contemporaneous interim advances of defense expenses . . . subject to recoupment in the event it is ultimately determined no coverage was afforded.'" *Axis Reinsurance Co. v. Bennett,* No. 07 Civ. 7924, 2008 WL 2600034 (S.D.N.Y. June 27, 2008) (quoting *National Union Fire Ins. Co. of Pittsburgh, PA. v. Ambassador Group, Inc.,* 157 A.D.2d 293, 299 (N.Y. App. Div. 1990)).

Most recently, the Appellate Division, First Department, permitted the recoupment of defense costs under an attorney Errors and Omissions policy, where the insurer had reserved the right to claim that recovery should it be determined that it had no obligation to indemnify its

insured. *See Certain Underwriters at Lloyd's London Subscribing to Policy No. SYN-1000263 v. Lacher & Lovell-Taylor, P.C.,* 2013 NY Slip Op 08112 (12/05/13).

In *Gotham Ins. Co. v. GLNX, Inc.,* No. 92 Civ. 6415, 1993 WL 312243 (S.D.N.Y.1993), an insurer sued for a declaratory judgment that it was not obligated to defend or indemnify an insured in an underlying lawsuit, and sought reimbursement for defense costs it had incurred. After finding that the insurer was entitled to summary judgment that it had no obligation to defend, the court also declared that the insurer was entitled to recover defense costs. *Id.* The court relied on the fact that the insurer had sent the insured a letter explicitly stating that it reserved its right to seek reimbursement in the event of a determination that it had no duty to defend. Because the insured offered no evidence that it refused to consent to this reservation, the court found this reservation valid and issued a declaration that the insurer was entitled to reimbursement of defense costs. *Id.*; *See also One Beacon Ins. Co. v. Freundschuh,* No. 08–CV–823, 2011 WL 3739427 (W.D.N.Y. Aug. 24, 2011) (granting summary judgment to an insurer seeking a declaration that the insurer had no obligation to defend the insured in an underlying action, and determining that the insurer was entitled to a judgment that it could recoup fees from the underlying action).

See also Max Specialty Ins. Co. v. WSG Investors, LLC, 09-CV-5237 CBA JMA, 2012 WL 3150579 (E.D.N.Y. Apr. 20, 2012), *report and recommendation adopted*, 09-CV-05237 CBA JMA, 2012 WL 3150577 (E.D.N.Y Aug. 2, 2012), where the carrier explicitly cited its intent to recoup fees in its reservation of rights and the court found the insurer was entitled to recovery.

While it is unclear whether a right to recoupment would be lost if not specifically reserved in a letter to the insured, it appears that in every case where recoupment was permitted, the insurer specifically reserved the right and the court so noted.

7. What are the consequences of not issuing a proper reservation of rights/partial disclaimer letter (*e.g.*, estoppel, waiver, procedural bad faith)?

Under the *statutory scheme*, a failure to timely and properly issue a disclaimer letter leads to a waiver of policy defenses and a loss of the right to rely upon policy exclusions and breaches of policy conditions. This can be fatal to the protection of an insurer's rights and does not require that the insured demonstrate that he, she or it was prejudiced. As indicated in the section, and as described below, the *statutory scheme* requires that copies of the letter be sent to the injured party or any other claimant, including potential cross claimants. A failure to do so will lead, again, to a loss of the insurer's right to rely on those policy defenses.

In *Zappone v. Home Ins. Co.*, 55 N.Y.2d 131, 136-37 (1982), the Court of Appeals spoke of three kinds of disclaimers (1) a breach of a policy condition, (2) an exclusion, and (3) a situation where coverage is not available because the risk is not within the grant of coverage. The high court made it clear that under the *statutory scheme,* a failure to timely disclaim would be fatal to the carrier in the first two instances. However, in the third, when the claim did not fall within the grant, coverage would not be created where none existed. *See also*

1812 Quentin Road, LLC v. 1812 Quentin Road Condominium, 94 A.D.3d 1070 (N.Y. App. Div. 2012) (reiterating that no disclaimer is required where there is no coverage in the first instance).

In *Max Specialty Ins. Co. v. WSG Investors, LLC*, 09-CV-5237 CBA JMA, 2012 WL 3150579 (E.D.N.Y Apr. 20, 2012), *report and recommendation adopted*, 09-CV-05237 CBA JMA, 2012 WL 3150577 (E.D.N.Y Aug. 2, 2012), the court noted that the terms used by an insurance policy are not necessarily determinative on the question of whether a lack of coverage is due to an exclusion or a lack of inclusion. Rather, the distinction comes from a practical examination of what the policy terms amount to. Applying this analysis, the court found no disclaimer was required.

A failure to raise particular exclusionary language or a breach of a policy condition within the time so prescribed will result in a waiver of the insurer's right to raise that ground for disclaimer later. A reservation of rights letter does not preserve the insurer's right to do so and the courts have held that such a letter is not a substitute for a disclaimer. It is well settled that an insurance carrier may not disclaim liability if it fails to give the insured timely notice of disclaimer as soon as is reasonably possible after it first learns of the accident or grounds for disclaimer of liability. *State Farm Ins. Co. v. Brosnan*, 220 A.D.2d 599 (N.Y. App. Div. 1995).

A written reservation of rights by an insurer is not a substitute for required notice of disclaimer. *All City Ins. Co. v. Pioneer Ins. Co.*, 194 A.D.2d 424 (N.Y. App. Div. 1993).

With regard to disclaimer outside of the *statutory scheme*, an insured must demonstrate prejudice before it can create coverage by estoppel. *See Kamyr, Inc. v. St. Paul Surplus Lines Ins. Co.*, 152 A.D.2d 62, 66 (N.Y. App. Div. 1989); *Interested Underwriters at Lloyd's v. H.D.I. III Assoc.*, 213 A.D.2d 246, 247 (N.Y. App. Div. 1995).

8. Under what circumstances does the issuance of a reservation of rights letter require independent counsel (and if independent counsel is required, must the insurer so notify the insured)?

Under the holding of the New York State Court of Appeals in *Public Service Mutual v. Goldfarb*, independent counsel is not required in every case where an insurer sends out a partial disclaimer or reservation of rights:

> Independent counsel is only necessary in cases where the defense attorney's duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable. When such a conflict is apparent, the insured must be free to choose his own counsel whose reasonable fee is to be paid by the insurer. On the other hand, where multiple claims present no conflict—for example, where the insurance contract provides liability coverage only for personal injuries and the claim against the insured seeks recovery for property damage as well as for personal injuries—no threat of divided loyalty is present and there is no need

> for the retention of separate counsel. This is so because in such a situation the question of insurance coverage is not intertwined with the question of the insured's liability.
>
> *Pub. Serv. Mut. Ins. Co. v. Goldfarb*, 53 N.Y.2d 392, 401 (1981).

For a discussion on the necessity of advising the insured of that right, see the response to Question 4 above, in particular, the review of the two *Elacqua* decisions.

9. To whom must the insurer send the reservation of rights letter and to whom must the insurer send a copy (*e.g.*, must the reservation of rights be sent to the broker, the underlying plaintiff, the purported additional insured, or the named insured only)?

Under the *statutory scheme*, where there is a claim for bodily injury or wrongful death, the accident occurs in New York and the policy was issued or delivered in New York, Insurance Law § 3420(d)(2) requires the insurer to give written notice as soon as is reasonably possible of such disclaimer of liability or denial of coverage to **the insured and the injured person or any other claimant** within the brief period of time discussed above.

The statute has been construed to mean that an insurer must give prompt written notice of disclaimer of liability or denial of coverage not only to the insured but also to any party that has *a claim against the insured arising under the policy*. *See, e.g., Hartford Acc. & Indemn. Co. v. J.J. Wicks, Inc.*, 104 A.D.2d 289, 293 (N.Y. App. Div. 1984), *appeal dismissed,* 65 N.Y.2d 691 (1985); *Bovis Lend Lease LMB, Inc. v. Royal Surplus Lines Ins. Co.*, 27 A.D.3d 84, 90-91 (N.Y. App. Div. 2005). A failure to give such notice renders the disclaimer under the *statutory scheme* ineffective. *Hartford Ins. Co. v. Nassau Cnty.*, 46 N.Y.2d 1028, 1030 (1979).

10. Are there any other notable cases or issues regarding reservation of rights letters that are important to the law of this state?

Specificity

In addition to strict adherence to the timing of disclaimers of coverage and the obligation to provide notice to the injured party and any other claimant, New York courts also require insurers to apprise the necessary parties of the grounds for disclaimer with a high degree of specificity. This is illustrated by a decision from New York's highest court, the Court of Appeals, entitled *General Accident v. Cirucci*, 46 N.Y.2d 862 (1979). New York courts afford an injured party the independent right to provide notice of an accident for which coverage is sought to an insurer. Here, the injured party exercised this right. The insurer, deeming the notice afforded by the injured party to be untimely, disclaimed coverage. Their disclaimer, however, did not specifically refer to late notice by the injured party as a basis for denial, but rather referred only to the insured's failure to timely report the accident. This defect, the court found, was fatal. Thus, the court invalidated the disclaimer and the insurer was obligated to afford coverage.

Who May Challenge Compliance

Where an insurer, on behalf of its insured, tenders to another insurer, does the disclaiming insurer have an obligation to comply with the statutory requirements of Insurance Law § 3420 discussed above and does the tendering insurer have standing to raise the deficiencies? Where the tender is made on behalf of the insured rather than in a subsequent equitable subrogation or contribution suit between insurers, an insurer is so obligated. *JT Magen v. Hartford Fire Ins. Co.*, 64 A.D.3d 266 (N.Y. App. Div. 2009). Those within the class of persons entitled to the protections of Insurance Law § 3420(d) may properly raise an insurer's non-compliance with the statute.

In *Industry City Mgmt. v. Atlantic Mutual Ins. Co.*, 64 A.D.3d 433 (N.Y. App. Div. 2009), the court held that a letter written to Atlantic Mutual on Industry's behalf by its own insurer's claims administrator constituted timely notice to Atlantic Mutual within the meaning of Insurance Law § 3420 and, as such, the insurer was obligated to issue a timely disclaimer of coverage. The disclaimer was not issued until seven months later and thus, the court held that it was untimely and, therefore, ineffective.

Who May Commence a Declaratory Judgment Action to Challenge a Reservation of Rights or Disclaimer Letter

In 2004, New York State's highest court determined that a injured claimant does not have standing and, therefore, does not have the right to commence an action, declaratory or otherwise, to challenge a liability insurer's decision to deny coverage, *Lang v. Hanover Ins. Co.*, 3 N.Y.3d 350, 356 (2004), until after it has obtained a judgment against the insured. New York Insurance Law § 3420(a)(2) allows a claimant who has obtained judgment against an insured and, therefore, becomes a judgment creditor of the insured, to present that judgment to the insurer and the insured for payment. If the insurer refuses to pay the judgment, the judgment creditor is then entitled to bring a direct action against the carrier at which time coverage defenses can be litigated. The Court of Appeals, in *Lang*, decided that this was the only remedy the claimant had to challenge a coverage denial. The insured or the insurer each has the right to commence a declaratory judgment action at any time after a denial, even before the underlying lawsuit is resolved.