

A QUESTION OF INTEREST/LEGISLATIVE UPDATE

In a case where a judgment has been entered against an insured in an amount in excess of the insurance policy limit, is the insurer required to pay the accrued interest only on the amount of its policy, or on the entire amount of the judgment, including the excess? This interesting "question of interest" was the subject of a recent decision of the Appellate Division, Second Department, discussed below.

Two Schools of Thought

One school of thought on the question presented, mostly heard in other states, holds that, in general, for public policy reasons, the insurer should be required to pay interest on the entire judgment, rather than only on its pro-rata share of the judgment, because it is the insurer who has "control over the litigation" and, as such, could, theoretically, delay settling a meritorious claim to the detriment of the insured. The underlying principle of this contention was summarized by the court in *Wilkerson v. Maryland Casualty Co.*, 119 F.Sup. 383, 388 (E.D.Va. 1953), *affd.* 210 F.2d 245 (4th Cir. 1954), as follows: "Not infrequently judgment is obtained against an insured for an amount in excess of the coverage of the policy and it would seem a harsh rule to permit the insurer to litigate the entire case in an effort to save the amount of its coverage while interest on the excess accumulates against the insured. In some situations the consequences to the insured would be serious. With the company in control of the conduct of the case the policyholder is powerless should he desire to effect a settlement unless the company consents. Upon the other hand, the company may at any time relieve itself of liability for the excess interest by paying or tendering or depositing in court the amount of the limit of its liability under the policy."

Because the insurer has the power to stop the running of interest by discharging its obligations through the payment of the amounts due or by tendering those amounts into court, one commentator has argued that it would be inequitable to put the burden on the insured for the interest that arises prior to the payment by the insurer of the full policy limits. In the words of Professor Appleman, "inasmuch as the insurer has control of the litigation and can make its election to appeal irrespective of the insured's desires in the matter, . . .

. [i]t seems fair to compel the insurer to pay all the interest which accrues pending an appeal, even though the judgment is in excess of the policy limits, for the reason that the insured might desire to pay the excess judgment and thus prevent the running of interest, but the insurer's control of the litigation would prevent him from doing so." 8A Appleman, Insurance Law and Practice, §4894.25, at pp. 78-83.

New York Rule

The second school of thought, represented by the court of New York, take the opposite position. The Regulations of the Superintendent of Insurance of the State of New York, set forth at 11 NYCRR §60.1(b)], provide, in pertinent part, as follows:

"An `owner's policy of liability insurance' shall contain in substance the following minimum provisions or provisions which are equally or more favorable to the insured . . ."

* * *

With respect to such insurance as is afforded, the insurer, subject to the policy terms, shall: . . . pay . . . all costs taxed against the insured in any such suit, and all interest accruing after entry of judgment until the insurer has paid or tendered or deposited in court such part of such judgment as does not exceed the applicable policy limits" (Emphasis added).

This Regulation, and the "standard" policy provision its prescribes, has traditionally and consistently been construed to mean that in a case such as the instant case, where a judgment has been entered against the insured in the amount in excess of the insurance policy limit, the insurer is only required to pay interest on that portion of the judgment that is covered by the policy limits. See Schnarch v. Empire Mut. Ins. Co., 144 AD2d 795 (3d Dept. 1988), mot. for leave to appeal dismissed, 74 NY2d 715 (1989) ("In New York, the long-standing interpretation of such a policy clause has required insurance carriers to pay postponement interest only on that portion of the judgment which does not exceed the policy limit"); Coveney v. Nationwide Mutual Ins. Co., 58 Misc.2d 480 (Sup. Ct. Monroe Co. 1968), affd. without opinion, 33 AD2d 992 (4th Dept. 1970) ("In New York, the phraseology of the clause in the defendant's policy has been consistently held to mean that the carrier is not responsible for interest on a verdict which has exceeded the stated policy limits [citations].") Lehman v. County of Erie, 53 Misc.2d 710 (Sup. Ct. Erie Co. 1967) ("It is well-established law that interest is only payable by an insurer, pursuant to its insurance contract, to the limit of its contractual coverage of liability."; Holubetz v. National Fire Ins.

Co. of Hartford, 13 AD2d 228 (3d Dept. 1961) (insurer liable for interest from the date of the judgment on the sum of \$10,000 only, the limit of its liability under the policy.).

In Home Indemnity Co. v. Corie, 206 Misc. 720, affd. without opinion 286 App. Div. 996 (1st Dept. 1955), the plaintiff insurer issued a policy to defendant with a limit of \$10,000 for damages sustained by two or more persons in one accident. Judgment subsequently was entered against defendants in the amount of \$76,992.15. The policy bound the insurer to pay "all interest accruing after entry of judgment until the company has paid, tendered or deposited in court such part of such judgment as does not exceed the limit of the company's liability thereon." The insurer contended that it was obligated to pay interest only on the part of the judgment for which it was liable, i.e., on the \$10,000 limit fixed by the policy. Defendant insureds, on the other hand, took the position that the insurer was bound to pay interest on the full amount of the judgment.

The Supreme Court agreed with the insurer. Relying upon prior precedents (Devlin v. New York Mutual Cas. Taxicab Ins. Assn., 213 App. Div. 152, 155 (1st Dept. 1925); Sheridan v. Hartford Acc. & Indem. Co., 238 App. Div. 780 (1st Dept. 1933)), the court stated: "When the nature of interest, compensation for the use or detention of money, is borne in mind, the result reached is far more reasonable than that sought by the defendants. Since the limit of the plaintiff's liability on the judgments themselves is \$10,000, this is the sum of money for whose use it should pay. It [the insurer] is not liable for any part of the judgment in excess of \$10,000; therefore, in the absence [of] provision to that effect, it should not be charged with interest on the excess."

In USF&G v. Hotkins, 8 Misc.2d 296 (Sup. Ct. Kings Co. 1957), plaintiff insurer issued a policy of liability insurance to the defendant with limits of \$20,000 per person and \$20,000 per accident. A judgment was entered against the defendant in the sum of \$253,578.96. The policy provided, in a section called "Supplementary Payments," that the insurer would pay, inter alia, "all interest accruing after entry of judgment until the company has paid, tendered or deposited in court such part of such judgment as does not exceed the limit of the Company's liability thereon." The insured argued that USF&G was required under the policy to pay "all interest accruing after entry of judgment," not merely interest on such portion of the judgment as did not exceed the limit of the insurer's liability. Following the precedent of Home Indemnity v. Corie, supra, the court rejected the insured's

contention and held that the insurer's payment into court of an amount which included interest on its \$20,000 policy limit constituted "the total for which it is liable under the policy. As the court explained: ". . . [I]t seems clear to me that only liability for interest on the amount withheld by the company was intended to be assumed under the `Supplementary Payments' part of the policy Interest is compensation for the use or detention of money; when the policy requires the insurer to pay `interest' it can only reasonably mean interest on such sum as the insurer is obligated to and fails to pay, namely the limit of the policy." 8 Misc.2d at 301.

If, as noted in *USF&G v. Hotkins*, *supra*, "[i]nterest is compensation for the use and detention of money," the logical argument goes, the amount of interest for which the insurer may be liable can reasonably refer only to interest on the sum it is obligated under the policy to pay, since during any delay in the payment of that portion of a judgment against the insured which exceeds the insurance coverage the insured would maintain the use of that money. And, as the court noted in *Home Ins. Co. v. Corie*, *supra*: "The insured's surrender or control of the action, incidental to the insurance, does not justify the imposition of liability for interest on the part of the judgment which it is in no event bound to pay. To read the provision as the [insureds] wish to have it read would, as the court persuasively reasoned in *Standard Accident Ins. Co. of Detroit, Mich. v. Winget*, *supra*, impose vicarious liability on the insurer." *Accord*, *Standard Accident Ins. Co. v. Winget*, 197 F.2d 97 (9th Cir. 1952) ("If we hold an insurer liable for interest, not on the portion of the judgment for which it is liable, which it does not pay, but on the whole amount recovered against it, we are imposing vicarious liability And a contract should not be interpreted in such a manner as to impose upon a person responsibility for the obligations of others, even if it be in the form of interest only.").

Although in *Rodriguez v. Sanchez*, 93 AD2d 748 (1st Dept. 1983), the First Department held that the New York Regulation required an insurer to pay interest on the entire judgment against its insured, even when the judgment was in excess of the policy limit, the basis for that decision was the fact that the interest provision in the policy at issue failed to meet the minimum requirement of the Regulation, *i.e.*, it was not equally or more favorable to the insured, but, rather, less favorable. Where, however, the policy provision

is at least equally favorable to the insured as the Regulation's provision, the prior cases are controlling.

Accrual of Interest in Bifurcated Trials

Another "question of interest" arises in the context of bifurcated trials, where the liability trial may, for various reasons, be held long before the damages trial and thus, while liability may be determined early on, the determination of amount of that liability, and the sum upon which interest is to be calculated, may be substantially delayed. In such cases, does the obligation to pay interest commence from the date liability is established or the date the damages upon which such interest accrues are fixed?

In *Love v. State of New York*, 78 NY2d 540 (1991), the Court of Appeals resolved this question by holding that in a bifurcated trial the interest obligation accrues from the time that liability is established, *i.e.*, retroactive to the date of the liability verdict or judgment, rather than from any later date upon which the actual damages are fixed.

However, because *Love*, *supra*, which was an action against the State, did not involve an insurer or insurance policy, the Court of Appeals did not have occasion to discuss the application of that general rule to a case involving a judgment in excess of the defendant's insurance policy and did not answer the question of to whom liability for interest on that portion of the judgment that exceeds the insurance coverage may be imposed as between the defendant insured and the insurer.

Recent Case

The recently decided case of *Dingle v. Prudential*, NYLJ, May 2, 1994, p. 30, col. 4 (Second Department) dealt with both of the "questions of interest" raised above.

In that case, an insured under defendant's automobile liability policy, with bodily injury limits of \$100,000.00 per person, was involved in an accident and was sued for her alleged negligence. The trial was bifurcated and the liability portion ended on April 18, 1989 in a judgment adjudicating the insured 100% responsible for the accident and injuries. The damages trial was not held until over a year later and resulted in a jury verdict on May 14, 1990 against the insured in the amount which, after adjustments, costs,

disbursements and interest from the date of the liability verdict, totalled \$592,672.21 when a judgment was eventually entered on July 27, 1990.

On December 4, 1990, the insurer tendered to the plaintiff, and she accepted, the sum of \$140,563.19 which consisted of the full policy limits of \$100,000.00, interest on those policy limits from the date of the liability verdict (\$15,000.00), costs from the date of the liability verdict (\$4,077.89) and interest on the amount of the judgment in excess of the policy limits from the date of the damages verdict (\$21,485.30). This latter calculation and payment was based upon the specific provision in the insurer's "plain English" policy, which provided as follows:

"After the case is decided, we'll pay the amount which the Court decides you or anyone else is responsible for up to the maximum amount drawn for this part on the Declarations page. We'll pay any costs you may be responsible for. We'll also pay all interest on the amount for which the Court judges you or any other insured responsible that builds up between the time the Court decides the amount and the time we pay the amount which we're obligated to pay." (Emphasis added).

In an action for declaratory judgment, the injured underlying plaintiff contended that the defendant's insurer was liable to her for an additional amount of interest. Specifically, plaintiff contended that interest on the (entire) judgment at the time of the tender should have been calculated from the date of the liability judgment, rather than the insurer going back to that point only on the policy amount and calculating the remainder from the date of the damages award -- the difference being \$39,508.54. The insurer, claiming that it fulfilled all of its obligations under the policy and was not liable for any additional interest, moved to dismiss the declaratory judgment complaint on various grounds. As pertinent herein, the insurer argued that the terms of its interest provision were broader and more favorable to its insured than the Regulation required. By stating that it would pay "all interest on the amount for which the Court judges you or any other insured responsible", the insurer broadened the scope of its interest payment duty beyond simply the amount that it was obligated to pay under the Regulation and its interpreting case law (see above) to include the total amount of the judgment, including those amounts in excess of the policy limits. With respect to that additional, voluntarily assumed interest liability, which the law did not require it to pay at all, the insurer expressly limited its scope to the date the damages were fixed. This, it claimed, it was clearly entitled to do, so as long as the final

result was still more favorable and the total interest payments were still greater than would have otherwise been the case.

The IAS court, upon notification to both sides, treated the insurer's motion as a motion for summary judgment, and, upon consideration of the issues, granted the insurer's motion and dismissed the action. In so holding, the court specifically noted that the insurer's interest provision was more generous than the Regulation "has traditionally required." In the words of the Court: "Prudential, by paying interest on its policy limit of \$100,000 from the date of the liability judgment and on the balance of the unpaid judgment from the date of the damages verdict, has complied with the traditional requirements of §60.1(b) as well as with the more generous terms of its own policy. To impose even greater responsibility on Prudential absent clear appellate authority to do so, does not comport with this Court's view of the present state of the law in regard to interest calculation in a bifurcated determination nor would it comport with reasonableness and equity for in reaching this conclusion, the Court is not holding that plaintiff is not entitled to the added interest, rather that she must seek such added interest, if at all, from the underinsured tortfeasor. The Court need not address the possibility of a different conclusion if the interest clause in Prudential's policy simply met or fell shy of meeting the requirement of §60.1(b)."

On plaintiff's appeal to the Second Department, the trial court's order was unanimously affirmed. As noted by the Court, "The cases construing 11 NYCRR 60.1(b) have consistently held that where a judgment has been entered against an insured in an amount in excess of the insurance policy limits, the insurer is required to pay interest only on so much of the judgment as is covered by the policy (see e.g., *Schnarch v. Empire Mut. Ins. Co.*, 144 AD2d 795; *Holubetz v. National Fire Ins. Co. of Hartford*, 13 AD2d 228; *United States Fidelity & Guar. Co. v. Hotkins*, 8 Misc2d 296; *Home Ind. Co. v. Corie*, 206 Misc 720, affd. 286 App. Div. 996)." Moreover, "Although the obligation to pay interest on the policy limits accrues from the date that liability is established, rather than from the date on which damages are fixed (see, *Love v. State of New York*, 78 NY2d 540), the insurance policy at issue here contained a provision which as 'more favorable' to the insured than the prevailing law (see, 11 NYCRR 60.1[b]). According to this policy term, the defendant agreed to pay additional interest on the full judgment against its insured, computed from

'the time the court decide the amount' - i.e., the date damages were fixed (see *Trimboli v Scarpaci Funeral Home*, 37 AD2d 386, affd. 30 NY2d 687). The defendant fulfilled that obligation. Where, as here, the language of the policy is clear and unambiguous, the court properly enforced the contract terms as written (see, *Matter of Valente v. Prudential Prop. & Cas. Ins. Co.*, 77 NY2d 894; *Government Employees Ins. Co. v. Kligler*, 42 NY2d 863)."

RECENT INSURANCE-RELATED LEGISLATION

Insurance Company Insolvency

In an effort to combat the increasing problem of insurance company insolvency, the Legislature, in Ch. 215 of the Laws of 1993, effective July 6, 1993, has established a risk-based capital formula that provides the Superintendent of Insurance with a powerful new tool in identifying inadequately capitalized life and accident/health insurers and the authority to take corrective action. This formula takes into account the amount of capital an insurer needs to successfully operate in relation to the risks inherent in the insurer's operations, rather than a fixed-dollar minimum capital requirement. Under this new law, all New York domestic life and accident/health insurers must submit to the Superintendent by March 15 of each year a report of their risk-based capital levels as of the end of the prior calendar year. Licensed foreign insurers must submit such reports upon request.

In a related matter, the Superintendent of Insurance, in a recent circular letter, announced that because the net value of the Property/Casualty Insurance Security Fund (assets minus liabilities) exceeded \$150 million, no additional contributions will be required in 1994 for this fund, which was established to protect policyholders in the event of a property/casualty insurer insolvency.

Viatical Settlement Companies

Under existing Insurance Department Regulation 143, life insurers are permitted to provide accelerated death benefits to policyholders. Notwithstanding this Regulation, many insurers have chosen not to offer this benefit. Many consumers who are unable to receive accelerated benefits from their insurers often turn to "viatical settlement companies", which pay a policyholder compensation in return for having the policy's death benefit assigned

to it. Until recently, viatical settlement companies have been unregulated. To prevent the possibility of such companies taking undue advantage of consumers who suffer catastrophic or life-threatening conditions, Chapter 638 of the Laws of 1993, effective August 4, 1993 (except for amendments to the Insurance Law that will be effective July 30, 1994 or earlier if the Superintendent promulgates Regulations before then), requires such companies and their brokers to be licensed by the Insurance Department. In addition to requiring viatical settlement companies to file annual financial statements and submit to Insurance Department examinations, the new law requires that such companies' settlement agreements must be in writing and must be filed with and approved by the Superintendent. Moreover, certain disclosures must be made to the policyholder, including such matters as alternatives to receiving accidental death benefits, the possible tax consequences and potential ineligibility for public assistance that might result from receiving a viatical settlement, and the right to rescind a viatical settlement within 15 days of receiving the proceeds. Finally, the law prohibits viatical settlement companies from paying a finder's fee or other compensation to a policyholder's physician, attorney, accountant or other representative and prohibits them from releasing the applicant's medical and financial information without their specific written consent.

Mandated Health Benefits

Three new mandates have been added to health insurance policies offered in New York. Chapter 378 of the Law of 1993, applicable to policies issued or renewed after January 1, 1994, provides coverage for equipment and supplies for the treatment of diabetes, including self-management education.

Chapter 380 of the Laws of 1993, effective January 1, 1994, provides coverage for nutritional supplements for individuals suffering from phenylketonuria (PKU) and related disorders.

Chapter 728 of the Laws of 1993, effective April 1, 1994 and applicable to all policies issues, renewed or amended on or after April 1, 1994, requires every policy that provides medical, major medical or similar comprehensive-type coverage to provide coverage for primary and preventive care services to the insured's dependent children from birth to age nineteen. The preventive services include an initial hospital check-up, well-

child visits at prescribed time periods and necessary immunizations. This new mandate is not subject to annual deductibles and/or co-insurance.

Pre-Existing Condition Limitations

Under the prior community rating and open enrollment law (Chapter 501 of the Laws of 1992), insurers, including HMOs, of individuals and small groups (50 or fewer members) were prevented from imposing pre-existing condition waiting periods of more than a year and were required to credit time covered under a previous policy when applying a pre-existing condition limitation if no more than 60 days elapsed between prior and present coverage. A regulation promulgated thereunder, Regulation 62, does not permit pre-existing condition limitations for groups with over 300 members (excluding dependants). However, groups with 51 to 299 members remained vulnerable.

Chapter 650 of the Laws of 1993, effective December 2, 1993, closed this loophole and affords the same protection to groups of 51 to 299 members as well. Similar provisions apply to group disability policies.

Breast Cancer Survivors

Chapter 601 of the Laws of 1992, effective January 1, 1994, prohibits insurers from refusing to issue or renew life insurance policies to individuals who have had breast cancer, provided that the initial diagnosis was at least three years before the date of application and that a physician has certified that the disease has not recurred. These prohibitions also apply to the issuance and renewal of non-cancelable disability policies.

Conversion Contracts

Chapter 677 of the Laws of 1993, effective August 4, 1993 (with certain provision applicable to contracts issued or renewed on or after September 1, 1993), updates and clarifies the law concerning "conversion contracts," which allow insured persons terminated from coverage under a group policy to obtain their own health coverage at their own cost from the group insurer. This law, *inter alia*, prohibits commercial insurers from terminating conversion coverage on insureds who are covered by or eligible for Medicare for any reason other than age, *e.g.*, disability.

Auto Insurance Consumer Protection

In order to alleviate the problem in obtaining automobile insurance coverage facing many New York drivers who do not own their own car, Chapter 422 of the Laws of 1993, effective January 17, 1994, prohibits auto insurers from refusing to issue coverage to drivers who have been licensed for at least 39 months simply because they have not owned or leased a vehicle during that period, unless the underwriting decision to refuse such coverage is based on actual or anticipated loss experience.

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Much of the material presented in this section of the article was obtained from the Legislative Update sections of the New York State Insurance Department's "The Bulletin," December 1993 and January/February 1994, written by Karen Eldred, Senior Public Information Specialist.

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