

CAVEAT SETTLOR

As we have often discussed, the "Catch-22" of underinsured motorist coverage, i.e., the difficulty created by the typical pre-Regulation 35-D underinsured motorist endorsement provisions that simultaneously required the insurer to exhaust the underlying limits of the tortfeasor's insurance policies or bonds, to obtain the underinsured motorist carrier's consent to the settlement with the tortfeasor, and to avoid prejudicing the underinsured motorist carrier's subrogation rights, has been the bane of underinsured motorist claimants and their attorneys for many years.

Happily for such individuals, their plight has been ameliorated by Regulation 35-D's "Release or Advance" provision (11 NYCRR §60-2.3(e) (Condition 10)), which effectively avoids the "Catch-22" by shifting the burden from the insured to the insurer. Under that important provision, an insured who has obtained an offer of settlement of the full available limits of coverage would advise the SUM carrier, in writing, of the potential or proposed settlement; within thirty days of such written notice, the SUM carrier would be required to either agree that the insured could settle the case and execute a release with the tortfeasor, or agree to advance the amount of the settlement to the insured in return for the insured's cooperation in a subrogation action to recover from the tortfeasor. If the 30-day period for the SUM carrier's response expires without a response forthcoming, the insured would be free to execute a release with the tortfeasor without risking the loss of SUM benefits and would then be allowed to proceed to arbitration of the SUM claim.

Despite the fact that Regulation 35-D is, by its express terms, applicable only to "every new or renewed motor vehicle liability insurance policy issued to become effective on and after October 1, 1993," several courts have effectively applied this "Catch-22" antidote in the pre-Regulation 35-D context as well.¹

Beware of Pitfalls

Several other courts have indeed gone so far as to hold, in the pre-Regulation 35-D context, that where the insured advises the underinsured motorist carrier of the tortfeasor's settlement offer, takes steps to ensure that the underinsured carrier's subrogation rights are preserved, and requests the underinsured carrier's consent to settle on several occasions, the insured satisfied the conditions precedent to arbitration because, in that

circumstance, the underinsured carrier "cannot arbitrarily withhold consent and at the same time argue that a condition precedent has not been complied with."²

Based upon the foregoing, a well-informed pre-Regulation 35-D claimant (yes, there are still pre-Regulation 35-D cases in the system) might feel fairly confident that he or she could, with a little finesse, successfully elude the pitfalls of underinsured motorist practice. While such a claimant might be correct with regard to the known pitfalls, no such guarantee could, of course, be made, however, with regard to what until recently was an unknown pitfall in this complex area -- the discontinuance of the underlying action after expiration of the statute of limitations as prejudice to an otherwise protected subrogation right.

The interesting case of *Prudential Prop. & Cas. Ins. Co. v. Bacchus*, __ AD2d __, 640 NYS2d 237 (2d Dept. 1996), in which our firm represented the carrier, only recently brought that pitfall to the forefront.

The case had all the earmarks of a typical pre-Regulation 35-D underinsured motorist proceeding: the claimant was injured in a motor vehicle accident on September 26, 1990; the tortfeasor had the then-minimum bodily injury liability coverage of \$10,000/\$20,000 and the claimant had bodily injury (and uninsured/underinsured motorist) coverage of \$100,000/\$300,000; the claimant received an offer of the full amount of the tortfeasor's coverage and then demanded arbitration of her underinsured motorist claim; and the underinsured motorist carrier petitioned for a stay of the arbitration upon numerous grounds.

In its Petition, Prudential noted the existence of the three "Catch-22" provisions and contended that Bacchus was not entitled to proceed to arbitration because, *inter alia*, (1) there was no proof that the tortfeasor's coverage was actually limited to \$10,000/\$20,000 and that he did not have an applicable excess policy; (2) there was no proof that she actually exhausted the underlying limits of tortfeasor's policy by the payment of a judgment or settlement; and (3) she did not obtain Prudential's consent to any settlement, which consent was withheld if it meant settlement via a general release because Prudential intended to pursue its subrogation right against the tortfeasor.

Bacchus (1) submitted proof that the tortfeasor had no excess or umbrella coverage; (2) submitted proof that the \$10,000 limits of the tortfeasor's policy were, in fact, paid; and (3) argued that she was not required to obtain Prudential's consent to the settlement

because in making the settlement she "preserved and protected" Prudential's subrogation rights. In support of this last contention, she attached a copy of a "conditional release and closing papers."

This release contained the following pertinent language:

"It is respectfully understood that an underinsured claim has been made by RELEASOR against its underinsured carrier, PRUDENTIAL INSURANCE COMPANY, Policy #183A476690, and that said insurance carrier will reserve its right for subrogation against RELEASEE for those sums paid to RELEASOR under the underinsured motorist coverage and this Release is specifically so conditioned."

The release was dated July 13, 1994.

Subrogation Rights

In its Reply papers, Prudential noted that while Bacchus had established that she had exhausted the underlying insurance policy limits of the tortfeasor, she did not, contrary to her assertion, demonstrate the dispositive points that she either obtained Prudential's written consent to the settlement or that she actually "preserved and protected" its subrogation rights. Critically, Prudential noted that while Bacchus may, in fact, effectively have preserved Prudential's subrogation rights at the time she issued the conditional release on July 13, 1994, by simultaneously discontinuing the action more than three years after it accrued, she, unfortunately, had already allowed any and all of such subrogation rights to lapse and be forever barred by the running of the applicable statute of limitations.

Insofar as the accident took place on September 26, 1990, the statute of limitations expired on September 26, 1993.³

Thus, Prudential argued that the release and discontinuance of July 13, 1994 -- after the expiration of the statute of limitations -- was, therefore, "ineffective to preserve previously expired rights and (Bacchus') alleged preservation of those rights was illusory."

Justice Ralph Yachnin of the Supreme Court, Nassau County (now retired) ruled in favor of Prudential and granted the Petition, holding that because the settlement was made after the statute of limitations had run, the insurer's rights were prejudiced notwithstanding the qualifying language in the release. Justice Yachnin specifically noted that the release did not include a waiver of the tortfeasor's statute of limitation defense. Bacchus appealed to the Second Department.

On appeal, Bacchus took the rather unique position that "Any right to subrogation that (Prudential) may have had against the tortfeasor was, by operation of law, already barred by the Statute of Limitations at the time (Bacchus) executed the conditional release. The Statute of Limitations ran by operation of law and not by any act or omission by (Bacchus)," and, therefore, Prudential was not prejudiced by Bacchus's settlement with the tortfeasors.

In response, Prudential noted, inter alia, that Bacchus' creative argument to the contrary, it was clear that, in fact, the expiration of the statute of limitation on Prudential's subrogation claim did result from an act or omission on Bacchus' part -- the formal discontinuance of the action (in its entirety) after the statute had expired. If, as Bacchus contended, the conditional release she executed on July 13, 1994 effectively preserved Prudential's subrogation rights, whatever rights may have been salvaged thereby were then promptly defeated and destroyed by her issuance of the Stipulation of Discontinuance the very same day.

Once the action was voluntarily discontinued after the expiration of the statute of limitations, it could not legally be recommenced. Bacchus was in a position to guard against the running of the statute of limitations and to maintain the viability of any action that had been timely commenced in order to ensure that Prudential's subrogation right would not be defeated or rendered worthless.

The Second Department affirmed Justice Yachnin's grant of Prudential's Petition to Stay Arbitration on April 1, 1996. As stated by the Court: "It is undisputed that the appellant failed to obtain the petitioner's written consent, as required by the policy, before settling with a party who may have been liable for her injuries. Since the settlement and release were executed more than three years after the date of the accident, the petitioner's subrogation claim was time-barred, as the applicable three-year limitations period commenced on the date of the accident (see, Nationwide Mut. Ins. Co. v. Motor Vehicle Acc. Indem. Corp., 190 AD2d 798, 593 NYS2d 561). Notably, the burden is on the insured to establish by `virtue of an express limitation in the release or of a necessary implication arising from the circumstances of its execution that the release did not operate to prejudice the subrogation rights of the insurer' (Weinberg v. Transamerica Ins. Co., 62 NY2d 379, 382-383, 477 NYS2d 99, 465 NE2d 819). Here, the appellant failed to carry her burden

of demonstrating that the absence of written consent did not prejudice the petitioner. Accordingly, the court properly granted the petitioner's motion to stay arbitration (citations omitted)."

Once again, claimants who are not aided by Regulation 35-D's provisions are, therefore, clearly warned to tread carefully, lest they fall into yet another trap in this dangerously tricky area of the law. Caveat settlor -- let the settler beware!

ENDNOTES

1. See Tri-State Consumer Ins. Co. v. Hundley, NYLJ, March 2, 1993, p. 33, col. 2 (Sup. Ct. Nassau Co.), affd. 208 AD2d 754, 618 NYS2d 41 (2d Dept. 1994); Allstate Ins. Co. v. Sullivan, ___ AD2d ___, ___ NYS2d ___ (2d Dept. 1996) (NYLJ, August 9, 1996, p. 28, col. 2); Poole v. State Farm Auto Ins. Co., 164 Misc.2d 697, 625 NYS2d 399 (Sup. Ct. Wayne Co. 1994); Allstate Ins. Co. v. Sompolinski, NYLJ, December 23, 1994, p. 33, col. 5 (Sup. Ct. Nassau Co.); Zurich Ins. Co. v. Wilburn, NYLJ, April 8, 1993, p. 26, col. 5 (Sup. Ct. Nassau Co.); Huth v. Nationwide Ins. Co., 148 Misc.2d 1003, 560 NYS2d 724 (Sup. Ct. Suffolk Co.).

See also Dachs, N. and Dachs, J., "Regulation 35-D: Prospective or Retroactive?," NYLJ, January 10, 1995, p. 3, col. 1.

The highest courts in several other states have made similar rulings. See Lambert v. State Farm Mut. Ins. Co., 576 So.2d 160 (Ala. 1991); Buzzard v. Farmers Ins. Co., 824 P.2d 1105 (Okla. 1991); McDonald v. Republic Franklin Ins. Co., 45 Ohio St. 3d 27 (Ohio 1989); MacInnis v. Aetna Life & Cas. Co., 403 Mass. 220 (Mass. 1988); Schmidt v. Clothier, 378 Minn.2d 256 (Minn. 1983); Hamilton v. Farmers Ins. Co., 107 Wash.2d 721 (Wash. 1987); Vogt v. Schroeder, 383 NW2d 879 (Wis. 1986).

2. See Prudential Prop. & Cas. Ins. Co. v. King, 198 AD2d 421, 604 NYS2d 136 (2d Dept. 1993); Dwyer v. G.A. Ins. Co., NYLJ, June 3, 1996, p. 29, col. 3 (Sup. Ct. N.Y. Co.); Prudential Prop. & Cas. Ins. Co. v. Dixon, 161 Misc.2d 87, 612 NYS2d 813 (Sup. Ct. Nassau Co.). See also Allstate Ins. Co. v. Sullivan, ___ AD2d ___, ___ NYS2d ___ (2d Dept. 1996) (NYLJ, August 9, 1996, p. 28, col. 2).
3. See Nationwide Mutual Ins. Co. v. MVAIC, 190 AD2d 798, 593 NYS2d 561 (2d Dept. 1993).