

De Novo's Demise and Exceptions to Stolarz

In our last column (NYLJ, January 10, 1995, p. 3, col 1), we touched upon two of the most significant aspects of Regulation 35-D, the State of New York Insurance Department's "new" regulation governing supplemental uninsured motorist coverage for policies issued or renewed on or after October 1, 1993 -- the elimination of the right to de novo review of arbitration awards and the reinstatement of the reduction-in-coverage/offset provision -- in the context of whether or not the regulation's provisions are to be applied retroactively. Assuming, notwithstanding some of the judicial language quoted in that column, that the regulation is to be applied prospectively only, and assuming that many pre-Regulation 35-D cases are still "in the system," we focus this month on the pre-regulation state of the law with regard to de novo review and the viability of the reduction-in-coverage clauses.

As will be seen, the question of whether a provision for de novo review is valid and enforceable may have different answers depending upon where the matter is litigated. The question of whether a reduction-in-coverage provision is valid and enforceable, previously believed to have been settled by the Court of Appeals' decision in *Allstate Ins. Co. v. Stolarz*,¹ may be subject to a newly carved exception to the *Stolarz* rule.

De Novo Review

Pursuant to the terms of many, if not most (but not all), pre-Regulation 35-D supplementary uninsured or underinsured motorist endorsements, a party aggrieved by an arbitration award may seek a trial de novo in court.² The typical pre-Regulation 35-D de novo trial provision provides that if the amount awarded by the arbitrator exceeds the minimum statutorily mandated limits of insurance (i.e., \$10,000 per person/\$20,000 per accident; \$50,000 per death/\$100,000 for more than one death), either party may demand the right to trial. Most such policies do not make any distinction between that portion of the award that is within the basic mandatory policy limits and that portion which exceeds those limits, and subject the entire award to de novo judicial review. Under some policies, however, that portion of the award that is within the basic mandatory limits is binding. In

any event, it is well-established that the court in a de novo trial could reexamine only the amount of damages, not the issue of liability.³

Where it is applicable, the right to de novo review could be exercised by either party. Accordingly, it could be used to attempt to either increase or decrease the arbitration award. Pursuant to most policies, a demand for trial de novo must be made within sixty days of the award, or the amount of damages becomes binding.⁴

Waiver

The right to trial de novo can be waived. Several courts have held that a party waives its right to trial de novo by consenting or failing to object to arbitration by a single arbitrator under the rules of the American Arbitration Association where the policy instead provides for arbitration by a panel of three arbitrators. In *Liberty Mutual Ins. Co. v. Lodha*,⁵ the Supreme Court, Queens County held that "by voluntarily participating in a form of binding arbitration pursuant to AAA rules, petitioner waived its right to claim that the arbitration was nonbinding," and thus waived its right to a trial de novo. Similarly, in *General Accident Ins. Co. v. Giacomazzo*,⁶ the First Department agreed with the Supreme Court, New York County that petitioner waived its contractual right to a trial de novo of respondent's underinsured motorist claim in the event of an award exceeding \$10,000 "by acquiescing in the appointment of one arbitrator, as called for by the rules of the arbitral forum designated in respondent's demand for arbitration, instead of three arbitrators, as called for in the policy, and by otherwise failing to advise the forum that the dispute was to be arbitrated in accordance with the policy and not the rules of the forum prescribed for binding arbitration." And, more recently, in *Eckart v. Aetna Cas. & Sur. Co.*,⁷ the Second Department held that the insurer waived its right to a trial de novo by proceeding with arbitration in accordance with AAA rules, rather than in accordance with the policy provisions.

Abandonment

Even a properly and timely demanded de novo action may be abandoned. In *Gersten v. American Transit Ins. Co.*,⁸ the Supreme Court, New York County addressed,

as a matter of first impression, the question of the effect of the commencement and abandonment of a de novo judicial review by an insurer on the underlying arbitration award (there, a no-fault arbitration award). Although the insurer timely sought to exercise its right to adjudicate the dispute de novo after the Master Arbitrator confirmed the award in the insured's favor, and commenced an action against the insured by serving him with a Summons and Complaint, it subsequently failed to prosecute the action. After an order was entered dismissing the action for lack of prosecution, the insured commenced a proceeding to confirm the Master Arbitrator's award.

In opposition to the insured's petition, American Transit argued that "by definition, the effect of a de novo action is to eliminate the arbitration award -- [it] ceases to exist." While agreeing that this assertion had "some merit," particularly in cases where the action "is commenced in good faith and prosecuted to its conclusion," the court went on to conclude that "from this flows the presumption that commencing a de novo action eliminates the underlying award because the parties are in essence starting anew and a superseding resolution will result. If a judgment on the merits does result, the arbitration award is eliminated and the judgment replaces the award. Since the de novo action here did not result in a judgment which replaces the arbitration award, however, the award is revived. American Transit's entitlement to plenary judicial determination of the dispute is clear. However, to avail itself of this right, and the benefit of eliminating the arbitration award that it considered unfavorable, American Transit was required to prosecute the action to judgment or, in the alternative, to reach a settlement with Gersten."

Validity and Enforceability

The courts appear to be split on the issue of the validity and enforceability of de novo review provisions. Several lower court decisions have criticized typical de novo trial provisions and, in fact, have challenged their validity on public policy grounds. Relying upon judicial precedents from other states,⁹ these courts have expressed negativity on what they perceive as attempts to obtain "the proverbial second bite of the apple," which unfairly favor insurers.¹⁰ For example, in *Hanover Ins. Co. v. Losquadro*,¹¹ the Supreme Court, New York County agreed with the insured's contention that the provision for a trial

de novo was unenforceable as against public policy in that it unfairly favors insurers because under the terms of the subject endorsements the insured was bound by an award that did not exceed \$10,000, whereas an award in excess of that amount was non-binding. As stated by Justice Lehner, "the trial de novo provision at issue cannot be said to be in harmony with the goal of providing arbitration as an `expeditious and inexpensive forum' for the resolution of disputes between insureds and insurers." Justice Lehner further concluded that the "escape hatch" which allows the insurer to relitigate a high damage award was "unconscionable" because it "unfairly discriminates against insureds," and, therefore, "may not be enforced." In *Amica Mutual Ins. Co. v. Stone*,¹² Justice Freedman of the Supreme Court, New York County adopted the opinion of Justice Lehner in *Losquadro, supra*.

On the other hand, in *Allstate Ins. Co. v. Purdy*,¹³ Justice Miller of the Supreme Court, Orange County rejected the insured's contention that the de novo provision was unconscionable and against public policy. As stated by the court, "At the time the parties entered in to the insurance contract, such a provision was not prohibited by the regulations of the Insurance Department, the right to demand a trial was recognized in case law [citations omitted] and, as noted in *Hanover Insurance Company v. Losquadro*, was a fairly standard provision in policies issued throughout the country. While case law in other jurisdictions may have found the subject provision against public policy, no appellate New York court has yet embraced that portion. Measured against the mores and business practices of the time, the provision is neither unreasonable or unconscionable. Indeed, it offers an insured, as well as an insurer, an opportunity to litigate an arbitration award over \$10,000, either on grounds of inadequacy in the case of the insured, or excessiveness in the case of the insurer." In *Allstate Ins. Co. v. Masie*,¹⁴ Justice Winick of the Supreme Court, Nassau County agreed with Justice Miller in *Purdy, supra*, and held that "The insurance policy provision is not so grossly unreasonable or unconscionable in light of the mores and business practices of that time and place so as to render the provision unenforceable."

Appellate Division Cases

The most recent and perhaps most important pronouncement on the subject of the validity and enforceability of de novo review provisions -- insofar as it is only New York appellate level decision on this subject -- comes from the Second Department in *Allstate Ins. Co. v. Jacobs*.¹⁵ In that case, the court stated that the de novo provision was "consistent with the Insurance Law and relevant public policy, as is evidenced in part by the New York State Superintendent of Insurance's approval of the policy provision (see, e.g., *Reichel v. GEICO*, 107 AD2d 463)." Moreover, the court found that the de novo provision was "not unconscionable" because, in essence, it "does not necessarily benefit only the insurance carrier."

Thus, the law in the Second Department is now clear that de novo provisions are valid and enforceable. The law in the First Department, where the Appellate Division has not yet spoken, appears to be contrary. However, it must be remembered that "The Appellate Division is a single statewide court divided into departments or administrative convenience" and, therefore, the doctrine of stare decisis requires trial courts in one department to follow precedents set by the Appellate Division of another department until the Court of Appeals or an appellate court in that department pronounces a contrary rule.¹⁶

Regulation 35-D

Finally, as our readers should be aware by now, Regulation 35-D and its new SUM endorsement has completely eliminated the trial de novo provision. Thus, for cases under the new regulation, de novo is de-funct.

Reduction-in-Coverage/Offset Provisions

Prior to Regulation 35-D, supplementary uninsured or underinsured motorist endorsements typically provided that the stated policy limits shall be reduced by "all sums paid by or on behalf of persons or organizations who may be legally responsible." In *United Community Ins. Co. v. Mucatel*,¹⁷ the Court of Appeals affirmed and adopted the reasoning of Justice Gammerman of the Supreme Court, New York County to the effect that such a reduction-in-coverage clause, which reduces the maximum coverage available by the amount recovered from a third-party insurer, was misleading and created an

ambiguity in the policy as to the amount of coverage provided and, therefore, was not to be given effect. The court reasoned that since, by definition, underinsured motorist coverage presupposes that the offending vehicle has liability insurance coverages for at least the minimal amount of coverage required by law, *i.e.*, \$10,000, if an underinsurance policy contains a reduction-in-coverage or offset clause, the underinsured motorist carrier will never have to pay the amount indicated on the policy declaration. The court further noted that "[T]o clarify the policy and render it internally consistent, the reduction clause must be excluded from the policy or the dollar amounts must be changed to reflect the reality of the company's intention."

The holding of *Mucatel*, which effectively invalidated reduction-in-coverage clauses, was followed in numerous appellate level decisions,¹⁸ although some lower court decisions continued to apply the offset on the rationale that the particular policy provisions at issue were distinguishable from that which appeared in *Mucatel* and, for various reasons, were not ambiguous or misleading.¹⁹

Grandstaff

The Third Department expanded upon the *Mucatel* analysis in *CNA Insurance Co. v. Grandstaff*,²⁰ and held that not only was the reduction-in-coverage provision misleading and ambiguous because the insurer in the underinsurance context would never pay the amount on the declaration sheet, it was misleading and ambiguous as well because the declaration sheet did not inform the policyholder of the deductible created by the reduction-in-coverage clause.

Stolarz

It was against this backdrop that the Court of Appeals decided *Allstate Ins. Co. v. Stolarz*.²¹ In *Stolarz*, the court examined a reduction-in-coverage clause in a policy that was written with a single combined limit for uninsured and underinsured motorist coverage, *i.e.*, "un/underinsurance." In holding that the offset in such a case was valid, the court stated that the distinction between a policy that only contained underinsurance coverage and one which contained both uninsured and underinsurance coverage was "critical."

Mucatel's rationale, that the policy's stated limit would never be paid in full does not apply in the latter context because there are circumstances, i.e., when the claim involves an uninsured motorist, where the stated limit would, in fact, be fully paid. Accordingly, the un/underinsurance situation does not present a similar deception to that identified in Mucatel. The court rejected the argument that offsets against underinsured motorist coverage are invariably void under Mucatel and stated, "There is nothing inherently objectionable about offsets against the limits of an insurance policy -- indeed they are common. In Mucatel we concluded that the policy was misleading because the insurer would not `ever pay the amount indicated on the policy declaration' . . . and where that is the case Mucatel of course controls, but that situation is not present here." In addition, the court recognized that the New York Superintendent of Insurance promulgated Regulation 35-D, which permitted single limit un/underinsurance coverage and required offsets for amounts recovered from third-party carriers. Notwithstanding the fact that the regulation was not applicable to the case before it, the court found it to be "persuasive" in showing that reduction-in-coverage clauses relating to combined uninsured and underinsured motorist coverage limits are not misleading.

Post-Stolarz Cases

Stolarz appeared conclusively to settle the reduction-in-coverage issue -- the clauses were valid in policies with combined un/underinsurance coverage and invalid in policies with only underinsurance coverage. However, after Stolarz, the Second Department, in Nationwide Mutual Ins. Co. v. Davis,²² rejected a reduction-in-coverage clause in a single limit un/underinsurance policy. Citing, inter alia, CNA v. Grandstaff, supra, the court reasoned that the policy was misleading because the declaration page did not indicate that the payment of underinsured motorist benefits would be subject to a reduction, notwithstanding the fact that it did indicate a similar reduction for collision and comprehensive coverages. The court further found the policy misleading to the extent that it purported to reduce the underinsurance coverage so as to spare the carrier from ever having to pay the coverage limit.

Interestingly, *Davis* did not refer to *Stolarz*. Nationwide's motion to reargue on the basis of *Stolarz* was denied, as was leave to appeal to the Court of Appeals.²³

Several months later, in *Nationwide Mutual Ins. Co. v. Corizzo*,²⁴ the Second Department, citing, *inter alia*, both *Davis* and *Grandstaff*, again held that a reduction-in-coverage clause was invalid where the declaration sheet did not indicate that the payment of underinsured motorist benefits would be subject to a reduction, as it did for collision coverage and where the policy purported to reduce underinsurance coverage "so as to spare the carrier from ever having to pay the coverage limit."

In the more recent cases of *Nationwide Mutual Ins. Co. v. Baraket*,²⁵ and *Nationwide Ins. Co. v. Damaskinos*,²⁶ both courts held that the decisions in *Davis*, *Corizzo* and *Grandstaff* remain viable notwithstanding *Stolarz*, in light of Regulation 35-D, which requires that the declaration page of policies issued or renewed after October 1, 1993 contain language warning the insured of the coverage reduction created by an offset provision.²⁷ Even where, as in those prior cases, the policies were not subject to Regulation 35-D insofar as they were issued prior to its effective date, both courts recognized that the regulation is, as the Court of Appeals noted in *Stolarz*, "persuasive."

Exception to Stolarz

It is, therefore, now apparent that an exception to *Stolarz* may exist. Neither *Stolarz* nor *Mucatel* expressly considered the additional inconsistency and ambiguity contained in the declaration sheets of the policies identified and described by the *Grandstaff*, *Davis* and *Corizzo* courts. The applicability of *Stolarz* to a particular case is, therefore, not the end of the inquiry. The declaration sheet must be carefully examined. Where, as in those cases, the declaration sheet notes a reduction-in-coverage pertaining to collision and/or comprehensive coverage, but does not similarly provide for underinsured motorist coverage, the reduction-in-coverage provision will be deemed void notwithstanding *Stolarz*.

Regulation 35-D

Finally, it must again be noted that Regulation 35-D and its new standard SUM endorsements specifically requires a reduction-in-coverage for amounts recovered from the underinsured tortfeasor. Regulation 35-D also eliminates the declaration sheet ambiguity problem by requiring all post-October 1, 1993 declaration sheets specifically to state thereon that "the maximum amount payable under SUM coverage shall be the policy's SUM limits reduced and thus offset by motor vehicle bodily injury liability insurance or bond payments received from, or on behalf of, any negligent party involved in the accident, as specified in the SUM endorsement."²⁸

1. 81 NY2d 219, 597 NYS2d 904 (1993).
2. See Commercial Union Ins. Co. v. Ewall, 168 AD2d 247, 562 NYS2d 484 (1st Dept. 1990). See also Reichel v. GEICO, 66 NY2d 1000, 499 NYS2d 385 (1985).
3. See Lassitter v. CNA Ins. Co., 195 AD2d 362, 600 NYS2d 59 (1st Dept. 1993).
4. See Nationwide Mut. Ins. Co. v. Riccarduli, NOR, NYLJ, February 18, 1994, p. 36, col. 2 (Sup. Ct. Westchester Co.) (discussing the 60-day period in the context of the new commencement by filing rule -- CPLR 304).
5. 131 Misc.2d 670, 500 NYS2d 989 (Sup. Ct. Queens Co. 1986).
6. NOR, NYLJ, February 16, 1993, p. 26, col. 2 (Sup. Ct. N.Y. Co.), affd. 204 AD2d 236, 612 NYS2d 43 (1st Dept. 1994).
7. ___ AD2d ___, 616 NYS2d 789 (2d Dept. 1994). But see Commercial Union Ins. Co. v. Bratt, NOR, NYLJ, May 6, 1993, p. 35, col. 2 (Sup. Ct. Nassau Co.), and Royal Ins. Co. v. Innes, NOR, Sup. Ct. Suffolk Co., September 19, 1989 (Mem. Dec., Dunn, J.).
8. 161 Misc.2d 57, 613 NYS2d 555 (Sup. Ct. N.Y. Co. 1994).
9. See e.g., Schmidt v. Midwest Family Mut. Ins. Co., 426 NW2d 870 (Minn. 1988); Mendes v. Automobile Ins. Co., 212 Conn. 52, 563 A.2d 695 (1989); Pepin v. American Univ. Ins. Co., 540 A.2d 21 (R.I. 1988); Worldwide Ins. Group v. Klopp, 603 A.2d 788 (Del. 1992); Schaeffer v. Allstate Ins. Co., 653 Ohio St. 3d 708, 590 NE2d 1242 (1992); O'Neill v. Berkshire Mut. Ins. Co., 786 F.Supp. 397 (D.Vt. 1992); Field v. Liberty Mut. Ins. Co., 769 F.Supp. 1135 (D.Hawaii 1991).
10. Bratt v. Commercial Union Ins. Co., NOR, NYLJ, August 11, 1992, p. 25, col. 1 (Sup. Ct. Nassau Co.).
11. 159 Misc.2d 1014, 600 NYS2d 419 (Sup. Ct. N.Y. Co. 1993).
12. NOR, NYLJ, October 27, 1994, p. 28, col. 6 (Sup. Ct. N.Y. Co.).
13. 159 Misc.2d 783, 606 NYS2d 535 (Sup. Ct. Orange Co. 1994).
14. NOR, NYLJ, July 28, 1994, p. 26, col. 4 (Sup. Ct. Nassau Co.).
15. ___ AD2d ___, 617 NYS2d 360 (2d Dept. 1994).
16. Mountain View Coach Lines, Inc. v. Storms, 102 AD2d 663 (2d Dept. 1984).
17. 127 Misc.2d 1045 (Sup. Ct. N.Y. Co. 1985), affd. 119 AD2d 1017 (1st Dept. 1986), affd. for the reasons stated at Special Term, 69 NY2d 777 (1987).
18. See e.g., Maurizzio v. Lumbermen's Mut. Cas. Co., 73 NY2d 951, 540 NYS2d 982 (1989); Brentnall v. Nationwide Mut. Ins. Co., 194 AD2d 537, 598 NYS2d 315 (2d Dept. 1993); Federal Ins. Co. v. Rheingold, 181 AD2d 769, 581 NYS2d 249 (2d Dept. 1992); LaPar v. Nationwide Mut. Ins. Co., 177 AD2d 983, 579 NYS2d 919 (4th Dept. 1992); Berger v. Public Serv. Mut. Ins. Co., 177 AD2d 280; 576 NYS2d 16 (1st Dept. 1991); Liberty Mutual Ins. Co. v. Balaran, 163 AD2d 314, 557 NYS2d 159 (2d Dept. 1990).
19. See e.g., Santillo v. Indemnity Ins. Co. of N. Am., NOR, NYLJ, May 5, 1988, p. 12, col. 4 (Sup. Ct. Nassau Co.); Nationwide Mut. Ins. Co. v. Himmel, NOR, No. 1102/89 (Sup. Ct. Nassau Co.); Gates v. Nationwide Ins. Co., NOR, No. 89-5490 (Sup. Ct. Onondaga Co.); Nationwide Mut. Ins. Co. v. Aprile, NOR, No. 26530/90 (Sup. Ct. Nassau Co.); Nationwide Mut. Ins. Co. v. Lewkowitz, NOR, No. 8933/90 (Sup. Ct. Nassau Co.).
20. 188 AD2d 965, 591 NYS2d 900 (3d Dept. 1993).

21. 81 NY2d 219, 597 NYS2d 904 (1993).
22. 195 AD2d 561, 600 NYS2d 482 (2d Dept. 1993).
23. 82 NY2d 664, 610 NYS2d 152 (1994).
24. 200 AD2d 621, 606 NYS2d 719 (2d Dept. 1994).
25. NOR, NYLJ, November 17, 1994, p. 33, col. 5 (Sup. Ct. Westchester Co.).
26. NOR, NYLJ, January 6, 1995, p. 29, col. 2 (Sup. Ct. Nassau Co.).
27. See 11 NYCRR §60-2.3[a][1], [2].
28. See 11 NYCRR §60-2.3(a).

{ET