

SUM COVERAGE AND EXCESS/UMBRELLA POLICIES

In our last column (NYLJ 7/25/94, p. 3, col. 1), we discussed two of the more interesting, significant and recently litigated questions of law that arise in the context of underinsured motorist or SUM coverage -- the treatment of combined single-limit policies in the context of the "trigger" comparison, and the treatment of multiple tortfeasors in the context of the "exhaustion" requirement. This month, we examine two other recently litigated questions of law, dealing with excess or umbrella policies, that we believe are equally interesting and significant -- the treatment of excess and umbrella policies in the context of the "trigger" comparison, and whether such policies themselves can and do afford underinsurance coverage. We also address the issue of the "obligation of good faith" that is read into contracts, including uninsured/underinsured motorist policies, and how that obligation has been construed in the context of the condition precedent of obtaining the underinsured motor carrier's written consent to settle the underlying claim under most pre-Regulation 35-D endorsements. Finally, we bring to your attention a new statute dealing with "gap insurance."

Excess/Umbrella Policies in The Trigger Comparison

As the Court of Appeals most recently reiterated in *Prudential Prop. & Cas. Ins. Co. v. Szeli*, 83 NY2d 681, 613 NYS2d 113 (1994), in determining whether, in fact, a claimant's underinsured motorist coverage is "triggered", i.e., applicable and effective, in accordance with the terms of Ins. L. 3420(f)(2), the proper comparison is between the claimant's bodily injury coverage and the tortfeasor's bodily injury coverage. The very same trigger comparison is incorporated in Regulation 35-D (see 11 NYCRR §60-2.3(e)(l)(c)(3)(i)). One question that naturally arises in the context of this trigger comparison is the effect, if any, an applicable excess or umbrella policy may have in determining whether a tortfeasor is, definitionally, underinsured, thus giving rise to an underinsured motorist or SUM claim. For example, is underinsured motorist or SUM coverage triggered if the claimant/insured has a \$300,000 bodily injury liability policy and a \$1,000,000 excess or umbrella policy, when the defendant/tortfeasor has a \$500,000 bodily injury liability policy? Conversely, if the claimant/insured has a \$500,000 bodily injury liability policy and the defendant/tortfeasor

has a \$300,000 bodily injury liability policy and a \$1,000,000 excess or umbrella policy, is the underinsured motorist or SUM coverage triggered? As usual, the answer lies in a careful examination and analysis of the language of the statute, and of the specific insurance policies based thereon.

Insurance Law §3420(f)(2) provides, in pertinent part, that supplementary uninsured motorist coverage is available "if the limits of liability under all bodily injury liability bonds and insurance policies of another motor vehicle liable for damages are in a lesser amount than the bodily injury liability insurance limits of coverage provided by such policy" (emphasis added) -- "such policy" being the claimant's liability policy to which the supplementary uninsured motorist endorsement is attached. Similarly, Regulation 35-D's new SUM endorsement defines an "uninsured motor vehicle" to include one where "the bodily injury liability insurance coverage or bond applicable to such motor vehicle . . . is less than the third party bodily injury limits of this policy" (emphasis added) -- "this policy" again referring to the liability policy to which the claimant's SUM policy is attached (Regulation 35-D, supra). The singular references to "such policy" and "this policy" with regard to the claimant/insured suggests quite clearly that only the policy limits of his or her automobile bodily injury liability policy, and none other, should be considered for purposes of the trigger comparison. Indeed, many courts have so held.

For example, in *Federal Ins. Co. v. Reingold*, 181 AD2d 769, 581 NYS2d 249 (2d Dept. 1992), the court stated that "Neither the case law nor the applicable statute . . . authorizes an injured party to combine her liability coverage from several policies, to determine whether or not the underinsurance benefits of one of the individual policies is triggered. . . ." Similarly, in *Astuto v. State Farm Mut. Auto. Ins. Co.*, 198 AD2d 503, 604 NYS2d 200 (2d Dept. 1993), the court held that "The petitioner's attempt to base his claim on a consideration of the existence of an umbrella policy issued by a different insurer by which he was also covered is precluded by the pertinent provision of the policy on which he had made his claim. Most recently, in *State Farm Mut. Auto. Ins. Co. v. Roth*, __ AD2d __, 613 NYS2d 713 (2d Dept. 1994), the court stated that "Neither the case law nor the applicable statute . . . authorizes an injured party to combine its liability coverage from several policies, to determine whether or not underinsurance benefits of one of the policies is triggered. . . ."

On the other hand, the broader, plural, references in the statute and the endorsement to "all bodily injury liability bonds and insurance policies" and "the bodily injury coverage" with regard to the defendant/tortfeasor suggest equally clearly that his or her applicable limits for purposes of the trigger comparison may be expanded to include the limits of any applicable bodily injury policies, as well as any excess or umbrella policies covering the defendant/tortfeasor. We should point out, however, that, although this logic appears to be unimpeachable, we have not found any case to date that has specifically ruled on the applicability of excess or umbrella policies on the defendant/tortfeasor's side of the trigger comparison.

Assuming, arguendo, that our analysis is correct, the questions we raised at the outset, regarding the triggering of underinsured motorist or SUM coverage, would both be answered in the negative. That is to say, underinsured motorist or SUM coverage would neither be triggered where the claimant/insured has a \$300,000 bodily injury liability policy and a \$1,000,000 excess or umbrella policy, but the tortfeasor has a \$500,000 bodily injury liability policy, nor where the claimant/insured has a \$500,000 bodily injury liability policy and the defendant/tortfeasor has a \$300,000 bodily injury liability policy and a \$1,000,000 excess or umbrella policy.

Excess/Umbrella Policies and SUM Coverage

The involvement of some excess or umbrella policies in the context of SUM coverage is sometimes substantially more direct -- the policies themselves may contain their own additional limits of uninsured and/or underinsured motorist coverage.

Of course, whether an excess or umbrella policy provides uninsured or underinsured motorist coverage depends upon the specific language of the policy.

In Connolly v. St. Paul Fire & Marine Ins. Co., 198 AD2d 652, 603 NYS2d 611 (3d Dept. 1993), the claimant argued that his umbrella policy, entitled "Personal Injury Catastrophe Policy," afforded underinsured motorist coverage because of an alleged ambiguity in the policy, which specifically excluded coverage for "uninsured motorist" claims, but did not refer to "underinsured motorist" claims. The Third Department rejected that claim because the policy at issue was clearly and unambiguously a third-party liability policy, governing claims made against the insured ("this is a liability policy -- [i]t covers only

someone else's claim against you") not a first-party policy applicable to a claim made by the insured, such as an uninsured or underinsured motorist claim would be.

Of course, although the umbrella policy in Connolly did not afford underinsurance coverage, other excess or umbrella policies may contain language providing this extra protection. Consequently, as always, it is critical to READ THE POLICY!

Good Faith and the Consent to Settle Requirement

It is, or should, by now, be well known, that the mandatory uninsured motorist endorsement provides that coverage is inapplicable if the insured or other person entitled to payment under the endorsement "shall without written consent of the company, make any settlement with . . . any person or organization who may be legally liable" for the damages claimed. Prior to the enactment of Regulation 35-D, many underinsured motorist endorsements contained similar provisions, for example, a provision that the insured "may not settle with anyone responsible for the accident without [the insurer's] written consent." Regulation 35-D's new SUM endorsement also contains such a provision, stating that "an insured shall not otherwise settle with any negligent party, without our written consent, such that our rights would be impaired." 11 NYCRR §6-2.3(e), Condition 10.

The purpose of all of these provisions is to prevent the claimant from prejudicing any rights of subrogation against the tortfeasor that the uninsured or underinsured motorist carrier may possess -- subrogation rights which are, themselves, expressly provided for in the various endorsements, both pre- and post-Regulation 35-D. Indeed, it is the simultaneous workings of the consent to settle clause, the protection of subrogation rights clause and the exhaustion of coverage clause that has been responsible for the much-complained of and oft-written about "Catch-22" of underinsured motorist coverage (See Dachs, N. and Dachs, J., "A Call for Legislative Action", NYLJ 8/14/90, p. 3, col. 1; "Lopez Revisited", NYLJ 11/13/90, p. 3, col. 1; "The Underinsured Motorist", NYLJ 12/11/90, p. 3, col. 1; "The Catch in Underinsured Motorist Coverage", NYLJ 6/11/91, p. 3, col. 1), which has effectively been eliminated by the "Release or Advance" provision of Regulation 35-D (Condition 10).

It is well-established that "in every contract there is implied a requirement of good faith," and this requirement is certainly applicable to insurance contracts. Scheffler v.

Livestock & Casualty Ins. Co., 44 AD2d 811; 355 NYS2d 608, 609 (1st Dept. 1974); Aetna Cas. & Sur. Co. v. Crown, 181 AD2d 883, 581 NYS2d 418, 419 (2d Dept. 1992).

Under the pre-Regulation 35-D policies, while it reasonably may be assumed that the underinsured motorist carrier could not unreasonably, unjustly and/or in bad faith, withhold its consent to a settlement with the underlying tortfeasor when the claimant has obtained a policy limits offer, the right of the carrier to withhold its consent absent protection of its subrogation rights was clearly and consistently recognized and enforced by the courts. In most situations, where the carrier could demonstrate even the possibility or hope of a valid subrogation claim, the refusal to consent to an unrestricted settlement was not considered a "lack of good faith" or "bad faith."

For example, in Matter of CNA Ins. Co. v. Grandstaff, 170 AD2d 794, 566 NYS2d 101 (3d Dept. 1991), the court affirmed the stay of arbitration ordered by the trial court on the ground that the claimant's demand for arbitration was premature and the claimant had no arbitrable claim where the insurer refused to consent to a settlement with the tortfeasor that unconditionally released the tortfeasor and did not preserve the subrogation rights as required in the policy. As stated by the court, "While the insurance policy on [the tortfeasor's] vehicle would have been exhausted upon respondent's acceptance of the settlement offer, petitioner was entitled to withhold its consent absent protection of the subrogation rights reserved in its policy [citations omitted], if, in good faith, it intended to or expected that it might exercise those rights against the entity or individuals whose insurance was being exhausted by the settlement." The court further specifically noted that "There has been no showing of a lack of good faith in the refusal to consent."

Similarly, in Nationwide Ins. Co. v. Taylor, 177 AD2d 929, 930, 576 NYS2d 682 (3d Dept. 1991), the court found nothing in the record to demonstrate a lack of good faith on the part of the underinsured motorist carrier in refusing to consent to a settlement without protection of its subrogation rights, and, therefore, affirmed the grant of the insurer's petition for a stay of arbitration. And, in State Farm Mut. Auto. Ins. Co. v. Sanchez, __ AD2d __, 607 NYS2d 838 (4th Dept. 1994), the court reversed the denial of the insurer's petition to stay arbitration on the grounds that, as here, "although an offer of settlement to pay the full policy has been made by . . . the insurer of the owner of the other car involved in the accident, the settlement has not been consummated `by payment of judgments or

settlements' (Insurance Law §3420(f)(2))", and "the record contains no evidence to support respondent's contention that petitioner's refusal to consent to the settlement, in the absence of protection of the subrogation rights contained in the policy, constituted a lack of good faith"

Recent Case

A recent case of note in the Second Department has shed interesting light on the question of when the underinsured motorist carrier's withholding of consent can, in fact, be considered in violation of its obligation of good faith, i.e., in "bad faith."

Sentry Ins. Co. v. Kolb, 190 AD2d 804, 594 NYS2d 639 (2d Dept. 1993), is, at first glance, the typical pre-Regulation 35-D "Catch-22" case. The claimant, who was lucky and smart enough to be covered by an underinsured motorist policy, was seriously injured in a motor vehicle accident with a tortfeasor who had minimal insurance. When, following the commencement of litigation against the tortfeasor, the tortfeasor's insurer offered its full policy limits in settlement of the action, the claimant's attorney, in accordance with the provisions of the underinsured motorist policy, promptly requested the underinsured motorist carrier's consent to the settlement. After waiting for quite some time for a response, claimant ultimately received a formal denial of consent to settle.

Unaccepting of the untenable position in which he now found his client -- he could neither settle the underlying claim, nor proceed to underinsured motorist arbitration -- claimant's attorney commenced arbitration by serving a demand for arbitration upon the underinsured motorist carrier. Predictably, this demand was greeted in due course (within 20 days (CPLR 7503(c)) by a Petition to Stay Arbitration on the grounds that consent to settle was not given and the carrier's subrogation rights were not protected. Claimant opposed the Petition by arguing that the insurer's withholding of consent was unreasonable and unfair.

It is in the words and conduct of the underinsured motorist carrier, as gleaned from an examination of the Record on Appeal, that the Sentry case is distinguishable from those cases discussed above. Therein lies the key to the trial court's determination that the arbitration should not be stayed and the claimant should be allowed to settle with the tortfeasor and proceed to arbitration because "Petitioner has offered nothing to rebut

respondent's assertion that the withholding of consent to settle was unreasonable" which determination was, in fact, subsequently affirmed by the Appellate Division as a provident exercise of discretion under the circumstances. Instead of basing its denial of consent to settle on the possibility or hope of a valid subrogation right which needed to be protected, the carrier in Sentry did precisely the opposite -- the claims representative concededly stated outright to claimant's attorney over the telephone as follows: "We are not going to give consent because the defendant has no assets and we will not get our money back." Thus, it was clear that the carrier had no good faith intention to pursue its subrogation rights, had acknowledged that it had no valid subrogation rights to protect, and had no reason to withhold its consent to the settlement other than to be obstructive of claimant's rights to proceed to arbitration. In the absence of any contrary showing by the carrier, the court determined that its conduct was arbitrary and capricious and evidenced a lack of good faith, and, therefore, should not be countenanced.

Gap Insurance

Leasing a motor vehicle has become, perhaps, the most common form of vehicle "ownership" these days. Unfortunately, when the leased vehicle is stolen, or totally destroyed in an accident, the lessee may be saddled with a financial obligation to the lessor that far exceeds any potential insurance settlement, because the lessee's ultimate financial responsibility often exceeds the actual cash value of the vehicle as determined by the physical damage insurer. In such a situation, a "gap" exists, which can often run to several thousand dollars, or more in the early years of the lease agreement.

To address this "gap" problem, lessors have sold what many have called "gap insurance," intended to cover the difference between the lessee's total obligation and the vehicle's actual cash value. Because, until recently, such insurance was not authorized, what was actually being sold by the lessor was a waiver that eliminated the lessee's obligation in the event of a total loss or theft.

As recently reported in the New York State Insurance Department's "The Bulletin" (August 1994), the Legislature has recently stepped into the breach. Legislation enacted earlier this year as part of the Omnibus Consumer Protection and Banking Act of 1994 (Chapter 1 of the Laws of 1994) has added "gap insurance" as a new type of insurance.

This statute authorizes motor vehicle gap coverage for lessees as well as motor vehicle lessor insurance for lessors that sell gap waivers. (The law also authorizes motor vehicle gap insurance for borrowers and lenders under credit transactions, such as loan agreements, where at the time of the lease the size of the outstanding loan balance may exceed the actual cash value of the vehicle.)

As of June 30, 1995, a lessor will not be able to sell a waiver on consumer leases unless an appropriate gap insurance policy is purchased from a licensed property/casualty insurer. Lessors or lenders that fail to comply with the new statutory requirements could be charged with conducting an insurance business without a license, in violation of the Insurance Law.

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