

Procedural Considerations For Insurance Coverage Declaratory Judgment Actions

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Eric A. Portuguese

Lester Schwab Katz & Dwyer, LLP

Introduction

- Purpose of a declaratory judgment action is to give parties guidance concerning their rights and obligations with respect to coverage.
- Disputes involving past events or events likely to occur in the foreseeable future.
- The Courts can issue declarations prior to or after resolution of an underlying claim, or where the rights are contingent or based upon future events.

Forms of Insurance Litigation

- A. Suits on Policies for Money Damages: Money already paid by one party seeking reimbursement from another party.
- B. Direct Actions: Suits Under Insurance Law, §3420 - Suits by Claimants Directly Against Insurance Companies.
- C. Suits on Policies for Declarations of Rights and Obligations:
 - Judicial declarations relating to the duty to defend and duty to indemnify, priority of coverage, and coverage under first-party policies.
 - Judicial interpretation of policy coverages/insuring agreements, conditions and exclusions, the number of occurrences, and application of deductibles or self-insured retentions.
 - Suits are permitted to obtain a judicial declaration while the underlying action is pending.
- D. Claims for Bad Faith: Extra-contractual damages (in excess of policy limits), punitive damages and consequential damages.

Statutory Authority

New York State Law, CPLR 3001:

- The Court may render a declaratory judgment as to the rights and other legal relations of the parties to a justiciable controversy
- Insurance Law, §3420, Direct Action by Claimant
 - a. Where Judgment Obtained Against Insured, or
 - b. Where the sole question is Late Notice (For Personal Injury and Wrongful Death Actions)

Federal law – Declaratory Judgment Act

- 28 U.S.C. §2201 - Creation of Declaratory Judgment remedy
- 28 U.S.C. §2202 – Further relief
- Need Actual Case or Controversy
- Need Separate Basis for Federal Jurisdiction
- Discretion of District Court whether to exercise jurisdiction
- Under either New York or Federal statute, plaintiff must satisfy all the requirements of personal jurisdiction, subject matter jurisdiction, venue, and joinder of necessary parties.

Considerations as to Whether to File a Declaratory Judgment Action

- Cost-benefit analysis.
- How much money is a stake (exposure and defense costs in underlying action).
- Is dispute limited to defense, indemnity, contribution between insurers?
- Strength of positions of the parties (novel or settled legal questions, etc.)
- Financial resources of client.
- Need to resolve coverage dispute before underlying action can be settled.
- Expenses likely to be incurred in coverage action (complexity, factual disputes and need for discovery, number of parties).
- Availability of alternative remedies (contractual indemnification versus additional insured coverage).
- If insurance company sues its insured and loses, the insurer would be liable for the attorney's fees incurred by the insured in defense of the coverage action.
- Whether the facts necessary to determine coverage will likely not be resolved in the underlying action.

Timing Considerations

- May need to wait for key factual developments in underlying action (e.g. deposition testimony).
- May need to wait for legal determinations in underlying action (e.g. rulings on summary judgment motions).
- Direct actions by claimants – need to have judgment against insured and unsatisfied for 30 days.
- Should tender to insurer first with appropriate documentation (complaint, contracts, court rulings, deposition testimony, etc.) before starting coverage action.
- Should consider written challenge to insurer's position before starting coverage action.
- May want to wait and see how serious the injuries are in the underlying action before starting coverage action.
- Insurer defending insured under reservation of rights cannot unilaterally terminate defense without court ruling in coverage action.

Statute of Limitations

- Declaratory Judgment Actions are covered under the six-year “catchall” statute of limitations provision in CPLR 213.
- A cause of action against an insurer for breach of contract accrues when the underlying litigation has been finally terminated.

Standing to Sue

- Claimants generally have no standing to sue an insurance company for coverage until a judgment has been obtained against the insured tortfeasor. Insurance Law § 3420. The claimant must first serve a copy of the judgment with notice of entry on the insurer, and wait 30 days for payment.
- There is an exception, for claims arising out of death or personal injury, if the insurer disclaims based on late notice, the injured person or other claimant may bring an action directly against the insurer based solely on the issue of late notice, unless within 60 days following the disclaimer, the insured or insurer brings an action and joins the injured party or other claimant as a party to the action.
- After a loss occurs, a party to an insurance contract may assign its rights to accrued insurance proceeds to another party.

Declaratory Judgment Actions Can Involve Many Types of Coverage Disputes

- Insured(s) seeking coverage (defense and/or indemnity) from an insurer or insurers.
- Insurer can bring action against Insured seeking a declaration of no coverage or limited coverage (or to terminate a defense previously offered).
- Insurer can bring action against other insurers seeking a declaration of priority of coverage (primary versus excess) or seeking contribution (or reimbursement) for a share of defense and/or indemnity costs.

The Duty to Defend is Broad

- The insurance company is obligated to defend the insured in a lawsuit if *any* allegation is even *potentially* covered under the insurance policy.
- The duty to defend extends to the entire action, not just the covered or potentially covered causes of action or allegations.
- Under New York law, an insurer generally cannot rely on extrinsic evidence to defeat the duty to defend.

Equitable Estoppel

- If an insured is given a defense without reservation, only to be informed, e.g., on the eve of trial, that there is no coverage, an insurer may be estopped to deny coverage if the insured was “prejudiced.”
- Prejudice may arise when the insurance company has controlled the defense of the case, and it is too late for the insured to change course. Some cases presume prejudice after several years, and particularly after the discovery deadline.
- An insurer that breaches the duty to defend is not barred from relying on policy exclusions or if the claim is otherwise outside of coverage as a defense to the duty to indemnify.

Duty to Indemnify

- The duty to indemnify is determined by the actual basis for the insured's liability to a third party.
- The duty to indemnify does not turn on the pleadings or allegations, but whether the loss, as established by the facts, is covered by the policy.
- There are circumstances, however, where the undisputed facts can create a duty to indemnify even before liability is determined in the underlying action.
- For example, for additional insurance coverage, the “arising out of your work” requirement is satisfied as a matter of law where the plaintiff is employed by the named insured; or
- When the insurer's only coverage defenses are found invalid as a matter of law.

Declaratory Judgment Complaints

Generally, there are certain allegations that are important to include in most insurance coverage complaints:

- Insurer has issued an insurance policy or policies to named insured (and perhaps also covering other parties).
- The policy or policies were in full force and effect on the date of loss (or including claims made on the date the underlying claim was first made).
- A description of the underlying accident or incident, and the underlying action.
- Coverage has been requested by or on behalf of an insured or insureds from certain insurer or insurers.

- The insurer is obligated to defend the insured or to pay or reimburse the costs of defense.
- The insurer is obligated to indemnify the insured or to pay or reimburse the indemnity costs
- The insurer has denied the obligation to defend or to pay or reimburse the costs of defense.
- An actual controversy exists between the parties.
- A judicial declaration is specifically sought (e.g., an insurer owes a duty to defend and indemnify, an insurer does not owe a duty to defend or indemnify, an insurer is excess over another insurer's coverage, or an insurer is a co-insurer with a duty to contribute to the costs of defense and indemnity, etc.)
- Set forth the various causes of action (e.g., breach of contract, declaratory judgment relief, equitable estoppel) bad faith or breach of disclaimer statute Insurance Law § 3420(d)(2), etc.

Declaratory Judgment Answers

- An answer filed by an insurance company can itself constitute a disclaimer under Insurance Law § 3420(d)(2). The answer should set forth all of the applicable or potentially applicable defenses. Generally, the insurer will include an allegation that the defendant insurer is not obligated by the terms of the policy or policies (or at law) to defend or indemnify the plaintiff.

The defenses can include:

- The alleged insurance policy does not exist, was cancelled prior to the loss, or was not in effect on the date of loss.
- The policy limits have been exhausted by payment of other claims under the same policy.
- Plaintiff breached the duty to cooperate.
- Late notice of the occurrence, claim or suit.

- Plaintiff made material misrepresentations and/or omissions in its application for insurance.
- Certain exclusions bar coverage for all or part of the underlying claim or action.
- The insuring agreement of the policy does not afford coverage for all or part of the underlying claim or action.
- The policy is not triggered until all underlying policies or self-insured retentions are exhausted.
- Separate limits or sub-limits for various types of coverage, locations, projects, or insureds.
- Reference to “other insurance” provisions.

Policy Interpretation

- Where policy terms are clear and unambiguous, interpretation of such terms is a matter of law for the Court.
- Policy Terms will be given their plain and ordinary meaning in accord with the reasonable expectations of ordinary business persons.
- The test for ambiguity is whether the policy, as read as a whole, is susceptible to two (or more) reasonable interpretations.

Burdens of Proof

- The party seeking coverage (named insured, additional insured or omnibus insured) has the burden to prove that the claim is covered by the insuring agreements of the policy.
- The insurer has the burden to prove the applicability of policy exclusions.
- The insured has the burden to prove the applicability of an exception, if any, contained in a policy exclusion.
- The insured has the burden to prove that any delay in providing timely notice of an occurrence, claim or suit to the insurer (including a good faith belief in non-liability), and the insurer has the burden to prove prejudice from the late notice (unless irrebuttable presumption applies under Insurance Law § 3420).
- The insurer has the burden to excuse any delay in disclaiming coverage where Insurance Law, § 3420(d)(2) applies.
- The insurer has the burden to prove a failure to cooperate.