

# ABRAMS, GORELICK, FRIEDMAN & JACOBSON, P.C.

## CASES AND POINTS

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### OPENING STATEMENT

It has long been the rule in New York that an insurer may properly deny coverage where the insured fails to comply with the notice provision of the policy, without the need to show prejudice of any kind. Security Mutual Ins. Co. of NY v. Acker-Fitzsimon Corp., (1972). However, on November 12, the U.S. Court of Appeals certified the question to New York's highest court of whether the "no prejudice rule" has been completely overruled by the New York Court's recent decisions or whether it has only been abrogated when the insured, although providing prompt notice of an under-insured motorist claim, subsequently fails to immediately furnish suit papers to its insurer.

In Varricho v. Chicago Ins. Co., the Circuit Court certified the question so that New York's highest court could clarify whether, and to what extent, the "no prejudice" rule still applied in New York.

This case may have a significant effect on insurance law in New York and will be reported on as soon as the certified question is answered.

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### Will Directors and Officers Insurance Policies Provide Coverage for Fraud?

By: Gabriel Hidalgo

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No matter what newspaper you may have read, inevitably, you will stumble across an article depicting a corporation which has recently been accused of fraud. Communications giant, WorldCom, allegedly boosted profits by "adjusting" current expenses as future expenses that allowed for greater current profits. Former energy broker, Enron, appears to have shifted huge debts off its books by "trading" them to offshore shell corporations who "held" these debts so that Enron's bottom line looked profitable. Tyco is also accused of using dishonest accounting tactics to create excellent profit margins while its CEO lavishly spent corporate money to purchase artwork for his home. Allegations have brought to the forefront questions regarding corporate malfeasance.

After the discovery of fraudulent financial schemes, scores of shareholder suits emerged along with Securities and Exchange Commission investigations. For the most part, corporations have purchased general liability insurance to provide coverage and defense from lawsuits. Additionally, many corporations purchase Directors and Officers ("D&O") insurance policies to protect

their executives from liability suits arising from their corporate decisions. However, the question remains, do insurance companies have to provide coverage to a corporate executive who may have committed corporate malfeasance?

The legal principles which govern the interpretation of D&O policies are fairly well established. In New York, the law creates a strong presumption that an insurer must provide a defense for insured directors and officers if a complaint is received that contains any allegations that may bring the action within the protection that was purchased. Avondale Indus. v. Travelers, 887 F.2d 1200 (2d. Cir. 1989). Furthermore, a single claim that alleges negligence by a director or officer will trigger the defense obligations incorporated in the D&O policy, effectively forcing the insurer to defend the entire matter. Seaboard Sur. Co. v. Gillette Co., 64 N.Y.2d 304, 486 N.Y.S.2d 873 (1984).

When an insurer seeks to avoid defending a claim, the insurer must show that as a matter of law there is "no possible factual or legal basis on which the insurer could be held to defend or indemnify the insured". City of Johnstown, NY v. Bankers Standard Ins. Co. 877 F. 2d 1146 (2<sup>nd</sup> Cir. 1989). Additionally, the duty to defend shall not be based on the potential merits of the claim, the only factor is whether any claims

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potentially fall within the contracted policy. Johnstown at 1148.

An insurer seeking to successfully craft D&O policy exclusions must draft them so that they are stated in clear and unmistakable language. Furthermore, the exclusions must not be subject to another reasonable interpretation. Continental Casualty Co. v. Rapid Am. Corp., 80 N.Y. 2d 640 (1993). Although the D&O insurers of Worldcom, Enron and Tyco may have ironclad exclusionary clauses, the fact remains that the cautious plaintiff's bar tends to attach a negligence cause of action to their fraud complaints, with the intent of triggering all available coverage.

Breach of fiduciary duty lawsuits have been filed by shareholders against directors in the past with great success. The plaintiff's bar has used negligence causes of action to trigger D&O policies, as well as the general corporate liability policies. The triggering of the two policy types allows for a greater pool of possible settlement sources. With many corporations feeling pressure to settle shareholder suits, defense counsel are seeking to create as big a reserve of settlement funds as possible.

Although D&O policies may provide carefully crafted exclusions for intentional fraud and criminal activity, any claim of negligence perpetuated by insured officers named in a suit will trigger the defense obligations of the insurer. As the insurers for Enron, Tyco and Worldcom have found out, there is no direct coverage for alleged fraud, but once a negligence claim is attached, they must cover the whole action, even the allegations of intentional fraud.

It is likely that more coverage litigation will ensue as suits against corporate officers and directors, as well as professionals such as auditors and attorneys, are filed.

### Strategy For "Peripheral" Defendants In Asbestos Litigation

By Joseph Fitapelli

As asbestos litigation in New York enters its third decade of existence, with no end in sight, litigation strategy for the so-called "peripheral" defendant must be adapted to suit the changing environment of this niche litigation. Once the moniker of the small player in asbestos litigation, the term "peripheral" defendant has in reality, lost its meaning as companies once regarded as ancillary, rapidly become mainstream defendants. As a result of the demise of more than sixty defendants since 1982, the plaintiff's bar has made a concerted effort to locate new sources of revenue to fuel a machine which has already been responsible for the payment of over \$22 billion dollars in claims.

The Chapter 11 filings by former deep-pocket, high visibility manufacturers, have left smaller, downstream "mom and pop" businesses finding themselves pursued with a zeal once reserved only for the most prolific former asbestos manufacturers. Now, during the course of litigation, a comparatively small defendant may now find itself the subject of vast demands for document discovery and witness production. Preparing responses to these demands can be a Herculean task, especially for small companies whose records were often haphazardly kept, if at all, during a time when asbestos litigation was decades from its infancy. Accordingly, the once "peripheral" defendant must now revise its approach to this litigation, as keeping a low profile has become, for all intents and purposes, an obsolete litigation strategy.

With advances in medical technology over the past three

decades, the length of time from asbestos exposure to the onset of symptoms has increased giving way to much older asbestos plaintiffs. As time passes and more defendants file for Chapter 11 protection, the “peripheral” defendant will be placed in the predicament of having to defend more and more *extremis* cases. The expedited nature of this litigation can be daunting to a “peripheral” or otherwise solvent first time defendant, as early dismissal becomes less common. In order to properly defend these actions, corporate history must be thoroughly investigated by both attorney and client. Ignoring the distant past is often a mistake made by corporations who perceive themselves to have no apparent asbestos connection. Past acquisitions or divestitures of companies which made asbestos containing products, sometimes over half a century ago, can lead active corporations with no perceptible asbestos connection into the mire of endless litigation. Many small corporations have recently found themselves being sued or having suits tendered to them because at some point in their history they acquired the stock or the assets of companies which once produced asbestos containing products. Still others are being sued because they divested themselves of subsidiaries or assets of companies which once made asbestos containing products and indemnified the acquiring party.

A clear history of, not only, the subject corporation, but that of those which acquisitions or divestitures were made, is essential to an application for early discontinuance where corporate identity is at issue. In addition, a well researched corporate genealogy is fundamental in not only crafting a successful summary judgment motion but defending against attempts to pierce the corporate veil. In TNS Holdings v. MKI Securities Corp., the Court of

Appeals held that “[t]hose seeking to pierce the corporate veil bear a heavy burden of showing that the corporation was dominated as to the transaction attacked *and* that such domination was the instrument of fraud or otherwise resulted in wrongful or inequitable consequences.”. Moreover, in TNS, the Court held that evidence of domination alone is not sufficient to pierce the corporate veil without a showing that it led to inequity, fraud or malfeasance. TNS Holdings v. MKI Securities Corp., 92 N.Y. 2d 335, 703 N.E. 2d 749, 680 N.Y.S. 2d 891; Walkovszky v. Carlton 18 N.Y.S. 2d 414, 223, N.E. 6, 276 N.Y.S. 2d 585; Morris v. New York State Department of Taxation and Finance, et. al., 82 N.Y. 2d 135, 623 N.E. 1157, 603 N.Y.S. 2d 807; Chase Manhattan Bank v. 264 Water Street Associates, 174 A.D. 2d 504, 571 N.Y.S. 2d 281.

Although the standard for those attempting to pierce the corporate veil is generally strict, a proper corporate genealogy will allow a defendant to maintain an offensive, rather than a defensive posture. The ability to present either the Special Master or presiding judge with a history of these transactions and the pertinent documents, can eliminate questions of ownership or control which may keep a defendant in a particular action. With the relaxed burden of proof afforded to asbestos plaintiffs in New York, and the increased focus on smaller defendants, a corporate genealogy must become part of every “peripheral” defendant’s litigation plan.

**Recent Case Developments**

**Automobile Liability-Threshold**

The Court of Appeals has recently handed down a decision that significantly changes the rules for establishing a “serious injury” under New York’s Insurance Law §5102(d).

In Toure v. Avis Rent A Car Systems, Inc., 2002 N.Y. Slip Op. 05748, 746 N.Y.S.2d (2002) the court actually reviewed three separate cases. In the first case, Toure v. Avis Rent A Car Systems, Inc., defendant moved for summary judgment upon the ground that plaintiff did not meet the “serious injury” threshold. In opposition to the motion plaintiff submitted his own affidavit and the affirmation of a neurosurgeon. Plaintiff averred that he could no longer perform numerous activities, including lifting moderate weights, sitting for more than a half hour without discomfort or walking moderate distances. The affidavit of plaintiff’s treating physician indicated that he reviewed plaintiff’s medical records and that the results of MRI scans revealed bulging and herniated discs. He also noted that he had observed muscle spasms and decreased range of motion of the lumbosacral spine. However, he did not quantify these limitations. The physician related his assessment to plaintiff’s complaints of difficulty sitting, standing and walking and concluded that the complaints were a natural and expected medical consequence of his injury. In Manzano v.O’Neil the defendant moved for a directed verdict after a trial of damages only. In that case plaintiff and an examining physician testified in a similar manner as the plaintiff in the Toure case. In Nitti v. Clerrico defendant moved for a directed verdict at the close of plaintiff’s case. Plaintiff testified that she was unable to perform many of her daily activities. Her chiropractor testified that plaintiff had restricted motion in her back and neck but did not quantify the restriction. However, the chiropractor conceded that the tests were subjective because they relied in part on plaintiff’s complaints of pain. He reviewed plaintiff’s MRI report but the films were not admitted into evidence. The chiropractor

concluded that plaintiff had sustained a L4-5 intervertebral disc disorder with neuritis. The defendant's motion for a directed verdict was denied by the trial judge. The jury then determined that the plaintiff met the "90/180" category of serious injury.

The Court of Appeals held that "in order to prove the extent or degree of physical limitation, an expert's designation of a numeric percentage of a plaintiff's loss of range of motion can be used to substantiate a claim of serious injury. An expert's *qualitative* assessment of a plaintiff's condition also may suffice, provided that the evaluation has an objective basis and compared the plaintiff's limitations to the normal function or system."

The Court concluded that although the plaintiffs in the Toure and Manzano cases had not established a quantified limitation, the "qualitative" assessment provided by plaintiffs' physicians and supported by objective testing such as MRIs and the doctors' own observations, satisfied the requirement to establish a "permanent consequential" or "significant" limitation under the Threshold Law. With respect to the Nitti case, the Court concluded that plaintiff had not met the "serious injury" threshold because he had not produced objective evidence to support a medically determined injury.

The Court's holding that a "qualitative assessment of the plaintiff's condition may suffice" is a significant change in the prior law on this matter. While the Court relied upon its own prior decision in Dufel v. Green, 84 N.Y.2d 795, 622 N.Y.S.2d 900, 647 N.E.2d 105 (1995), to support the decision in Toure, in reality in the years since the Dufel case the lower courts have firmly and consistently held that "in order to successfully oppose a motion for summary judgment on the issue of whether an injury is serious within the meaning of Insurance Law § 5102(d), the

plaintiff's expert *must submit quantitative objective findings* in addition to an opinion as to the significance of the injury." See e.g., Grossman v. Wright, 268 A.D.2d 79, 707 N.Y.S.2d 233 (2d Dept. 2000) With the Toure decision the Court of Appeals now makes clear that not only a "quantified" assessment of plaintiff's limitation is sufficient, but also a "qualitative" assessment supported by objective proof akin to those provided by plaintiff's medical provider in the Toure and Manzano cases. The Court also reaffirmed that *objective* evidence is necessary to establish a medically determined injury, even under the "90/180" provision of Insurance Law 5102(d)

The Court's latest ruling would appear to undermine defendants' ability, to move for summary judgment and directed verdicts based upon the No-Fault Threshold since the ruling provides yet another means for a plaintiff to establish a "serious injury". Well drafted affidavits or an experienced expert's testimony may provide the basis for establishing a "serious injury" without providing "quantified" limitations of plaintiff's range of motion.

The Court's holding represents a significant change in the law on this matter which appears to allow plaintiffs a greater ability to establish a "serious injury". However, it will not be until the Toure case is sufficiently interpreted and applied by the appellate courts that the full effect of the Toure decision can be measured.

- **Negligence – Notice of Defect or Condition**

In Rapino v. City of New York, et al., AGF&J represented American Golf Corporation, a manager of golf courses, as appellate counsel on the appeal of a judgment of the Supreme Court, Richmond County. The judgment had been entered based on a jury verdict after trial, awarding plaintiff \$155,000.00. On appeal, the

Appellate Division, Second Department, reversed the judgment of the lower court and dismissed the complaint.

The plaintiff brought the action for personal injuries he allegedly sustained when he fell on a drain cover in the floor of American Golf's clubhouse.

To establish constructive notice at trial, the plaintiff relied on the presence of rust on the drain cover as shown in several photographs taken by the plaintiff. In addition to rust, these photographs depicted the drain cover as being misaligned. However, the plaintiff acknowledged that the photographs did not depict the precise position of the drain cover immediately after the accident. Moreover, the plaintiff failed to offer any evidence at trial that the drain cover was misaligned before or at the time of the accident.

Upon examination of the photographs and without the benefit of a site inspection, the plaintiff's expert testified that such a drain cover is a tight fit if it is not rusted and that periodic inspections should have revealed the same.

However the Appellate Division noted that no evidence was offered by the plaintiff at trial that rust would have alerted a layman that the drain cover was loose. Citing two prior decisions, the Court found that if a defect could not have been discovered by a layman, even by inspection, it is considered a latent defect (Marquart v. Yeshiva Machezikel Torah D'Chasidel Belz of N.Y., 53 A.D.2d 688, 670; Ivancic v. Olmstead, 66 N.Y.2d 349, 351).

Consequently, the Appellate Division reversed the judgment of the lower court as it found the plaintiff failed to establish that the presence of rust, alone, was sufficient to give the defendant constructive notice of the defect (citing Mingone v. Ardsley Union Free School Dist., 215 A.D.2d

463; Ferris v. County of Suffolk, 174 A.D.2d 70).

The Rapino appellate brief was written by Daniel J. Friedman and the appeal was argued by Joseph A. Fitapelli. For more information you may contact either of them at [dfriedman@agfjlaw.com](mailto:dfriedman@agfjlaw.com) or [jfitapelli@agfjlaw.com](mailto:jfitapelli@agfjlaw.com).

**AGFJ DEVELOPMENTS**

- Michael Gorelick has been appointed as New York State liaison to the Commercial Litigation Committee of the Defense Research Institute.

- Gail J. McNally has successfully defended AGF&J's clients in a bodily injury lawsuit arising of a serious automobile accident in Queens County. AGFJ's clients received a defendant's verdict while the co-defendant was found to be 100% at fault for the accident.

- Michael Gorelick has recently participated in a Law Firm Management Conference sponsored by the F.D.C.C. in Chicago. The Conference was attended by managing partners of defense firms ranging in size from as few as seven attorneys, to firms in excess of 700 attorneys.

**PUBLIC EDUCATION SERVICE**

It is our policy to appear as speakers at seminars, business and professional meetings, as well as before industry groups. In addition, whenever possible we attempt to fulfill requests for articles from industry publications. We will also make presentations on a variety of legal issues to claim and risk management departments. For further information, please contact Michael Gorelick at (212) 422-1200.

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In Toure v. Avis Rent A Car Systems, Inc., 2002 N.Y. Slip Op. 05748, 746 N.Y.S.2d (2002), the Court of Appeals ruled on three separate cases. In two cases the plaintiff failed to produce evidence of an objectively measured quantified limitation of use of a body organ, member, function or system. However, the plaintiffs testified to limitations of activities. The plaintiff's physicians affirmed or testified that they reviewed the plaintiffs' records, examined the plaintiffs and found limitations in motion and spasms. They also submitted MRI films revealing disc herniations and bulges into evidence which they stated was the cause of. The Court of Appeals held that the plaintiffs successfully established a "permanent consequential" or "significant" limitation of use under Insurance Law §5102(d). The Court held that "In order to prove the extent or degree of physical limitation, an expert's designation of a numeric percentage of a plaintiff's loss of range of motion can be used to substantiate a claim of serious injury. As experts *qualitative* assessment of a plaintiff's condition also may suffice, provided that the evaluation has an objective basis and compared the plaintiff's limitations to the normal function or system." Toure, supra (emphasis in original).

While the court relied upon its own prior holding in a case called Dufel v. Green, 84 N.Y.2d 795, 622 N.Y.S.2d 900, 647 N.E.2d 105 (1995) to support the possibility that a "qualitative assessment" may suffice to establish a "significant" limitation, in the years since the Dufel decision the Appellate Courts have firmly held that "the plaintiff's expert *must submit quantitative objective findings* in addition to an opinion as to the significance of the injury." See e.g., Grossman v. Wright, 268 A.D.2d 79, 707 N.Y.S.2d 233 (2d Dept. 2000) (emphasis added). With the Toure decision the Court of Appeals makes

clear that, so long as it is supported by objective evidence, not only a "quantified" assessment of plaintiff's limitation but a "qualitative" assessment will be sufficient to meet the "serious injury" threshold. ///