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

## CASES AND POINTS

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### **O** OPENING STATEMENT

Although it is still early in the year, New York's highest court has already decided a surprising number of cases of great interest to insurance and liability claims practitioners. Those cases cover a wide variety of areas, including: claims by innocent co-insureds under fire policies; statutes of limitations applicable to "professional liability" claims against insurance agents and brokers; the effect of indemnification provisions upon rental companies' liability for accidents involving their vehicles; gun makers' and distributors' liability for deaths and injuries to members of the general public as a result of the criminal use of their handguns; and, the measure of damages sustained by property owners' from the breach of their tenants agreement to purchase insurance naming the owners as additional insureds.

This issue of Cases & Points will review these recent Court of Appeals decisions.

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### **DIGEST OF RECENT NEW YORK COURT OF APPEALS DECISIONS**

#### • **Rights of Innocent Co-Insureds**

New York's Court of Appeals has thwarted a fire insurer's attempt to preclude recovery by one insured when the loss was the result of a fraudulent act of a person who was also insured under the same policy.

In 1988 the New York Court of Appeals upheld the right of an 18 year old "homeowner" to recover the proceeds of a fire insurance policy although the trial jury found that her father had intentionally set the fire, finding that she was an "innocent coinsured". The industry's response was to amend the language of fire policies in an effort to bar recovery if the loss was caused by the intentional act of any insured. Now, thirteen years after the Reed decision, the Court of Appeals has again upheld the "innocent coinsured's" right to recover, even where any reasonable reading of the policy would preclude recovery.

#### **The Reed Case**

In its 1988 decision, the Court of Appeals held that a coinsured could recover the insurance proceeds even though another coinsured intentionally started the fire which damaged the insured property.

In Reed v. Federal Insurance Co., there were a series of transfers of the legal ownership of the family home among corporations of which Reed family members were the shareholders, culminating in the

transfer of the home from one of the corporations to Cherylan Reed, the 18 year old daughter of Russell Reed. Cherylan paid no consideration for the property. While the deed to the home was in Cherylan's name, a fact that had been disclosed on the application for insurance, the mortgage payments were made by her father, who was responsible for maintaining the property.

The coinsured, Russell Reed, was heavily in debt; the bank that held the mortgage to the home was threatening foreclosure; he had been convicted of forgery, mail fraud and securities fraud; and, in a separate incident, he had been convicted of petty larceny in connection with a check-kiting scheme. After commencement of foreclosure proceedings by the bank and before the cancellation of the insurance policy for failure to pay the first premium, a fire destroyed the home.

The insurer denied the claim based upon evidence that Russell Reed had set the fire. After a trial the jury found that Russell Reed had intentionally caused the fire; that Cherylan was not involved in setting the fire; and that she had not sworn falsely at her Examination Under Oath or on her Proof of Loss. Finding that the fire had been set by her father without her knowledge, they awarded Cherylan the cash value of the destroyed home. In 1988, this decision was upheld by the Court of Appeals.

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Based upon the Reed decision, a finding that one insured committed arson would not preclude recovery by a totally innocent insured, regardless of their relationship, where the policy excluded damages resulting from the wrongful act of “the insured”.

### Lane v. Security Mutual

In response to the Court of Appeals decision in Reed, many fire insurers amended their policies to exclude damages caused by wrongful acts of “an insured”, rather than by “the insured”. However, in Lane v. Security Mutual Insurance Company, which was decided on February 13, 2001, the Court of Appeals held that the amendment of the policy language from “the insured” to “an insured” violates the New York State Insurance Law and was, therefore, unenforceable.

The Court of Appeals (in reversing the decision of the Appellate Division, Fourth Department) held that the change in the policy provision that excludes coverage for intentional acts committed by “an insured” in place of “the insured” violated Insurance Law §3404(f)(1)(A) because it contains terms that are less favorable to the insured than those contained in the standard fire insurance policy. Insurance Law § 3404(f)(1)(A) provides that an insurance policy that provided fire insurance coverage, either alone or in combination with other kinds of insurance, may deviate from the terms of the standard fire insurance policy only if “. . . the policy contains, with respect to the peril of fire, terms and provisions no less favorable to the insured than those contained in the standard fire policy”.

The Lane policy contained a provision stating that the policy does not pay for losses, “which result from an act committed by or at the direction of *an insured* with the intent to cause a loss”. The Court of Appeals found

this clause to be unenforceable because it provided significantly less coverage to insureds than did the standard fire policy which restricts “. . . for losses occurring. . . while the hazard is increased within the control or knowledge of *the insured*”.

### Conclusion

The Lane decision does not leave insurers totally defenseless. First, the innocent coinsured must truly be innocent and have no knowledge or complicity in the wrongdoer’s acts. Second, an insurer may be able to void coverage in a case where the insured is a corporation and the wrongdoer was an agent of the corporation who will benefit from the payment of the policy proceeds. Lastly, Insurance Law § 3404 only applies to fire insurance coverage. The Lane decision would not be controlling in other forms of property policies or with respect to other types of losses, even if the policy also provides fire coverage.

Inquires regarding the Court of Appeal’s decision in Lane, fire insurance, or insurance fraud, in general, can be addressed to Dan Friedman by e-mail at [dfriedman@agfjlaw.com](mailto:dfriedman@agfjlaw.com)

- **Professional Liability – An insurance broker is not a “professional” for Statute of Limitations purposes.**

New York’s CPLR §214(6) mandates a three year Statute of Limitations in all non-medical malpractice actions, regardless of whether the underlying theory against the “professional” is based in contract or tort.

In two recent cases decided the same day, the Court of Appeals addressed the question of whether an insurance agent or broker was a “professional” within the meaning of that section of the CPLR.

In Chase Scientific Research Inc. v. The NIA Group, Inc., plaintiff sued its

insurance brokers, asserting a cause of action for breach of contract and negligence, based upon defendant’s failure to secure adequate insurance coverage for the plaintiff. Defendants moved to dismiss the entire action as time barred under CPLR § 214(6), contending that the claim against the defendants was one for malpractice which accrued on the policy inception date. They contended that since more than three years had elapsed before the action was commenced, the action was time barred. The plaintiffs contended that the action was governed by the six year Statute of Limitations applicable to contract actions and, further, that even applying the three year negligence Statute of Limitations, the claim was timely because it accrued not on the policy’s inception date but, instead on the date of loss.

The Supreme Court agreed with the defendants and dismissed the Complaint.

In Gugliotta v. Apollo Roland Brokerage, Inc., the defendant insurance agent purportedly procured CGL coverage for the plaintiff/building owner in December, 1994. In February, 1995, Herman Fermin slipped and fell in the building. In December 1995 Mr. Fermin commenced an action against the plaintiff for bodily injuries sustained in the accident. Only then did the plaintiff discover that he lacked general liability coverage.

Claiming both negligence and breach of contract, plaintiff commenced an action against his insurance broker on March 6, 1998 for failure to procure adequate insurance coverage.

The defendant broker moved to dismiss the action as time-barred. As in Chase, the Supreme Court agreed and dismissed the action and the Appellate Division affirmed.

The appeals to the Court of Appeals in these two cases were heard simultaneously. The Court of Appeals reversed each case and reinstated both causes of action against the defendant-broker in Chase, and the breach of contract claim against the defendant-broker in Gugliotta.

In doing so, the Court of Appeals held that while the definition of the term “professional” is inexact, the intent of the Legislature in amending the CPLR to provide for a particular Statute of Limitations in malpractice actions was to make that statute of limitations application to groups possessing qualities which included: extensive formal learning and training; licensure and regulation indicating a qualification to practice; a code of conduct imposing standards beyond those accepted in the marketplace; a system of discipline for violation of the standards; and a relationship of trust and confidence, carrying with it a duty to counsel and advise clients. The Court found that although insurance agents and brokers must be licensed, they are not required to engage in extensive specialized education and training (as are lawyers, engineers, architects and accountants). It found that they are bound by a standard of conduct for which discipline might be imposed. However, after weighing all the factors of “professionalism” and applying them to insurance agents and brokers, the Court concluded that although the standards to which insurance agents and brokers are held are high, they are simply not as rigorous as those intended by the Legislature when it enacted CPLR 241(6). Thus, the Court held that insurance brokers are not “professionals” and breach of contract actions against them are governed by the standard six year Statute of Limitations for such actions.

### **Rental car companies cannot avoid liability by indemnification provisions in their rental agreement.**

On April 3, 2001, the Court of Appeals decided four cases in a single opinion involving an issue which had divided the Appellate Divisions -- whether car rental companies could disclaim all liability for accidents involving their vehicles, based upon indemnification clauses included in their rental agreements.

All four appeals involved ELRAC, which owns the Enterprise Rent-A-Car chain. In each of the cases, a renter of an Enterprise automobile was involved in an accident which resulted in a bodily injury lawsuit by the injured parties seeking to recover from Enterprise. In all four cases, Enterprise sought full indemnification from the drivers based upon the provisions of the rental agreement. In all four cases, the Second Department upheld the indemnification clause and granted judgment over in favor of Enterprise against the driver. However, on appeal the Court of Appeals disagreed.

In the cases decided by the Court of Appeals it analyzed the provisions of §§ 370 and 388 of New York’s Vehicle and Traffic Law which require car rental agencies to provide minimum liability coverage of \$25,000 for personal injury and \$50,000 for death and \$10,000 for property damage, as well as the provisions of § 388 which impose liability on vehicle owners for damages resulting from the negligent use of their vehicles under New York law.

In reaching her decision, Judge Judith Kaye (writing for the unanimous Court) interpreted § 370 of the Vehicle and Traffic Law to require car rental agencies to provide primary coverage up to the minimum liability limits of the statute and thus found that, to that extent, the

indemnification clause in ELRAC’s contracts was unenforceable. However, the Court found that the indemnification clause was enforceable for amounts beyond the statutory threshold.

Thus, car rental agencies will remain responsible for at least the statutorily required limits of coverage and could not pass that portion of its potential liability along to the renters. (ELRAC Inc. v. Ward; Ward v. ELRAC Inc. and Seaton; American Home Insurance Co. v. ELRAC, Inc. and Medina; and ELRAC v. American Home Insurance Co. and Sabaris.)

### **Gun Manufacturers’ Liability for Negligent Marketing**

In Hamilton v. Beretta USA Corp., decided on April 26, 2001, the Court held (in a unanimous decision) that the link between the distribution of a legal product (handguns) that is then used in an illegal manner was far too tenuous to justify an extension of liability to its manufacturers. Significantly, the Court also held that even if the gun manufacturer could be held liable under these circumstances, a market-share theory of liability would not be warranted to apportion damages.

Hamilton involved the first jury verdict in the nation to hold firearms manufacturers liable for injuries allegedly resulting from their marketing and distribution practices. That verdict was rendered in the United States District Court in the Eastern District of New York. The trial judge (U.S. District Judge Jack Weinstein) ruled that the plaintiffs could pursue their liability theory that the manufacturers had over-saturated the market in the Southeastern United States, knowing that the “excess” product shipped to areas with weak gun control laws would put firearms into the hands of criminals in New York.

After a month long trial, the Hamilton jury found that 15 of the 25

defendants had neglected to use reasonable care in the distribution of their guns and that 9 of them proximately caused the deaths of the decedents of two of the wrongful death plaintiffs. Damages were awarded against 3 manufacturers and then apportioned according to their market share. An appeal to the United States Court of Appeals Second Circuit, led to the certification of the market distribution duty and market share liability issues to New York’s Court of Appeals.

In its decision on these two certified questions, the Court of Appeals, while acknowledging that a duty may arise when a defendant is in a position to protect a tort feisor or plaintiff from harm, found that the chain between the manufacturers, the wrongdoers and the plaintiffs who were injured by them, was too remote to establish the existence of a duty.

The Court did leave open the possibility of the establishment of liability against a manufacturer on a negligent entrustment theory when it can be proven by a plaintiff that “the manufacturer knows or has reason to know that distributors are engaging in substantial sales of guns into the gun trafficking market on a consistent basis” However, in this case, the Court found that no such evidence had not been presented.

In also denying certification on the market share liability question (which had first been adopted in New York in cases involving injuries from ingestion of the anti-miscarriage drug, DES), the Court found that:

“Unlike DES, guns are not identical, fungible products . . . Significantly, it is often possible to identify the caliber and manufacturer of the handgun that caused injury to a particular plaintiff”.

This case, although constituting a significant victory for gun manufacturers and their insurers, does provide a blueprint for plaintiffs

seeking to establish liability against gun manufacturers and distributors, in future cases. Whether plaintiffs will be able to come forward with sufficient evidentiary proof to warrant the imposition of a duty to the general public or to establish a negligent entrustment cause of action, will be answered in future litigations.

**Measure of Damages for Breach of the Agreement to Obtain Insurance**

In our Spring, 2000 edition of *Cases & Points*, we reported on a First Department case which limited the damages to be awarded for breach of contract where a tenant had failed to obtain or maintain general liability insurance for the benefit of the owner. (Inchaustegui v. 666 5<sup>th</sup> Avenue LLP.)

The Inchaustegui decision had been rendered by the Appellate Division in a 3 to 2 decision and, because of the split in the Court and the lack of unanimity between New York’s Appellate Divisions, we predicted that the case would be heard by the Court of Appeals.

As predicted, leave to appeal was granted. On April 3, the Court of Appeals affirmed the First Department’s decision, holding that since the landlord had obtained its own insurance and thus had suffered no loss beyond out of pocket expenses (the cost of the insurance premium), “it may not now look to the tenant for the full amount of the settlement and defense costs in the underlying court claim”. Instead, its damages were limited to the insurance premium it had paid for its own policy.

This decision will have great impact upon building owners, general contractors and their insurers, who have, in the past, expected to obtain complete indemnification from the insurers of tenants and subcontractors who were contractually obligated to obtain insurance on their behalf, without regard to their own degree of fault.

**AGF&J DEVELOPMENTS**

• AGF&J continues to grow. Carmen Nicolaou and Shafiq Choudhry have joined the Firm as associates. Carmen is a 2000 graduate of Brooklyn Law School and received her BA in criminology at John Jay College. Shafiq is a 1998 graduate of Albany School of Law and received his BA from CCNY. They are both defense litigations.

• In March, Michael Gorelick, together with William Herrbold, Senior Vice President of Claims of Jewelers Mutual Insurance Company, presented a seminar on the adjustment of jewelers block claims and coverage of the jewelers block policy at the PLRB/LIRB Claims Conference in Atlanta. If any of our readers have questions concerning the presentation or the paper on jewelers block case law distributed at the seminar, call Mike Gorelick at (212) 422-1200 or e-mail him at: [mgorelick@agflaw.com](mailto:mgorelick@agflaw.com).

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**Jewelers Block – Books and Records Clause**

The jewelers block policy contains a condition that the insured will “maintain a detailed and itemized inventory. . . including. . . separate listing of all traveler’s stocks. “New York law requires not literal, but only substantial, compliance with that condition by the insured.

Generally speaking, the question of whether the insured has substantially complied with that condition is a question of fact, requiring a trial. However, on occasion, New York Courts have found that, as a matter of law, the insured has failed to substantially comply with that condition.,

In that connection, New York’s Appellate Division, First Department (in a case decided on March 22, 2001) found that the trial court had been correct in granting the insurer summary judgment and dismissing the Complaint where the Record on Appeal did not indicate any facts from which the jury could reasonably conclude that the insured had maintained records sufficient to disclose to the insurer the extent of its liability, independently of any need to resort to evidence outside the insured’s books and records. Coin Roberto Inc. v. Reliance Insurance Co. (1<sup>st</sup> Dept. March 22, 2001).

**Automobile Liability – Serious Injury Threshold: Herniated Disc per se do not meet the statutory threshold of serious physical injury**

In order to remove a bodily injury case from the restrictions of New York’s No Fault Statute and permit the injured person to maintain a lawsuit for bodily injuries, the plaintiff must have suffered “serious injury” within the meaning of New York’s Insurance Law § 5102(d).

The initial burden for dismissal of actions based upon the plaintiff’s alleged failure to have shown the existence of a “serious injury” within the meaning of New York’s Insurance Law § 5012(d) rests upon the defendant. In an illustrative case, decided by the Appellate Division, Third Department (Rose v. Ferguson) the Court found that the defendant had met its initial burden by submitting a report of its orthopedic expert who performed an independent medical examination of the plaintiff. While the defendant’s doctor diagnosed the plaintiff as suffering from degenerative disc disease, he opined that this condition was of pre-existing origin which could have been temporarily aggravated by the accident. The defendant also submitted the transcript of plaintiff’s deposition testimony where he testified that after the accident he continued to play racket ball, once or twice a week, although he could not compete with the same frequency and level of intensity he did prior to the accident. Defendant also showed that plaintiff’s testimony admitted that he continued to participate in Tai Chi on a regular basis, although with some discomfort. He also was able to return to his employment as a teacher, although he testified that he sat more frequently while giving his lectures. He finally testified at his deposition that he was no longer taking any prescription medication for pain associated with the accident although he continued to use Ibuprofen.

The Court found that based upon its review of the medical records and deposition testimony, defendant had met her initial burden. It then became incumbent upon the plaintiff to “set forth competent medical evidence based upon objective medical finding to support his claim” that he had sustained a “serious injury”.

In that regard, plaintiff submitted proof of his examination and treatment

at the Emergency Room, along with an MRI report and various records. His physician has indicated that plaintiff had suffered herniated discs.

In reversing the decision below and in granting the defendant summary judgment, dismissing the Complaint, the Appellate Division noted that herniated or bulging discs do not per se meet the statutory threshold of serious physical injury absent “objective evidence of the extent or degree of the alleged physical limitations resulting from the injuries and their duration.

While plaintiff’s doctor did opine that plaintiff’s herniated discs were caused by the accident, and that the condition was not pre-existing, he failed to specify any resulting loss or limitation of motion caused by the accident. Instead, he stated in a conclusory fashion that the plaintiff sustained “permanent loss that is consequential to the motor vehicle accident”.

The Appellate Division concluded that such proof failed to overcome the evidence presented by defendant demonstrating the absence of serious injury sufficient to satisfy the “significant limitation” and “permanent consequential limitation” categories of the Insurance Law”. Furthermore, the Court found that it was necessary for the plaintiff to demonstrate that his usual activities were curtailed “to a great extent rather than some slight curtailment”. Thus, the Court found that based upon its review of the medical evidence and plaintiff’s own testimony concerning the restrictions placed on his life style as a result of his injuries, it agreed with the defendant’s contention that plaintiff had failed to satisfy the burden of raising a triable issue of fact in this regard, and granted the defendant summary judgment in dismissing the Complaint.

Thus, even where the plaintiff's expert contends that the plaintiff has suffered significant injuries, including herniated discs, a threshold motion for summary judgment by the defendant might still be available unless the plaintiff can establish the existence of a question of fact, by evidentiary showing, that he has suffered a "significant injury" as defined by the statute or that plaintiff's usual activities were curtailed to a great extent for at least 90 of the 180 days following the accident.

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This past quarter, New York's appellate courts have been unusually busy deciding cases involving insurance coverage and liability defense issues. This issue of Cases & Points will review those recent Court of decisions.

Of particular interest to property insurance claims defense practitioners is the Court of Appeals' recent decision in Lane v. Security Mutual may have wide ranging effect on fire insurers' obligations to pay claims resulting from fires intentionally set by their insureds.

The Lane, case, its potential impact, as well as the limitations of its effect, is the subject of this edition's lead article

Cut-out

The Court of Appeals' decision in Lane renders the change from "the insured" to "an insured" unenforceable with regard to the peril of fire and reinforces the rights of an innocent coinsured. The only way to change the standard fire policy exclusion to "an insured" is for the Legislature to amend the Insurance Law. It is, however, implicit in the Lane decision that there is a critical difference between the phrases "the insured" and "an insured". If the Insurance Law is amended, the wrongful act by *any* insured will preclude recovery by an innocent coinsured.

**Parent's liability for negligent entrustment of a dangerous instrumentality**

In Rios v. Smith, decided February 13, 2001, the Court of Appeals held the owner of an all terrain vehicle (an ATV) responsible for entrusting two of his ATVs to his teenage son, knowing that the son might allow his friend to use one of the vehicles.

At the time of the accident, each of the two teenage drivers had a female passenger who held on to the drivers as they operated the ATVs at the defendant's farm. The ATV driven by the son's friend struck a tree, seriously injuring his passenger. After reductions in its amount by both the trial court and the Appellate Division, plaintiff's verdict totaled \$3 million against the owner and operator of the ATV. The owner of the ATV appealed, asserting that the claim against him was based upon negligent supervision of a child and thus, failed to state a cause of action.

The Court of Appeals, in its unanimous opinion stated that the case was not, in fact, a "non-supervision" of a child case. Instead, the Court decided the case on the duty owed by a parent to protect third-parties from harm resulting from

an infant's child's improvident use of a dangerous instrument, especially when the parent is aware of and capable of controlling its use.

Thus, the Court held that it was within the jury's province to find that the ATVs were in the "parent's control" and that it was "clearly foreseeable" by the defendant's father and owner that the ATVs could become a "dangerous instrument" in a teenager's hand.