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Chronological Exhaustion of Policy Limits

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The existence of multiple claimants against a single, limited (and presumably inadequate) insurance policy is a common occurrence. When the number of claimants exceeds two, the insurer may be faced with the important, but difficult, question of how to divide its policy limits pie among several hungry claimants.

This question has been addressed, in various forms, by numerous courts throughout the years. See Dachs, Jonathan A., "The Contest of Multiple Tort Plaintiffs for Limited Insurance Policy Proceeds: Pro Rata Distribution or 'First Come, First Served?'" New York State Bar Digest (December 1998). Recent decisions have confirmed that although a different rule applies to vehicles for hire, which are governed by specific statutory provisions that call for ratable apportionment (see Vehicle & Traffic Law [VTL] §370), with respect to private passenger vehicles, the prevailing rule is "first in time, first in right," and, except under unique circumstances, an insurer may pay out its entire policy limit to the first claimants that approach it, even at the expense of later approaching claimants, without risking a finding of "bad faith."

Early Case Law

In *Duprey v. Security Mutual Ins. Co.*, 22 AD2d 544 (3d Dept. 1965), the defendant, who had a $10,000/$20,000 policy, settled the claim of one plaintiff for the sum of $9,000. The claims of two other claimants proceeded to trial and resulted in judgments against the defendant of $100,000 each. After reducing its $20,000 limits by the $9,000 settlement previously paid, the insurer paid $5,500 to each of the other claimants (a total of $11,000). In an action by one of those claimants to compel the insurer to pay an additional $4,500 towards the judgment in its favor, the question presented to the court was the effectiveness of the insurer's $9,000 settlement "when it was aware that there were other claimants to the policy proceeds, that the total claims would probably exceed the policy limits and that there would probably be no source of recovery other than the policy."

Special Term held that the settlement had no effect on the insurer's liability under the policy. After characterizing the settlement as a "voluntary payment," "a gift" or "additional insurance," the court found in the enactment of the Motor Vehicle Security Act [VTL §310] an expression of policy requiring ratable apportionment among all claimants where policy limits are insufficient to cover all claims. The Appellate Division, Third Department, disagreed, however, and reversed, stating:

> While we can recognize a certain cogency in such a rule, we are faced with considerable logic and precedent which compel its rejection. Clearly the policy itself would permit such a settlement, and section 60.1 of the Regulations of the Insurance Department (NYCRR 60.1), which prescribes the mandatory minimal provisions of automobile liability policies, indicates that the company can retain its settlement privileges. Also, although there is no case we have found directly in point in New York, a study of cases closely analogous would not support the construction of section 310 rendered below [citations omitted]. In other jurisdictions which have legislation similar to section 310 the cases also have uniformly recognized such settlements as reducing the liability remaining under the policy [citations omitted].
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> The court further stated, as follows: "It may well be that the position taken by the court below with respect to a ratable distribution of insurance policy proceeds where multiple claims are involved should be adopted for cases such as the present one as it has been for almost a half a century with respect to vehicles for hire (VTL §370), but this is solely within the prerogative of the Legislature which, in our opinion, has not by the enactment of section 310 in its present form as yet embraced such a position." See also *Negron v. Eveready Ins. Co.*, 53 AD2d 815 (1st Dept. 1976); *Gerdes v. Travelers Ins. Co.*, 109 Misc2d 816 (Sup. Ct. Suffolk Co. 1981); *David v. Bauman*, 24 Misc.2d 67 (Sup. Ct. Nassau Co. 1960).

More Recent Cases

In *State Farm Ins. Co. v. Credle*, 228 AD2d 191 (1st Dept. 1996), three occupants of a motor vehicle were injured in an accident with an uninsured vehicle. The host vehicle was insured by State Farm under a policy that provided uninsured motorist benefits of $10,000 per person/$20,000 per accident. Five months after the accident, claimant Credle filed a notice of intent to make an uninsured motorist claim against State Farm. She took no steps to advance that claim until two and one-half years later, when she served her demand for arbitration. By that time, however, State Farm had already settled with the other two claimants and paid each of them $10,000. Thus, upon receipt of Ms. Credle's demand for arbitration, State Farm petitioned for a stay of arbitration on the basis that its policy limits had already been exhausted by its prior payments to the other two claimants. The court, however, denied State Farm's petition and the matter proceeded to arbitration, wherein Ms. Credle was awarded $10,000. Thus, despite the fact that its policy expressly limited its liability to $20,000 per accident, State Farm was, in essence, being directed to pay a total of $30,000 for this accident.

On its appeal to the First Department, State Farm argued that the arbitrator exceeded his authority in rendering an award in excess of the contractual limits of the policy. State Farm also noted that there is no "pro-rating" statute in New York that alters the "first-in-time, first-in-right" principle (except for vehicles for hire) and no judicial precedent that would authorize a court to order an insurer to retain a portion of uninsured motorist benefits on behalf of a claimant who had unreasonably delayed in advancing her claim. Finally, State Farm noted

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that it may have had no choice but to settle with the first two claimants, for to have refused to accept their reasonable settlement offers on the theory that to pay such settlements would exhaust the coverage limits might have exposed it to a charge of bad faith.

The appellate court recognized that State Farm had made its payments "on a chronological basis" and concluded that while it was "arguably negligent" for the company "to have paid out proceeds to the first two applicants, exhausting the policy limits after respondent had filed her claim, such action did not rise to the level of 'gross disregard' so as to constitute bad faith as to [Ms.] Credle." Compare *Obad v. Allstate Ins. Co.*, 27 AD2d 295 (4th Dept. 1967). Accordingly, the court vacated the arbitrator's award in favor of Ms. Credle.

Subsequently, in *STV Group, Inc. v. American Continental Properties, Inc.*, 234 AD2d 50 (1st Dept. 1996), the First Department stated that "An insurer may settle with less than all of the claimants under a particular policy even if such settlement exhausts the policy proceeds" [citing *Duprey v. Security Mut. Cas. Co.*, supra; but not citing *Credle v. State Farm Ins. Co.*, supra].

Different Opinion

In *Matter of Belizaire v. Aetna Cas. & Sur. Co.*, 171 Misc.2d 473 (Sup. Ct. Kings Co. 1997), which involved a hit-and-run accident in which four passengers in the insured vehicle were injured, the court came to a different conclusion. In that case, the claimant filed a petition to compel arbitration of his uninsured motorist claim and the arbitration was subsequently held. Prior to the commencement of the hearing, counsel for the insurer advised the arbitrator that its uninsured motorist coverage (UM) coverage was limited to $10,000/$20,000 and that two of the other passengers in the insured vehicle had previously been awarded $9,500 and $8,000 respectively, leaving only $2,500 available to the claimant and the fourth passenger, who had also filed a claim. Following the presentation of evidence, and notwithstanding the foregoing, the arbitrator awarded claimant the sum of $10,000.

Claimant moved to confirm the $10,000 award and the insurer cross-moved to vacate it, or to reduce it from $10,000 to $2,500. Claimant strenuously opposed the insurer's assertion that its liability to him was limited to the $2,500 unexpended balance of the $20,000 per accident limit, contending that its failure to have moved for a stay of all four arbitrations and to consolidate all of the claims into one proceeding left it vulnerable to awards in excess of its policy limits. Indeed, claimant argued that by virtue of the insurer's failure to stay and consolidate the various claims, each claimant could be awarded up to $10,000 in separate arbitrations.

The court noted, inter alia, that "in situations where the carrier has settled with some claimants in a multi-party accident, the remaining parties who have not settled are bound by the policy limitations *where the policy gives the carrier the right to settle as it sees fit.* [Emphasis added]. Under these circumstances, any award to a claimant in excess of an unexpended balance after taking into account the settlements entered into with the other parties will be vacated [citations omitted]." In *Belizaire*, however, the court noted, without explanation, that "the policy provisions under which petitioner's rights arise do not give the carrier such unfettered authority."

Focusing upon the specific issues before him, the court cited to and discussed a Bronx Civil Court case, *McCoy v. New Jersey Manufacturing Ins. Co.*, 107 Misc2d 1090 (Civil Ct. Bronx Co. 1981), involving a no-fault arbitration, in which the arbitrator had not been informed of prior arbitration awards to other claimants when he awarded the claimant an amount within the policy limits, but which exceeded the balance remaining after the prior awards. There, the court held that, at worst, the arbitrator had made an unintentional error, which would not justify the vacatur of the award under the applicable standard of review. The court also referred to and discussed the decision of the Appellate Division, Second Department in *Aetna Cas. & Sur. Co. v. Cebularz*, 191 AD2d 690 (2d Dept 1993),

The Second Department held that, "as long as it does not act in bad faith, an insurer has no duty to pay out claims ratably and/or consolidate them."

wherein that court held that Aetna had waived its contention that the arbitrator exceeded his authority by rendering an award after the limits of the uninsured motorist coverage previously had been exhausted, finding that that ground should have been raised in a petition to stay arbitration.

In the court's view, the *Cebularz* decision stood for the proposition that "in the case of multiple claims against a limited liability policy, a carrier, who has notice of multiple claims, must consolidate such claims in the interest of dividing as fairly as possible the limited assets available. If the carrier fails to consolidate the claims, as here, then the carrier must be prepared to pay each claim that is awarded within the policy limits, even if cumulatively the awards exceed such limits." The court further said that, "The first-in-time rule seems to merely be an expedient rather than a reasoned response to a situation where an injustice will inevitably result to either the carrier or the claimant." Since, in his view, the arbitrator reached an equitable result and "sensibly applied the law to the novel situation confronting him," the court granted claimant's motion to confirm the award and denied the insurer's cross-motion. Thus, the insurer was compelled to pay out a total of $27,500 on a $20,000 policy.

See also, *Boris v. Flaherty*, 242 AD2d 9 (4th Dept. 1998), wherein the court expressed its approval of an interpleader action as part of the duty of good faith of an insurer in defending and settling claims over which it exercises exclusive control on behalf of its insured and as a means of avoiding unfairness and distributing insurance coverage in an equitable manner, rather than simply paying judgment creditors in the order that the judgments are entered until coverage is exhausted. "All claimants are treated fairly in the interpleader action and the rights of the insured are fully protected."

Most Recent Cases

In *Countrywide Ins. Co. v. Sawh*, 272 AD2d 245 (1st Dept. 2000), a proceeding to confirm a no-fault arbitration award of $2,250 to the respondent as reimbursement of health care expenses, the court held that the arbitrators exceeded their authority in directing the payment of the sum at issue because that award was in excess of the $50,000 limits of the policy. In the words of the court, "When an insurer 'has paid the full monetary limits set forth in the policy, its duties under the contract of insurance cease.'"

In *Zapata v. Cruz*, N.O.R., NYLJ, March 15, 2004, p. 17, col. 1 (Sup. Ct. N.Y. Co. 2004), the plaintiff was one of 17 passengers injured when the defendant lost control of a van and crashed into a guardrail. Defendant's insurance policy limited coverage to $25,000 per person and $50,000 per accident. The 16 other passengers settled their claims for a total of $40,750. The plaintiff, who continued her lawsuit, argued that due to the failure of defendant's insurer to consolidate claims, she, as the first and only passenger to obtain a judgment (albeit through stipulation), was entitled to the policy's limit of $25,000 per person. Defendant's insurer sought a declaration that the plaintiff was entitled to receive only $9,250 after deduction of the other settlement payments. Distinguishing *Belizaire v. Aetna Cas. & Sur. Co.*, on which the plaintiff relied, the court held that the plaintiff was entitled to only $9,250, the amount remaining on the policy's per-accident limit after deduction of all settlement claims.

The latest decision on this subject is *Allstate Ins. Co. v. Russell*, 13 AD3d 617 (2d Dept. 2004). Therein, the respondent, who was insured by Allstate with supplementary uninsured motorist (SUM) coverage of $25,000 per person/$50,000 per accident, was involved in an accident with an uninsured vehicle. He notified Allstate of his intention to make an SUM claim within a month after the accident, but did not file a demand for arbitration until almost two years later. Sometime before it received respondent's demand for arbitration, Allstate exhausted its SUM limits by paying out the entire policy limits to two other claimants. In its petition to stay arbitration, Allstate argued that it owed no obligation to the respondent because it had exhausted its policy limits.

The Supreme Court denied the petition, holding that in order to avoid awards in excess of its policy limits, Allstate was required to consolidate the claims. On appeal, the Second Department reversed, holding that, "as long as it does not act in bad faith, an insurer has no duty to pay out claims ratably and/or consolidate them." The court concluded that since the respondent failed to show, or even allege, that Allstate acted in bad faith, Allstate was entitled to a stay of the arbitration [citing *Duprey*, supra and *STV Group*, supra, and distinguishing *Cebularz*, supra and *Belizaire*, supra].