INSURANCE LAW

Fine Line Between Exclusions And Noncoverage

The courts have recognized that a distinction is to be drawn between the denial of coverage based upon noncoverage and a denial based upon an exclusion from coverage. In the former situation, the claim is not within the policy and, therefore, no notice of disclaimer is required, because mandating coverage on the basis of an insurer's failure to serve a timely notice of disclaimer would be to create coverage where none previously existed. In the latter situation, the policy covers the claim but for the applicability of the exclusion and, therefore, a notice of disclaimer is required.

The Court of Appeals has recognized that "drawing the line between a lack of coverage in the first instance (requiring no disclaimer) and a lack of coverage based on an exclusion (requiring timely disclaimer) has at times proved problematic." *Worcester Ins. Co. v. Bettenhauser*, 95 NY2d 185 (2000).

'Schiff'

Almost 30 years ago, in *Albert J. Schiff Associates, Inc. v. Flack*, 51 NY2d 692 (1980), the Court of Appeals held that a disclaimer of liability under two professional "errors and omissions" indemnity insurance policies, based upon three specific exclusions, did not waive the insurer's defense that a claim was outside the scope of the insuring clauses of the policies, which the insurer subsequently raised in opposition to a motion to dismiss the insured's subsequent action seeking a declaration that the insurer was bound to defend and indemnify it in a lawsuit. Indeed, the Court specifically held that the defense of noncoverage "is never waived by a failure to assert it in the notice of disclaimer."[1]

'Zappone' and 'Hobson'

A little over a year later, in *Zappone v. Home Ins. Co.*, 55 NY2d 131 (1982), the Court of Appeals held that "The principle, declared in *Schiff Assoc. v. Flack*, (51 NY2d 692), that the failure to disclaim coverage does not create coverage which the policy was not written to provide, applies to liability policies as well as professional indemnity insurance, notwithstanding the provisions of subdivision 8 of Section 167 of the Insurance Law [now Ins. L. §3420(d)(2)]," which require a liability insurer to give written notice "as soon as is reasonably possible" to the insured and the injured person or other claimant of its intent to "disclaim liability or deny coverage."[2]

By **Norman H. Dachs**

And **Jonathan A. Dachs**

> Careful analysis of the coverage agreements, definitions and exclusions contained in the policy is required.

The *Zappone* court further held that the words "deny coverage" in the statute "refer to denial of liability predicated upon an exclusion set forth in a policy which, without the exclusion, would provide coverage for the liability in question," and that "it does not encompass denial that the policy as written could not have covered the liability in question under any circumstances." As the Court further explained, "the Legislature did not intend by its use of the words 'deny coverage' to bring within the policy a liability incurred neither by the person insured nor in the vehicle insured, for to do so would be to impose liability upon the carrier for which no premium had ever been received by it and to give no significance whatsoever to the fact that automobile insurance is a contract with a named person as to a specified vehicle." 55 NY2d at 135-136.

In *Zappone*, supra, the policy's coverage clause at the outset conditioned recovery on liability "arising out of the ownership, maintenance or use of a [covered] or *non-owned* automobile (emphasis added)." Because the automobile involved in the accident was owned by a family member and was not within the coverage clause of the policy, the Court concluded that there was never a contractual relationship between the insurer and the claimant giving rise to any duty, including the statutory duty to timely disclaim.

In *Prudential Property Casualty Ins. Co. v. Hobson*, 67 NY2d 19 (1986), the Court held that the requirement of "physical contact" in the definition of a "hit-and-run automobile" contained in the uniform uninsured motorist endorsement was a matter of coverage, not exclusion from coverage, thereby eliminating the need for a timely disclaimer on that ground. As explained by the Court, "No coverage exists in the absence of the required contact."[3]

Contrasts and Comparisons

By contrast, in *Handelsman v. Sea Insurance Company, Ltd.*, 85 NY2d 96 (1994), rearg. denied 85 NY2d 924 (1995), the coverage portion of the policy required payment for "bodily injury or property damage for which any 'insured' becomes legally responsible because of an auto accident," and defined an "insured" as a "'family member' for the ownership, maintenance or use of any auto." The policy also contained a "specific exclusion" stating that the coverage described elsewhere did not apply to the ownership or use of a vehicle "owned by any 'family member' that was not a 'covered auto.'"

In that case, a son was involved in an accident while driving his mother's car. Both mother and son filed claims under the husband/father's insurance pol- » Page 9

NORMAN H. DACHS *and* JONATHAN A. DACHS *are partners at Shayne, Dachs, Corker, Sauer & Dachs, in Mineola.*

Noncoverage

« Continued from page 3

icy, which did not specifically list the vehicle involved in the accident as a "covered auto." Because the mother and son were "insureds" under that policy, who satisfied all of the conditions of the relevant coverage provisions—which did not contain any limitation with reference to vehicles—the Court of Appeals concluded that a relationship existed between the insurer and the claimants, which required timely denial of coverage based upon the policy's exclusion.

In *Planet Insurance Co. v. Bright Bay Classic Vehicles, Inc.*, 75 NY2d 394 (1990), the Court of Appeals considered whether definitional language that did not appear in the section of an insurance policy entitled "exclusions" eliminated coverage by reason of exclusion or lack of inclusion. Defendant Bright Bay obtained the policy in question for its fleet of rental cars. The policy defined "covered rental cars" as those rented for periods of less than 12 months. Id. at 398. One of Bright Bay's cars was later involved in an accident while being rented for a 24-month period.

The Court found that, although the insurance company disclaimed coverage based on the definition of "covered rental cars," as opposed to a provision in the policy's "exclusion" section, the definition's limiting language still amounted to an exclusion. The Court explained that the car was initially covered by the policy and only "became 'uncovered' upon the happening of a subsequent event: i.e., the rental... for a lease period other than that prescribed in the policy." Since the car was at one point covered, this was not a case where there "was never a policy in effect covering the involved automobile."

And, in *Worcester Ins. Co. v. Bettenhauser*, supra, where the claimant, who was driving his own automobile when he was seriously injured in a two-car accident, made a claim for underinsured motorist benefits under the policy of his parents, with whom he resided at the time, pursuant to which he was deemed an "insured," the Court held that the insurer's attempt to stay arbitration on the ground that "no coverage exists...in that [the claimant] was operating his own vehicle at the time of the accident and was not operating a vehicle owned by the policyholder" was ineffective and invalid because the insurer failed to timely deny coverage on that ground.

Essential to that determination was the Court's conclusion that "timely disclaimer was necessary because [the claimant's] claim falls squarely within the policy's coverage provisions set out in the "insuring agreement," which did not depend on the vehicle driven, and the denial of coverage was predicated on one of the specifically designated "exclusions" in the policy (for bodily injury sustained "while 'occupying' or when struck by, any motor vehicle owned by you or a 'family member' which is not insured for this coverage under the policy"). As the Court explained, "but for a specified circumstance—here, the use of a family-owned motor vehicle not insured by the policy—(the claimant's) claim would have been covered."

Recent Federal Case

Several recent decisions dealing with the issue of exclusion versus noncoverage have been rendered by the courts. Most recently, in *NGM Ins. Co. v. Blakely Pumping, Inc.*, 593 F.3d 150 (2d Cir. 2010), the insured corporation had purchased an insurance policy and endorsement that covered liability arising out of the use of a "hired auto" or "non-owned auto"—terms defined so as to include an auto owned by an executive officer or employee of the insured. An officer of the insured was injured when he crashed his pick-up truck into another vehicle while in the course of his work for the corporation.

Upon receipt of lawsuit papers from the driver of the other vehicle, the insured corporation requested the insurer to defend that action pursuant to its "businessowners liability coverage" policy, which generally covered liability for personal injuries, but contained a section entitled "exclusions," which expressly disclaimed coverage for damages "arising out of the ownership, maintenance, use or entrustment to others of any... 'auto'...owned or operated by or rented or loaned to any insured."

However, the insured had also purchased an endorsement that modified the policy by extending coverage to bodily injury arising from the use by the company or one of its employees of a "hired auto"—defined as "any 'auto' you lease, hire or borrow," not including "any 'auto' you lease, hire or borrow from any of your 'employees' or members of their households, or from any partner or 'executive officer' of yours"—or a "non-owned auto," defined as "any 'auto' you do not own, lease, hire or borrow which is used in connection with your business."

The insurer initially disclaimed coverage, based on the policy's exclusion for autos. Upon having the endorsement's extension of coverage for bodily injuries arising out of the use of a "hired auto" or "non-owned auto" called to its attention, the insurer subsequently disclaimed again, this time on the ground that the driver was an executive officer of the insured and, therefore, his pick-up truck was neither a "hired auto" nor a "non-owned auto," as defined.

The district court concluded that the insured corporation had borrowed the auto of one of its officers and that the accident was, therefore, not covered under the terms of the policy as modified by the endorsement. However, since the endorsement "generally covered auto accidents," the definitions of "hired auto" and "non-owned auto" constituted exclusions of that general coverage. Accordingly, the insurer was required to provide written notice of disclaimer on the ground that the subject pick-up truck was neither a "hired auto" nor a "non-owned auto." Since the insurer originally disclaimed on the basis of the exclusion for autos, it waived its right to disclaim coverage on other grounds.[4]

The U.S. Court of Appeals for the Second Circuit, in reversing the district court, concluded that the endorsement's definitions of "hired auto" and "non-owned auto" did not constitute exclusions requiring a notice of disclaimer. "The endorsement did not generally cover auto accidents; it covered only accidents arising from the use of a 'hired auto' or 'non-owned auto.' Those terms were defined in such a way that an employee's or officer's vehicle, like [the pick-up truck involved in this case] could *never* be covered [emphasis in original]."

The court concluded that this was not a case where the happening of a subsequent event implicated a definitional term that "uncovered" a formerly covered car, as in *Planet Ins. Co.*, supra, but rather a case in which the policy as written could not have covered the liability in question under any circumstances, as in *Zappone*, supra. In short, the court concluded that there was no coverage "by reason of lack of inclusion," and, thus, no notice of disclaimer was required.

In so holding, the circuit court distinguished two cases in which New York Appellate Courts found that definitional language could constitute a policy exclusion requiring a disclaimer in accordance with Ins. L. §3420(d)(2). Although in *Greater New York Mutual Ins. Co. v. Clark (Miller)*, 205 AD2d 857 (3d Dept. 1994), the Third Department found that despite the fact that nonpermissive use was not specifically denominated as an exclusion, but, rather, appeared as a definition of coverage, "a careful reading of the limiting language used to define who is an 'insured' under the policy reveals that nonpermissive use is in the nature of an exclusion," in that case the policy explicitly covered the auto and its driver in many other circumstances.

It should be also noted that the Second Department has held since an auto policy does not contemplate any coverage while the vehicle is in the hands of a thief, no written notice of disclaimer is required where the vehicle is operated without the owner's permission or consent. See *Katz v. Allstate Ins. Co.*, 96 AD2d 930 (2d Dept. 1983); *Allstate Ins. Co. v. Nelson*, 285 AD2d 545 (2d Dept. 2001).

And, although in *USAA v. Meier*, 89 AD2d 998 (2d Dept. 1982), the Second Department held that various definitions in the policy that

> The Court of Appeals has recognized that 'drawing the line between a lack of coverage in the first instance (requiring no disclaimer) and a lack of coverage based on an exclusion (requiring timely disclaimer) has at times proved problematic.'

withheld coverage from individuals engaged in automobile businesses were exclusions because they were "negative definitions, which, in effect, are nothing more than exclusions," that decision does not stand for the proposition that all definitions that limit coverage are exclusions. In fact, as the circuit court noted, the *Meier* court, itself, found that other definitions in the same policy, such as the definitions of "owned vehicle," "newly acquired vehicle," and "temporary substitute vehicle," were not exclusions. Where the vehicle in question failed to qualify as one of those defined terms, there was never "a contract of insurance with the person or for the vehicle involved in the accident."

Other Cases

In *Allstate Ins. Co. v. Massre*, 14 AD3d 610 (2d Dept. 2005), the court held that a disclaimer pursuant to Ins. Law §3420(d) is not required where the denial is based upon the fact that the collision that caused the claimant's injuries was intentional and not the result of an accident. Such a denial is based upon a lack of coverage, rather than a policy exclusion. See also *Liberty Mut. Ins. Co. v. Goddard*, 29 AD3d 698 (2d Dept. 2006).

In *State Farm Auto Ins. Co. v. Laguerre*, 305 AD 490 (2d Dept. 2003), the court held that there was no obligation to issue a disclaimer in accordance with Ins. L. §3420(d) because its denial was based upon a lack of coverage, where it claimed that the collision was deliberately caused to fraudulently obtain insurance benefits. See also *GEICO v. Spence*, 23 AD3d 466 (2d Dept. 2005) (since the insurer was endeavoring to adduce evidence of fraud—i.e., a staged accident—which may have established that the occurrence or collision was not covered, there was no need for it to disclaim in a timely fashion); *Eagle Ins. Co. v. Davis*, 22 AD3d 846, 803 NYS2d 679 (2d Dept. 2005) ("A collision caused in the furtherance of an insurance fraud scheme is not a covered accident under a policy of insurance").

More Recent Cases

In *New York Central Mutual Fire Ins. Co. v. Steiert*, 68 AD3d 1120 (2d Dept. 2009), the court held that the basis of the insurer's disclaimer of coverage, i.e., that the vehicle involved in the accident was provided to the driver, by his father, for his regular use, was a policy exclusion, rather than a lack of coverage, thus requiring a timely notice of disclaimer based thereon. See also, *State Farm Mut. Auto Ins. Co. v. Waite*, 68 AD3d 1006 (2d Dept. 2009) (petition to stay based upon exclusion rather than a lack of coverage—therefore, petition filed more than 20 days after receipt of demand for arbitration was untimely); *Allstate Ins. Co. v. Doyle*, 64 AD3d 775 (2d Dept. 2009) (same).

In *Essex Ins. Co. v. Oakwood Const. Corp.*, 59 AD3d 591 (2d Dept. 2009), the court held that the claimant's injury did not fall within the coverage of the policy, and, thus, the insurer was not required to timely disclaim coverage. And in *Progressive Ins. Co. v. Dillon*, 68 AD3d 448 (1st Dept. 2009), the court rejected the claimants' late disclaimer argument because the insurer contended that it never issued an SUM policy to the insured, and "estoppel cannot be used to create coverage where none exists, regardless of whether the insurance company timely issued its disclaimer."

As can be seen from the foregoing, careful analysis of the coverage agreements, definitions and exclusions contained in the policy is required in order to properly ascertain the existence and viability of a late disclaimer argument.

1. Interestingly, the *Schiff* Court noted, in a footnote, that "our Court long ago made clear that it will not countenance the avoidance of the law of waiver by respecting the labeling as an exclusion of what, substantively is a condition [citing *Draper v. Oswego County Fire Relief Assn.*, 190 NY 12, 18 (1907)]." 51 NY2d at 699. The Court also carefully distinguished the concept of waiver from "the intervention of principles of equitable estoppel," such as "where an insurer, though in fact not obligated to provide coverage, without asserting policy defenses or reserving the privilege to do so, undertakes the defense of the case, in reliance on which the insured suffers the detriment of losing the right to control its own defense." In such cases, "though coverage as such does not exist, the insurer will not be heard to say so [citations omitted]." Id.

2. It is well-established that if the insurer fails to disclaim or deny in a timely (or proper) manner, it will be precluded from later successfully relying upon its defenses to coverage. See *Hartford Ins. Co. v. County of Nassau*, 46 NY2d 1028, 1029 (1979).

3. See also *Erie Ins. Co. v. Calandra*, 49 AD3d 1237 (4th Dept. 2008).

4. See *General Acc. Ins. Group v. Cirucci*, 46 NY2d 802 (1979); *Maroney v. New York Central Mutual Fire Ins. Co.*, 5 NY3d 467 (2005).