URB INSIDER

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At The Supreme Court — October Term

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The year 2008 will long be remembered by many as a year of big news stories, especially those about politics and the economy.

But it has also been a year when the Supreme Court has made news with various cases it addressed or even rejected.

Some of the cases have been discussed earlier this year, but most recently in the October, 2008 term there were a couple of prominent cases.

In *Altria Group v. Good*, a 5-4 decision, the Supreme Court affirmed the decision of the Court of Appeals. The Court of Appeals had held that the state law claim at issue was not pre-empted by the Federal Cigarette Labeling and Advertising Act, as amended.

In *Winter v. National Resources Defense Counsel*, the Supreme Court upheld the power of the Navy to use sonar in military training exercises in spite of claims by environmentalists that the technology threatens marine life in the training zone where it is used.

The Supreme Court also heard a variety of other cases and granted a number of petitions for certiorari. ◆

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Editor's Note: *The material contained in this publication is provided as information only, and is not intended to be construed or relied upon as legal advice in any manner. Always consult an attorney with the particular facts of a case before taking any action. The material contained in this publication was not necessarily prepared by an attorney admitted to practice in the jurisdiction of materials contained in the publication.*

From The Court of Appeals

Lack Of Cooperation, Timely Disclaimer

The Court of Appeals addressed the issue of timely disclaimer in the case of *Continental Cas. Co. v. Stradford*, 2008 NY Slip Op 09256. Over nearly six years, defendant Terrance Stradford cooperated only sporadically with his professional liability insurer, plaintiff Continental Casualty Company, in the defense of two dental malpractice actions.

Stradford reported the underlying malpractice actions about a month after they were initiated. Many requests from Continental took the form of largely unanswered correspondence and telephone calls and failed visits by defense counsel to prearranged meetings. Continental repeatedly warned Stradford that his non-cooperative conduct could jeaopardize his coverage. These warnings went unheeded. But, at various times, Stradford indicated an awareness of his duty to cooperate and expressed his willingness to do so. After four years without production of a single relevant document, Stradford participated in a conference call he requested to discuss a settlement of one of the matters.

At that time, Stradford requested new counsel, to which Continental agreed and Supreme Court marked all cases pending against Stradford off calendar pending substitution of counsel. Despite calls and a letter from his new counsel, Stradford never executed the necessary form to effect the requested substitution.

In July, 2004, Continental mailed Stradford two detailed letters, one for each case, setting forth his history of noncompliance, evasion and broken commitments. A meeting with counsel was requested, he was warned that further non-cooperation could imperil coverage, and, given adverse expert findings, it was recommended that Stradford consent to settlement of both actions. The letters were returned unclaimed. About two months later, Continental's outside counsel sent a disclaimer. Continental then commenced a declaratory judgment action.

The disclaimer was the result of a process whereby the employee responsible for the underlying cases would make a coverage recommendation to his director, who would then make a recommendation to Continental's in-house coverage counsel. In addition, Continental sought an opinion from outside counsel regarding its coverage opinion. Continental's decision to disclaim was bolstered by a declaratory judgment issued earlier that year in two other malpractice actions then pending against Stradford. There, the court held that Stradford's failure to respond to multiple letters seeking his cooperation and his absence on trial dates constituted sufficient grounds for a disclaimer of coverage.

In this action, Continental moved for summary judgment on its declaratory judgment claim that Stradford's non-cooperation had terminated the company's contractual obligation to him. Defendants cross-moved for summary judgment, arguing that the company's disclaimer was untimely and, in the alternative, that it had not carried its burden of proving Stradford's non-cooperation. Supreme Court granted Continental's motion in all respects and similarly denied the cross-motion. The court concluded that Stradford was not entitled to a defense or indemnification because of his multiple breaches of the cooperation clause.

In a 3-2 decision the Appellate Division reversed. All members concluded that Continental had carried its burden of establishing Stradford's non-cooperation. The majority held, however, that Continental's approximately two-month delay in disclaiming was unreasonable as a matter of law. The dissent disagreed, reasoning that the company had discharged its "heavy burden" of attempting to bring about his cooperation prior to disclaiming. Plaintiff appeals from the order of reversal. The timeliness of the disclaimer was the sole issue before the Court of Appeals. The Court of Appeals modified by denying defendants' cross motion for summary judgment.

In its reasoning, the Court of Appeals discusses that even if an insurer possesses a valid basis to disclaim for non-cooperation, it must still issue its disclaimer within a reasonable time (*see* 14 Couch on Insurance 3d § 199:69). When construing Insurance Law § 3420 (d), which requires an insurer to issue a written disclaimer of coverage for death or bodily injuries arising out of accidents "as soon as is reasonably possible," the Court of Appeals has made clear that timeliness almost always presents a factual question, requiring an assessment of all relevant circumstances surrounding a particular disclaimer *Continental Cas. Co. v. Stradford*, *citing*, *First Fin. Ins. Co.*, 1 NY3d at 69, 69 [2003]; *Hartford Ins. Co. v. County of Nassau*, 46 NY2d 1028, 1030 [1979]; *Allstate Ins. Co. v. Gross*, 27 NY2d 263, 270 [1970].

Fixing the time from which an insurer's obligation to disclaim runs is difficult. That period begins when an insurer first becomes aware of the ground for its disclaimer *Continental Cas. Co. v. Stradford*, *citing*, *First Fin. Ins. Co.*, 1 NY3d at 68-69, *quoting Matter of Allcity Ins. Co. [Jimenez]*, 78 NY2d 1054, 1056.

Contrary to the Appellate Division, the Court of Appeals concluded that a question of fact remained regarding the amount of time required for Continental to complete its evaluation of Stradford's conduct in the two underlying actions, and the reasonableness of the insurer's approximately two month delay presented a question of fact precluding summary judgment.◆

No Address Update, No Coverage

In *Briggs Avenue LLC v. Insurance Corp. of Hannover*, 2008 NY Slip Op 09004, the Court of Appeals held that a liability insurer is entitled to disclaim coverage when the insured, because of its own error in failing to update the address it had listed with the Secretary of State did not comply with a policy condition requiring timely notice of a lawsuit.

Briggs is the owner of a building in the Bronx. The company was incorporated in 1999 and Shaban Mehaj is its manager and only member. As required by Limited Liability Company Law §301, Brigg's articles of organization designated the Secretary of State as its agent to receive service of process. The articles included Brigg's address, but Briggs later moved, and Mehaj did not notify the Secretary of State of the change. His explanation is that the lawyer who formed the company for him did not tell him of the need to keep the address updated.

In July, 2003, a tenant of the building, Nelson Bonilla, began a personal injury action against Briggs, and served the summons and complaint on the Secretary of State. Because the Secretary of State did not have a current address for Briggs, Mehaj did not receive the summons and complaint and did not know the lawsuit existed. He learned of it in April 2004, when Bonilla served directly on Briggs a motion for default judgment. Briggs then gave notice to its liability insurer, Insurance Corporation of Hannover (ICH), of the claim against it. ICH promptly disclaimed coverage, relying among other things on a policy provision saying: "If a claim is made or 'suit' is brought against any insured, you must ...[n]otify us as soon as practicable."

Briggs brought a declaratory judgment action in Supreme Court against ICH, asking that the insurer be required to defend the *Bonilla* case. ICH moved the action to the United States District Court for the Southern District of New York, and the District Court dismissed Briggs's complaint, holding that ICH's disclaimer was valid. Briggs appealed to the United States Court of Appeals for the Second Circuit, which certified to the Court of Appeals the following question: "Upon all facts of this case, given the terms of the insurance policy and the reason for the insured's failure to give more prompt notice of the lawsuit to the insurer, should the insurer's disclaimer of coverage be sustained?" The Court of Appeals answer to the question is yes.

According to the Court of Appeals, the validity of ICH's disclaimer turns on whether Briggs complied with the condition of the policy requiring it to given notice of a lawsuit to ICH "as soon as practicable." The Court of Appeals held that clearly it did not. It was unquestionably practicable for Briggs to keep its address current with the Secretary of State, and thus to assure that it would receive, and be able to give, timely notice of the lawsuit. Brigg's failure to do so was simply an oversight.

Briggs relies on *Agoado Realty Corp. v. United Intl. Ins. Co.*, (95 NY2d 141[2000]), in which the Court of Appeals held that there was an issue of fact as to whether the notice of a lawsuit was given "as soon as practicable." But *Agoado* is distinguishable. In that case, the Secretary of State sent documents to the insureds' lawyer, but the lawyer had died, and the insured claimed they did not know of his death. Thus, in *Agoado* it may really have been impracticable for the insureds to find out about the lawsuit and give timely notice to the insurer. In this case, however, it is clear that the insured could have prevented the mishap.

Brigg's argument is essentially that its mistake was understandable; that it caused no prejudice to the insurer; and that the loss of insurance coverage is a harsh result. All this may be true, but it is irrelevant. The Court of Appeals has long held, and recently reaffirmed, that an insurer that does not receive timely notice in accordance with a policy provision may disclaim coverage, whether it is prejudiced by the delay or not (*Argo Corp. v. Greater N.Y. Mut. Ins. Co.*, 4 NY3d 332, 339 [2005]; *Security Mut. Ins. Co. of N.Y. v. Acker-Fitzsimons Corp.*, 31 NY2d 436, 440 [1972]).

The Legislature, weighing the competing interests at stake, has recently enacted legislation that strikes a different balance, more favorable to the insured (See L 2008 ch 388, §§2, 4 [amending Insurance Law §3420, applicable to policies issued after January 17, 2009]), but that legislation has not yet become effective. The common law no-prejudice rule applies to this case. Accordingly, the certified question should be answered in the affirmative. ◆

Forms Update

- **NY STAT-1 ED. 11/08**

NY STATUTORY ENDORSEMENT Approved for use effective January 17, 2009. Intended to be attached on a mandatory basis to liability policies that are affected by the Late Notice/Declaratory Judgment legislation in compliance with Chapter 388 of the Laws of 2008, effective January 17, 2009.

- **UMBRELLA AGREEMENTS**

Sent to NYSID with a request to use without attaching UMB-84 Ed. 9/03 which removes the War Exclusion. Pending approval.

- **WORK IN PROGRESS**

Various LS exclusions for Silica, Bacteria, Exterior Insulation and Abuse.

Clarification for SF Employee Dishonesty Coverage. ◆

Spoliation Of Evidence

In December, 2005, plaintiff was seriously injured when a police car driven by defendant Matthew Hoy, a police officer employed by defendant, City of Schenectady Police Department, collided with her vehicle. Plaintiff sustained a traumatic brain injury and has no recall of the accident. Within days of the accident, plaintiff's attorney submitted a written request that both vehicles be preserved in their "immediate post-accident condition." Defendants soon thereafter permitted plaintiff's attorney to inspect plaintiff's vehicle but the attorney was denied access to the police vehicle which was being stored alongside her vehicle in the police station parking lot.

In January, 2006 a notice of claim was filed on plaintiff's behalf. In late February 2006, plaintiff was charged with and pleaded not guilty to two traffic violations related to the accident. Without notice to plaintiff's attorney, defendants performed their own accident reconstruction inspection of the police vehicle and then had it towed to a remote, outdoor storage site in another part of the city. On March 1, 2006, her attorney and his reconstruction expert went to inspect the police vehicle at its new location, and it had been vandalized. In a prelitigation proceeding, the court ordered defendants to "preserve all evidence," to put the vehicle inside and to make sure it is preserved in its "present condition."

Plaintiff commenced this negligence action and went to trial on the traffic violations in Schenectady City Court disputing that Hoy's sirens or lights were activated. City Court found plaintiff guilty of violated Vehicle and Traffic Law §1144(a) which is operation of vehicles on approach of authorized emergency vehicles, concluding that the police car emergency lights and sirens were operating at the time of the accident and the officer was operating his vehicle with reasonable care under the circumstances.

After issue was joined, plaintiff moved to strike defendants' answer based upon spoliation of evidence. Defendants cross-moved to amend their answer to include the affirmative defense of collateral estoppel-premised upon City Court's findings and to dismiss on that ground. After a hearing, Supreme Court granted plaintiff's motion only to the extent of ruling that she is entitled at trial to an adverse inference charge regarding spoliation of evidence. The court denied defendants' cross motion in its entirety and they now appeal.

Supreme Court, Appellate Division, Third Department rejected defendants' claim that Supreme Court abused its discretion in denying their cross motion to amend their answer to assert the affirmative defense of collateral estoppel, given that it is "plainly lacking in merit."

Indeed, as Supreme Court recognized, the testimony at plaintiff's traffic violation trial was limited due to the more narrow scope of that proceeding, and the issue of spoliation of evidence was not fully litigated or decided. Thus, while a guilty plea to a traffic violation may constitute some evidence of negligence (*see e.g. McGraw v. Ranieri*, 202 AD2d at 726) and the disposition of a traffic ticket may be admissible in a subsequent civil case for limited purposes (*see Martin v. Clark*, 47 Ad3d 981, 983 [2008]), a determination concerning a traffic violation should not be given collateral estoppel effect in a subsequent negligence action (*see Gilberg v. Barbieri*, 53 NY2d at 293). Accordingly, defendants' motion to amend their complaint and to dismiss was properly denied. Turning to Supreme Court's determination that plaintiff is entitled to an adverse inference instruction as a sanction for negligence spoliation of evidence, the court discerned no abuse of discretion. *Marotta v. Hoy*, 2008 NY Slip Op 08232.◆

Around The County

Another Wrinkle in D.C. Pants Case

This is an appeal from the Superior Court of the District of Columbia. The case has its origin in a dispute between plaintiff Roy Pearson and defendants Soo Chung, Jin Nam Chung and Ki Y. Chung over a pair of allegedly missing pants. The defendants own Custom Cleaners, a dry cleaning store. Mr. Pearson, the plaintiff, claims he took his pants there for alterations in May 2005, that they lost his pants and attempted to substitute another pair, which the defendants deny.

Mr. Pearson also claims that a "Satisfaction Guaranteed" sign that until recently was displayed in Custom Cleaners was an unconditional warranty that required the Chungs to honor any claim by a customer, without limitation, based on the customer's determination of whatever would make the customer "satisfied." Defendant contends that is an unfair trade practice under the Consumer Protection Procedures Act, D.C. Code § 28-3901 et seq. ("CPPA").

Pearson argued that each of the three defendants is liable to him for violations of the CPPA, for every day Custom Cleaners was open over a period of several years and he also sued for common law fraud based upon the "Satisfaction Guaranteed" sign and the "Same Day Service" sign. The damages sought could have been as much as $67 million dollars.

Pearson had a prior problem in 2002 with the Chungs that was rectified by the Chungs paying Pearson $150. After that time, the Chungs did not want to accept further business from Pearson, but he insisted.

In 2005, Pearson accepted a position that required him to wear a suit. He began leaving a series of pants at Custom Cleaners to be let out. One pair of pants was from a suit that according to Pearson, would cost $1,000 to replace, after they were allegedly lost by the Chungs.

The trial court, rejected Pearson's claims that the "Satisfaction Guaranteed" sign constituted common law fraud and a violation of various provisions of the CPPA. The trial court rejected the unlimited view of a "Satisfaction Guaranteed" sign, relying instead upon case law generally supporting the position that, as with a common law fraud claim, a claim of an unfair trade practice is properly considered in terms of how the practice would be viewed and understood by a reasonable consumer. It was noted that claims of common law fraud as well as violations of the CPPA, must be proven by clear and convincing evidence, and Judge Bartnoff concluded that the plaintiff did not meet his burden of proof. The trial judge rejected Pearson's argument that the "Same Day Service" sign violated various provisions of the CPPA, because Pearson provided no evidence to support the claim. Pearson also made a claim that the trial court erred by denying his late-filed motion for a jury trial.

The District of Columbia Court of Appeals affirmed the decision of the trial court. *Pearson v. Soo Chung*, 2008 D.C. App. Lexis 486.◆

In Pennsylvania

No Coverage For Crime Restitution

Appellant, Cynthia McKernan, appeals from an order entered on May 5, 2005, in the Court of Common Pleas, which granted the Motion for Summary Judgment of Appellee, Brethren Mutual Insurance Company. In granting summary judgment, the trial court, held that Pennsylvania public policy prohibits insurance coverage for an order of restitution imposed pursuant to a criminal conviction. After a careful review, the Superior Court of Pennsylvania affirmed.

In 1999, an argument took place between McKernan and her then boyfriend, Joseph Gardner, the decedent. At some point, McKernan grabbed a knife which struck Gardner, resulting in his death. McKernan was charged with a number of crimes and after jury trial, was convicted of reckless endangerment and simple assault. The trial court sentenced McKernan, among other things, to pay restitution of $5,190.00. This was equal to the funeral expenses incurred by Gardner's estate.

In 2002, Gardner's estate and minor children filed a wrongful death and survival action against McKernan. Subsequently, Brethren filed a declaratory judgment action seeking a determination that it was not obligated under its policy to defend the wrongful death and survival action. The motion was denied, and the trial court held that Brethren had a duty to defend and provide coverage to McKernan. Eventually, the wrongful death and survival action was settled but the policy limits were not exhausted.

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From The Department

Two Recent Circular Letters

Editor's Note: The New York State Insurance Department has recently issued a number of Circular Letters that may be of interest to property casualty insurers. Due to the relevance of the topics in Circular Letter No. 26 (November 18, 2008) regarding Notice Provisions in Liability Policies; Chapter 388 of the Laws of 2008 and Circular Letter No. 23 (November 19, 2008) regarding Mid-Term Cancellation of Policies Based Upon Residence Becoming Unoccupied, the full text of these Circular Letters is reprinted below for your information. Do remember that a Circular Letter presents the Department's position on a particular issue but does not have the force of law.

Circular Letter No. 26 (2008):

The purpose of this Circular Letter is to advise property/casualty insurers of the recent enactment of Chapter 388 of the Laws of 2008 ("Chapter 388"), which amends Insurance Law §§ 2601 and 3420 and Civil Procedure Law and Rules ("CPLR") § 3001. These amendments streamline litigation and prohibit the denial of liability coverage in certain circumstances. Chapter 388 culminates a nearly year-long endeavor involving the effort of this Department, working in conjunction with the Governor's office, the Legislature, industry and other interested parties, to put into place necessary and long overdue consumer protections in a manner that also is fair to both insureds and insurers. Chapter 388 accomplishes this delicate balancing act by bringing New York into the mainstream with respect to establishing a "prejudice" standard applicable to the late notice of claims.

The law takes effect on January 17, 2009 (180 days after it was signed by the Governor on July 21, 2008). The amendments apply to all liability policies (including renewals) issued or delivered in New York on or after the effective date of January 17, 2009, including policies issued in the excess line market. Liability insurers are reminded of the necessity of promptly revising their property/casualty insurance policy forms to comply with the bill's significant amendments. The key provisions of Chapter 388 are summarized below.

Insurance Law § 3420 establishes minimum policy provisions and other requirements with respect to liability policies issued or delivered in New York. One of those provisions, Insurance Law § 3420(a)(4), has long protected insureds, injured persons and other claimants by imposing a "reasonably possible" standard on insureds – i.e., every liability policy had to provide that failure to give any notice required by the policy within the time prescribed therein would not invalidate any claim if it could be shown not to have been reasonably possible to have given notice within the prescribed time, and that notice was given as soon as reasonably possible.

In adding new Insurance Law § 3420(a)(5), Chapter 388 establishes additional protections that complement the existing requirements. It requires every liability policy issued or delivered in New York to contain a provision stating that the failure to give notice as prescribed by the policy will not invalidate a claim made by the insured, an injured person, or any other claimant, unless the late notice has prejudiced the insurer, except as provided under Insurance Law § 3420(a)(4). In other words, the claim may not be denied if: 1) it had not been reasonably possible to give notice within the prescribed time, and notice is given as soon as reasonably possible, even if the insurer has been prejudiced; or 2) the insurer has not been prejudiced, even if the claim was not made as soon as reasonably possible.

With respect to a claims-made policy, pursuant to Insurance Law § 3420(a)(5), the policy may provide that the claim shall be made during the policy period, any renewal thereof, or any extended reporting period, subject to Insurance Law § 3420(a)(4). The reference to "any renewal" of a claims-made policy does not permit duplicate claims under multiple policy periods, or a late claim under a prior policy period, for example, where a subsequent policy's limits have been exhausted. Nor does the prejudice standard for late notice apply when notice is given under a claim-made policy after the expiration of: the policy period governing the time during which the event occurred; the renewal of such policy; and any extended reporting period under such policy. In reviewing policy forms, the Department will consider appropriate policy language reflecting this intent. Because Chapter 388 requires that the meaning of its provisions be construed by a Department regulation, New York Comp. Codes R. & Regs. ("NYCRR"), Tit. 11, Pt. 73 (Regulation 121) shall continue to govern the construction of any referenced definitions, as well as the establishment of minimum provisions, with respect to claims-made policies.

Chapter 388 adds Insurance Law § 3420(a)(6), which requires every liability policy to contain a provision that states, with respect to a personal injury or wrongful death claim, that if the insurer disclaims liability or denies coverage based on a failure to provide timely notice, then the injured person or other claimant may maintain an action directly against the insurer, on the sole question of late notice, unless the insured or the insurer, within 60 days of the disclaimer, initiates an action to declare the rights of the parties under the policy, and names the injured person or other claimant as a party to the action.

Chapter 388 amends Insurance Law § 3420(c) to provide that, in any action in which an insurer alleges that it is prejudiced by the failure of an insured, injured person or other claimant to provide timely notice, the insurer shall have the burden to prove that it was prejudiced, if notice was provided to the insurer within two years of the time required under the policy. If notice is provided to the insurer more than two years after the time required by the policy, then the insured, injured person or other claimant has the burden of proving that the insurer was not prejudiced. Further, the insurer's rights are not deemed prejudiced unless the failure to provide timely notice materially impairs the ability of the insurer to investigate or defend the claim. If notice is provided to the insurer after a court of competent jurisdiction or binding arbitration determines the insured's liability, or after the insured has settled the case, then there is an irrebuttable presumption of prejudice.

Chapter 388 amends Insurance Law § 3420(d) to establish a process by which an injured person or other claimant may receive from an insurer confirmation that the insured had an insurance policy in effect on the alleged occurrence date, and the liability limits under the policy. This requirement applies only if the policy: 1) provides coverage with respect to a claim arising out of death or bodily injury of a person; and 2) the policy is either subject to Insurance Law § 3425 (other than an umbrella or excess liability policy) or is used to satisfy a financial responsibility requirement imposed by law or regulation,including (but not limited to) a motor vehicle liability policy in satisfaction of

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Two Recent Circular Letters Continued

Circular Letter No. 26 continued

Article VI or VIII of the New York Vehicle and Traffic Law. Failure to disclose coverage pursuant to Insurance Law § 3420(d) constitutes an unfair claim settlement practice, in violation of Insurance Law § 2601.

Finally, Chapter 388 amends CPLR § 3001 to permit a claimant in a personal injury or wrongful death action to maintain a declaratory judgment action directly against the defendant's insurer, as provided pursuant to Insurance Law § 3420(a)(6).

The amendments apply only to liability policies, and do not apply to first-party benefits under the no-fault endorsement of a motor vehicle insurance policy issued pursuant to Article 51 of the Insurance Law. No-fault policies continue to be governed by Article 51 and 11 NYCRR § 65 (Regulation 68).

Chapter 388 does not require an insurer to send any conditional renewal notice pursuant to Insurance Law § 3426 (e)(1)(B), because the amendment does not effectuate a reduction in coverage under the policy.

As noted above, the amendments apply only to policies issued or delivered on or after January 17, 2009. It is expected that no insurer will prematurely issue or deliver policies with effective dates on or after Chapter 388's effective date. However, should insurers attempt to prematurely issue or deliver policies in an attempt to circumvent the law, the Superintendent may find such conduct to constitute an unfair or deceptive act, that violates Article 24 of the Insurance Law.

Although the Department expects insurers to be in full compliance by the effective date of the law, any liability policy issued or delivered in this state on or after January 17, 2009 that does not contain the provisions required by Chapter 388 shall, pursuant to Insurance Law § 3103(a), nonetheless be enforceable as if the policy conforms with the requirements of Chapter 388, and thus shall be valid and binding upon the insurer.

Please note that the Department expects to receive a large volume of policy form filings to review and approve. In order to ensure timely compliance with the statute, all affected insurers and rate service organizations are advised to submit, as soon as possible, revised policy forms to the Insurance Department for the Superintendent's review and approval. In order to expedite disposition of the filings, submissions should be limited to changes mandated by Chapter 388. In addition, insurers are encouraged to utilize the Speed-To-Market filing procedures for the required policy form filings. Information about the speed-to-market process can be obtained from the Department's website at www.ins.state.ny.us.

Any questions and/or comments with respect to this circular letter should be directed to:

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Circular Letter No. 23 (2008):

The Department has received numerous complaints from consumers whose homeowners' policies were cancelled after insurers claimed that their residences had become unoccupied. The Department investigated these complaints and determined that a number of insurers had improperly cancelled homeowners' policies on the ground that an apparently unoccupied residence constituted a "physical change" in the premises. The purpose of this Circular Letter is to review the relevant sections of the Insurance Law governing mid-term cancellations of homeowners' policies, and to advise insurers of the Insurance Department's interpretation of the law, so as to ensure that homeowners are protected from improper cancellations.

Homeowners' policies are "personal lines insurance" under Insurance Law § 3425. That statute governs cancellation and renewal of most non-commercial property/casualty insurance policies. Such policies may not be cancelled in the middle of the policy term, except for certain reasons specified in § 3425, which must be set forth in the notice of cancellation. In particular, Insurance Law § 3425(c)(2)(E) permits a mid-term cancellation of a personal lines insurance policy due to:

physical changes in the property insured occurring after issuance or last annual anniversary date of the policy which result in the property becoming uninsurable in accordance with the insurer's objective, uniformly applied underwriting standards in effect at the time the policy was issued or last voluntarily renewed…

The Department's investigation determined that a number of insurers, after apparently determining that residences had become unoccupied, improperly cancelled the owners' policies on grounds that the lack of occupancy constituted "physical changes" within the meaning of § 3425(c)(2)(E). One investigation revealed that an insurer had improperly cancelled the policy of a husband and wife while they were residing in a nursing home.

Insurance Law § 3425(c)(2)(E) applies only when there has been an actual *physical* change to the property that renders the property uninsurable in accordance with the insurer's underwriting guidelines. Physical change occurs only when the dwelling or property has been altered or changed in some manner. (See Opinion of Office of General Counsel No. 04-11-20, November 29, 2004). The fact that an insured is not occupying a residence does not constitute a physical change to the premises within the meaning of § 3425(c)(2)(E).

Similarly, the fact that an insured is not occupying a residence does not, standing alone, constitute grounds for cancellation of a homeowners' policy under Insurance Law § 3425(c)(2)(D). That provision permits an insurer to cancel coverage upon "discovery of willful or reckless acts or omissions increasing the hazard insured against." Whether an insured would be justified in cancelling a homeowners' policy pursuant to § 3425(c)(2)(D) depends on the totality of the circumstances. While lack of occupancy of the premises might be a relevant factor to consider, it is not necessarily a willful or reckless act or omission, which also must be demonstrated.

Nor may insurers use the existence of a foreclosure action as a basis to cancel a homeowners' insurance policy under Insurance Law § 3425(c)(2)(D) or (E). The filing of a foreclosure action does not constitute a willful or reckless act or omission or increase the hazard insured against, nor does it constitute a physical change in the property.

Questions regarding this Circular Letter should be addressed to Deborah Jewell, Senior Examiner, New York State Insurance Department, 1 Commerce Plaza, Albany, New York, 12257, 518-402-2312, djewell@ins.state.ny.us.◆

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No Coverage For Crime Restitution Continued

The dispute before the court arose when, on June 7, 2004, McKernan filed a counterclaim to Brethren's declaratory judgment complaint, seeking reimbursement for the funeral expenses McKernan paid pursuant to the restitution order entered by the trial court. On February 18, 2005, Brethren filed a motion for summary judgment with respect to McKernan's counterclaim, which the trial court granted on May 5, 2005. This appeal followed.

McKernan raises two issues. The first is where the insurance company contracted to cover damages caused by negligence of the insured, can it avoid the obligation simply because the insured paid for the damages to comply with a criminal sentence imposed for negligently injuring the victim? The second is whether the lower court erred in holding that the liability insurer had no duty to repay the insured for the civil damages that she paid as part of a criminal restitution order following a conviction for negligently injuring a person, an occurrence and damages covered under the contract?

Reduced to their essence, both issues present the same question, namely, whether an insured may seek reimbursement against his insurer for a criminal restitution award resulting from a criminal prosecution. The court concluded that Pennsylvania public policy mandates that Brethren, in the context of the instant declaratory judgment action, is not responsible for the court-ordered criminal restitution.

In arriving at the conclusion, the court examined the nature of the imposition of an order to pay criminal restitution. It noted the sentencing court was statutorily mandated to order restitution to a victim pursuant to a criminal conviction. In citing the case of *Commonwealth v. Runion*, 541 Pa. 202, 210, the court stated, "the purpose of the restitution statute is rehabilitative in nature." Thus, the court has repeatedly held that an order of restitution is not equivalent to an award of civil damages. See, e.g., *In re B.T.C.*, 868 A.2d 1203, 1205 (Pa. Super 2005); *Commonwealth v. Kerr*, 444 A.2d 758, 760 (Pa. Super. 1982); *Commonwealth v. Erb*, 428 A.2d 574, 580-581, (Pa. Super 1981). The court concluded that clearly an order for criminal restitution is imposed for its effect on the defendant. *Brethren Mut. Ins. Co. v. McKernan*, 2008 PA Super 270 (Pa. Super. Ct. 2008).◆