

KD Insurance Law Alert: To Disclaim Coverage, or Not to Disclaim Coverage, That is the Question

By Michael L. Zigelman, Eric B. Stern and Alexana Gaspari

Providing more clarity to New York Insurance Law's notice/prejudice standards in the context of an insured's default in an underlying lawsuit, a recent decision from New York's Southern District states that an insurer's time to disclaim coverage begins to run upon a finding of its insured's default, and, moreover, an insurer has no obligation to try to vacate the default, as such activity may actually result in a waiver of the insurer's right to disclaim.

In late October, the Southern District, in deciding *Montpelier U.S. Insurance Co., v. 240 MT. Hope Realty Co., et al.*, 2015 WL 6395949 (S.D.N.Y. Oct. 22, 2015), held that Montpelier U.S. Insurance Co. was statutorily estopped from disclaiming coverage for late notice under New York Insurance Law §3420(d)(2) because Montpelier delayed in disclaiming coverage to its insured based on late notice and the insured's default. Rather than disclaiming, Montpelier appointed defense counsel to attempt to vacate the default, without reserving rights. Although the default was vacated by the trial court, the First Department subsequently reversed the vacateur.

After the reversal of the vacateur, Montpelier disclaimed coverage. The Southern District determined that the disclaimer was invalid as the insured's initial default was, in and of itself, sufficient prejudice, thereby triggering Montpelier's time to disclaim coverage. However, Montpelier delayed in disclaiming coverage, relying first on appointed defense counsel to vacate the default and relieve any prejudice. Nonetheless, the Court found such reliance to be unreasonable. Accordingly, the Court found that Montpelier was estopped from disclaiming coverage due to its delay.

The Montpelier decision is important for two reasons – first, because it provides guidance on New York's ever-changing landscape concerning late-notice disclaimers of coverage which are based on prejudice. While the Montpelier Court relied on Insurance Law §3420(c)(2)(B) to rule that the initial default judgment, which was a determination of the insured's liability, created an "irrebuttable presumption" of prejudice, the Montpelier Court did not appear to have considered Insurance Law §3420(c)(2)(C), which limits such "prejudice" to situations where the late notice "materially impairs" the ability of the insurer to defend the claim. According to the Montpelier Court, the insured's default (and the subsequently-issued default judgment) was, in and of itself, sufficient material impairment so as to trigger Montpelier's duty to disclaim coverage, notwithstanding those procedural remedies that were available which, if successfully implemented, may have resulted in the vacateur of the default, thereby alleviating the underlying prejudice.

A second take-away from the Montpelier decision is the Court's consideration of Montpelier's failure to send a reservation of rights letter prior to assigning defense counsel as a basis to reject Montpelier's argument. Historically, reservation of rights letters did not protect insurers from statutory estoppel under §3420(d)(2). See, *Cent. Mut. Ins. Co. v. Willig*, 29 F. Supp. 3d 112, 117 (N.D.N.Y. 2014) ("[A] reservation of rights letter has no relevance to the question whether the insurer has timely sent a notice of disclaimer of liability or denial of coverage."). This became a more important issue once New York adopted the "material prejudice" standard for notice, as an insurer would not necessarily know, upon receipt of notice from its insured, whether the lateness of the notice would rise to the level of "material prejudice," so as to enable the insurer to deny coverage. However, now, in light of the Montpelier holding, there is an opening for insurers to argue that, under certain circumstances (i.e. – when facing a potential late notice issue), a reservation of rights letter may be appropriate, and ultimately upheld, when an insurer needs additional time to determine whether it has been sufficiently prejudiced so as to avail itself to the late notice defense to coverage.

Accordingly, despite the adverse decision as against Montpelier itself, the Court's decision should be viewed as a positive development for insurers in general as it: (1) provides guidance as to the appropriateness and timeliness of a disclaimer of coverage for late/no notice upon default; (2) instructs that an insurer need not exhaust all remedies prior to disclaiming based on the default; and (3) holds that the default by the insured is deemed prejudice as a matter of law for purposes of satisfying New York's Insurance Law.