Insurance and Reinsurance Legal Update

New York Appellate Court: Insurer's Failure to Advise the Insured of Its Right to Independent Counsel Constitutes a "Deceptive Trade Practice"

The New York Appellate Division, Third Department, recently held that where an insurer's and an insured's interests conflict, the insurer's failure to advise the insured of the right to independent counsel selected by the insured and paid by the insurer constitutes a "Deceptive Trade Practice" under General Business Law ("GBL") § 349. *Elacqua v. Physician's Reciprocal Insurers*, 2008 WL 2277860 (N.Y. App. Div. 3rd Dept., June 5, 2008) ("*Elacqua II*"). The court further held that damages for violation of the GBL could be awarded in the absence of pecuniary harm to the insured and that the insured's loss of the right to counsel, with undivided loyalty to the insured, constitutes "actual harm" within the meaning of the GBL, justifying an award of damages. This decision constitutes a significant departure from prior cases in which New York courts had held that while an insured was entitled to independent counsel under certain circumstances, insurers were under no affirmative duty to advise insureds of that right. The finding that the failure to properly advise the insured of its rights constitutes a deceptive trade practice is also significant.

Elacqua arose out of a professional negligence case against a medical partnership, the partnership's member physicians, and a nurse practitioner employed by the partnership. The partnership and the physicians were insured under one policy while the nurse practitioner had separate coverage. The insurer retained counsel to represent the partnership and the physicians, even though the insured's interests conflicted with the insurer's interests, because the insurer took the position that certain claims were covered but others were not.

Shortly before trial in the underlying malpractice action, the insurer assigned separate defense counsel for each of the two doctors and the partnership. After the close of plaintiff's evidence, counsel successfully moved for the dismissal of the claims against the two doctors. The lawsuit resulted in a judgment of $2 million against the partnership, based on vicarious liability for the negligence of the nurse practitioner. The insurer refused to pay the judgment, arguing that the policy's Limitation on Liability provision narrowed the coverage available to the additional insured/partnership such that coverage did not apply under the narrow circumstances of the case, that is, where the partnership's liability was vicarious and the negligent party (the nurse practitioner) had separate insurance with another carrier. This coverage issue was decided in favor of the insureds in the trial court. The trial court also held that the insurer failed to timely disclaim coverage, pursuant to New York Insurance Law § 3420(d). The appellate court did not address the substantive coverage issue; instead, it reversed the trial court's decision on the timeliness of the insurer's disclaimer, holding that a "triable issue" of fact precluded summary judgment. [1]

The court then turned to the question of whether the insurer was required to notify its insureds of the right to select independent counsel at the insurer's expense. The trial court answered the question in the negative because it was "constrained" to following the holding of the First Department in *Sumo Container Sta. v. Evans, Orr, Pacelli, Norton & Laffan*, 278 A.D.2d 169, 719 N.Y.S.2d 223 (1st Dept. 2000). [2] There, the court held that while an insurer is obligated to pay for its insured's independent counsel, it is not obligated to notify its insured of its right to independent counsel. The appellate court reversed, refusing to follow *Sumo*, thereby creating a conflict in the law of the First and Third Departments. *Elacqua v. Physician's Reciprocal Insurers*, 21 A.D.3d 702, 800 N.Y.S.2d 469 (3d Dept. 2005) ("*Elacqua I*"). Under *Elacqua I*, an insurer has an *affirmative obligation* to notify the insureds of their right to select independent counsel at the insurer's expense when there is a conflict between the insurer's and the insured's interests.

Subsequent to *Elacqua I*, the insureds sought and were granted leave to amend the complaint to add, *inter alia*, causes of action for Deceptive Trade Practices under GBL § 349, based on

the insurer's failure to notify them of their right to independent counsel at the insurer's expense. The trial court later dismissed the claim on the ground that the insureds were not able to demonstrate "actual harm," which is necessary to satisfy the elements of GBL § 349. Presumably, this is because the insurer ultimately paid the underlying plaintiff $2.4 million in settlement of the $2 million judgment (not including interest).

The appellate court reversed on the grounds that "actual harm" need not be pecuniary to state a claim under GBL § 349. The court held that the insured's loss of its ability to control the defense, and its loss of its right to representation by counsel with undivided loyalty, uncompromised by a conflict of interest, constituted "harm" within the meaning of GBL § 349. Notably, the court pointed out that the insurer continued to "misadvise" its insureds by advising them that they could retain counsel to protect their *uninsured* interest at their own expense but failing to advise them they were entitled to independent counsel at the insurer's expense even after *Elacqua I* was decided. The matter was remitted for a trial on damages.

Based on *Elacqua II*, the insurer may have to pay the attorney's fees the insureds incurred in pursuing coverage, which it would not otherwise have been obligated to do. Under New York law, an insurer only has to pay attorney's fees of its insured in an action seeking a coverage determination if the insurer brings the action and the insured prevails. *U.S. Underwriters Ins. Co. v. City Club Hotel LLC*, 3 N.Y. 3d 592 (2004); *Mighty Midgets v. Centennial Ins. Co.*, 47 N.Y.2d 12 (1979). If the insured brings the action, there is no recovery of attorney's fees even if the insured is successful. *Id*.

Elacqua II is significant in that it appears to be the first time a New York appellate court has recognized a cause of action for deceptive trade practice due to an insurer's failure to affirmatively advise its insured of the right to independent counsel when the insurer's and insured's interests conflict. Strictly speaking, the decision only applies in the Third Department; however, it is reasonable to assume that other courts will adopt *Elacqua II*, and insurers handling cases anywhere in New York (and elsewhere) should carefully evaluate whether independent counsel might be required and, if so, whether to advise the insured of its rights.

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1 Of note, the court held the Limitation of Liability constitutes "an exclusion from coverage" for the purpose of analyzing whether the insurer timely disclaimed coverage under Insurance Law § 3420(d).

2 New York's First Department covers the boroughs of Manhattan and the Bronx. The Third Department covers several counties in upstate New York, including Albany and surrounding counties.

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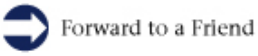

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