REISSUED/REVISED FEBRUARY 2022

eLANY ELABORATES

SEPTEMBER, 2018
ISSUE 18-2

Welcome to New York… Whether You Like It or Not

Last November, the New York Court of Appeals issued a very significant decision that broadened the application of §3420 of the New York Insurance Law. In the case of *Carlson v American International Group, Inc.*, the court found that under §3420, an insurance policy is "issued or delivered" in New York if both the insured and the risk have substantial contacts which amount to a "presence" in the state regardless of where the policy is actually issued or delivered. This precedent-setting decision raises serious questions about the jurisdiction of New York courts and the application of New York law to many insurance policies no matter where the policy was issued or delivered, as well as the effectiveness of mandatory arbitration clauses. At its core, *Carlson* highlights the specter of judicial overreach.

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§3420(a) states:

> (a) No policy or contract insuring against liability for injury to person, except as provided in subsection (g) of this section, or against liability for injury to, or destruction of, property shall be **issued or delivered** [emphasis added] in this state, unless it contains in substance the following provisions or provisions that are equally or more favorable to the insured and to judgment creditors so far as such provisions relate to judgment creditors:…

The statute requires specific contract provisions and permits a limited cause of action to be brought directly against insurers by judgment creditors as discussed below.

Michael Carlson sued to collect on certain insurance policies in his capacity as the administrator of his deceased wife's estate. Claudia Carlson was killed when a truck owned by MVP Delivery and Logistics (MVP) and operated by its employee, but with a DHL Worldwide Express (DHL) logo on it under a cartage agreement between MVP and DHL, crossed the divider and crashed into her car. DHL had three relevant insurance policies—a $3M primary policy with National Union Fire Insurance Company (National Union) that included hired auto coverage, a $2M excess insurance policy with American Alternative Insurance Company (AAIC) with identical coverage to the National Union primary policy, and a $23M umbrella policy with National Union which covered vehicles "hired by [DHL] or on [DHL's] behalf and used with [DHL's] permission." The excess liability policy was issued by AAIC in New Jersey and delivered in Washington to DHL's predecessor Airborne, Inc., and then assumed by DHL, a Florida-based company.

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Mr. Carlson had previously obtained a judgment against both MVP and the driver. He then brought suit in New York against National Union and AAIC to satisfy the outstanding judgment, claiming that MVP was an insured under DHL's policies and those policies were "issued and delivered" in New York, thereby giving him the right to bring a direct action and granting New York jurisdictional purview. The suit was brought pursuant to §3420(a)(2) which states:

> (a) No policy or contract insuring against liability for injury to person, except as provided in subsection (g) of this section, or against liability for injury to, or destruction of, property shall be issued or delivered in this state, unless it contains in substance the following provisions or provisions that are equally or more favorable to the insured and to judgment creditors so far as such provisions relate to judgment creditors:
>
> > (2) A provision that in case judgment against the insured or the insured's personal representative in an action brought to recover damages for injury sustained or loss or damage occasioned during the life of the policy or contract shall remain unsatisfied at the expiration of thirty days from the serving of notice of entry of judgment upon the attorney for the insured, or upon the insured, and upon the insurer, then an action may, except during a stay or limited stay of execution against the insured on such judgment, be maintained against the insurer under the terms of the policy or contract for the amount of such judgment not exceeding the amount of the applicable limit of coverage under such policy or contract.

Although DHL, Airborne and AAIC were not located in New York, DHL conducted a delivery business nationwide, including New York, and the court therefore found that DHL had a business presence in New York that the majority referred to as "substantial" and that DHL created risks in the state. Based on these findings, the court determined that DHL was "located" in New York. Furthermore, the court stated that DHL's liability insurance policies clearly meant to cover New York risks. Therefore, the court found that DHL's policy was "issued and delivered" in New York and as such, §3420's direct action provision requirement applied, allowing Mr. Carlson to directly sue the insurers for the uncollected judgment.

The court grounded its interpretation of "issued or delivered" on its reading of legislative intent based on a general belief that in enacting the Insurance Law, the legislature sought to promote consumer protection and the coverage of injuries occurring in New York. In so doing, the court ignored what most insurance professionals and regulators would consider the plain meaning of "issued or delivered" as applied to an insurance policy. The court's approach inserts a random element into the equation for insurers, producers and insureds alike.

The court's new interpretation raises some important questions. First, what about the effectiveness of mandatory arbitration clauses, which is a standard Bermuda Form feature? For example, even where New York law controls for substantive purposes under the Bermuda Form, §3420 grants judgment creditors the right to bring a direct action against an insurer to enforce rights under §3420. Assume an insurer and its insured have already arbitrated a dispute in Bermuda pursuant to the terms of their Bermuda Form insurance policy. The arbitration results in a finding of no coverage. A judgment creditor brings suit against the insurer in a New York court pursuant to §3420 even though the matter has been decided by

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arbitration pursuant to the policy terms. Will the New York court respect the "no coverage" arbitration result under the legal doctrine of collateral estoppel, or will it decide that §3420 affords the judgment creditor the right to bring a direct cause of action in New York regardless of the arbitration ruling? Will it matter if the judgment creditor was a party to the arbitration? Similar concerns were raised by a robust dissenting opinion in *Carlson*.

The nonadmitted market could be especially impacted by the applicability of the new standard to the Bermuda Form as well as other policies with mandatory arbitration clauses. Circular Letter No. 26 (2008) makes it clear the New York Department of Financial Services interprets §3420 as applying to policies issued in the excess line market. Under the Bermuda Form, which is often used for independently procured policies, modified New York substantive law and interpretation is the most common construct, although some policies may specify Bermuda or English law. English arbitration and procedural law is and has been the standard under the Bermuda Form. If §3420 can now be invoked where a Bermuda Form issued to a non-New York insured that has a presence in New York and creates risks in the state is involved, Bermuda Form policies may in practice be superseded by New York requirements in certain instances even though they were intentionally designed to differ, and will therefore effectively be subject to after-the-fact revision to conform with required §3420 provisions.

Another question is whether Risk Retention Groups (RRGs) will gain a distinct advantage based on *Carlson*. In the case of *Wadsworth v. Allied Professionals Insurance Company*, the U.S. Court of Appeals for the Second Circuit found that the requirements of §3420 do not apply to foreign Risk Retention Groups due to preemption under the federal Liability Risk Retention Act. Therefore, the "issued and delivered" analysis does not apply to RRGs and RRGs are not subject to direct action as authorized by §3420. Contrarily, foreign and alien insurers, whether admitted or not in New York, may well be exposed to direct actions regardless of insurance policy language. Additionally, other aspects of §3420 will also apply to such insurers while being inapplicable to RRGs. This may encourage more insurers to use sponsored RRGs instead of admitted or nonadmitted insurers to write business in New York, and may result generally in RRGs being more willing to write certain coverages than insurers in the admitted or nonadmitted market. RRGs are not subject to the stringent capital and surplus requirements that apply to nonadmitted insurers and often lack the financial strength that nonadmitted insurers must maintain to be eligible.

The court's decision creates significant ambiguity with potentially harmful impacts. If the plain meaning of the words in a policy cannot be relied upon, will foreign and alien insurers hesitate to write risks with a potential New York exposure to avoid choice of law and jurisdictional conflicts? The *Carlson* decision will likely result in uncertainty and the inability of insurers to determine exposures under a policy with a high degree of confidence. Insurers must now gauge the level of additional exposure and determine capacity appetite and pricing. For now, it is conceivable that we may see some policies include §3420 requirements on an "applies in New York only" basis.

Looking forward, although the court explicitly stated that it was not interpreting the definition of "issued or delivered" for any provision of law beyond §3420, can insurers, brokers and insureds be confident that a future court will not cite *Carlson* as precedent and apply the same broad jurisdictional reasoning to other facets of New York insurance law? The Court of Appeals decision in *Carlson* creates many questions and much uncertainty.

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