

2008 Year in Review

By Mark R. Garbowski

An attorney's review of the year in insurance (or any field) would normally be expected to focus on legal developments, including new major court decisions. In 2008, however, the economic developments of the third and fourth quarters of 2008 took center stage.

Economic Contraction and Subsequent Claims

The major risk event in the economy in 2008 relates to the market loss and bank failures due to the sub-prime mortgage collapse and general financial meltdown.

Lawsuits have been instituted against investment banks, investment advisors, banks, mortgage companies and virtually everyone involved in the securitization of mortgages. Many such claims may be covered under standard insurance policies already purchased prior to the financial crisis. Policies already purchased may cover costs of defending the lawsuits and costs of settlements or judgments in the lawsuits.

Depending on the lawsuit, coverage may be found in Directors & Officers (D&O) insurance coverage, professional liability (E&O) insurance coverage, fiduciary liability insurance, or financial institution bonds (FI bonds). Each of these policies cover the corporate policyholder and its managers, officers, and general partners against losses due to unintentional or negligent acts, errors, omissions or fraud.

Insurance Industry Bailout(s)

In September, the Federal Government provided a sub-

stantial bailout package to American International Group, Inc. (AIG), the parent company to a vast family of companies whose primary business is selling insurance products. The terms of the deal have and the amount of money involved has changed, and increased, since the original deal. As part of the deal, the government is set to obtain a significant equity stake in the company. Rumors of financial difficulty have surrounded certain other commercial insurance companies. Many policyholders are prudently checking the soundness of all their insurance providers as they renew for the coming year. The AIG situation also brought attention to Credit Default Swaps—a product similar to insurance but subject to considerably less regulation.

Legal Developments

Even with all of the above, most attorneys cannot resist noting some of important legal developments in their field. The following is not comprehensive, but does cover some of the highlights: As noted previously in this space, New York has had three important developments in insurance law in 2008. The first was the decision in the *Bi-Economy* case that allowed policyholders in New York to recover consequential damages from their insurance company, a right long enjoyed by policyholders in other jurisdictions. The second New York development was the *Elacqua v. Physicians' Insurers* decision ruling that an insurance company's failure to advise a policyholder of a right to independent counsel vio-

lated New York's deceptive business acts and practices law, specifically General Business Law § 349. The final New York development was the passage of a bill to relax—in certain circumstances—New York's very strict rules that allow insurance companies to avoid coverage when notice of a claim or occurrence is late, even if the insurance company was not prejudiced by the delay. New York has now joined the majority of states in imposing a prejudice standard for late notice denials when the statute applies.

Other states had significant Supreme Court decisions regarding insurance issues. Two come from Texas:

In January, the Texas Supreme Court similarly rejected the rule that prejudice is irrelevant to late notice and held that "an insured's failure to timely notify its insurer of a claim or suit does not defeat coverage if the insurer was not prejudiced by delay." *PAJ, Inc. v. The Hanover Insurance Company*. The next month, the Texas Supreme Court ruled in *Fairfield Ins. Co. v. Stephens Martin Paving, LP.*, that Texas public policy does not bar insurance coverage for punitive damages under some types of workers' compensation and employer's liability insurance.

Maine's highest court issued an important decision on insurance company efforts to rescind policies based on alleged misrepresentation in the policy application. To succeed in such an effort, the Court ruled, in *Liberty Ins. Underwriters, Inc. v. Estate of Faulkner*, that an insurance company must prove fraud, including the elements of materiality and actual reliance on the mis-

representation by the insurance company. On the other hand, the insurance company can rescind even if the material misrepresentation was made in an earlier policy application for which the current policy was a renewal. Even if the renewal application did not include the misrepresentation, the insurance company can be entitled to rescission.

In Washington, that state's highest court ruled in October that an insurance company is bound by the factual findings of a reasonable settlement of an underlying liability claim when a coverage determination depends upon those same facts. In *Mutual of Enumclaw Insurance Co. v. T&G Construction Inc. and Villas at Harbour Pointe Owners Association*, the Washington Supreme Court determined that a good faith settlement establishes the policyholder's damages even when the insurance company has not acted in bad faith, and noted that several other state courts agreed.

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