

CLIENT MEMORANDUM

ELANY Bulletin Highlights Regulatory Risk for Insurers and Brokers Using “Most Favored Nation” Clauses or Other Vehicles to Provide Coverage for Punitive Damages in Any Way

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On July 1, 2015, the Excess Line Association of New York (“ELANY”) issued a bulletin indicating that the New York State Department of Financial Services (“NYDFS”) is likely to take an expansive view of its previous rulings regarding coverage for punitive damages in policies issued in New York.

The ELANY bulletin suggests that NYDFS would consider punitive damages insurance coverage written by a New York insurer or placed by a New York-licensed broker (including excess line brokers) to run afoul of New York public policy even in situations where the risk to be insured is located outside of New York, and even if the policy contains language allowing for punitive damages to be covered only in a state that permits such coverage (a so-called “Most Favored Nation” clause). Insurers and brokers involved in the placement of policies containing Most Favored Nation or similar provisions should take action to ensure that they do not violate New York law regarding punitive damages coverage.

Background

The Office of General Counsel of NYDFS (the “OGC”) has repeatedly stated that insurance covering liability for punitive damages is against public policy as defined by the New York courts. The OGC has relied on New York State Court of Appeals cases in which the court addressed whether punitive damages coverage was enforceable where an insurer sought to avoid payment based on New York public policy. In each case, the court held that to allow insurance coverage

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for punitive damages would defeat the purposes of punishing the offender and deterring future wrongful acts. The court applied this rule and declined to enforce punitive damages coverage written by a New York insurer even where the punitive damages at issue had been awarded in a state where punitive damages are legally insurable.¹

The OGC opinions do more than state that coverage for punitive damages will not be enforced in a New York court. They suggest that the very issuance of punitive damages coverage—whether or not anyone seeks to enforce it in New York—is prohibited. See, e.g., OGC Opinion No. 89-46 (Sept. 26, 1989) (coverage for punitive damages may not be written by an insurer licensed in New York nor placed in the excess line market by a New York licensee); OGC Opinion No. 85-9 (Jan. 30, 1985) (NYDFS will not approve policy forms containing punitive damages coverage); OGC Opinion No. 2005-306 (Dec. 21, 2005) (transactions that attempt to evade the restrictions on punitive damages coverage imposed under New York law are impermissible).

In its most recent analysis of the insurability of punitive damages, in 2008, the OGC was alerted to the existence of “materials from Bermuda marketed to New York-licensed brokers that advertise the availability of insurance intended to cover punitive damages on risks located in New York State” written by out-of-state excess line insurers. The OGC stated that (i) a New York-licensed broker may not place insurance coverage in the excess line market on risks located in New York State that would cover punitive damages; and (ii) a New York-licensed broker may not lawfully hire a third party to place such coverage. Because it is “well settled” that as a matter of public policy New York courts will not enforce liability insurance covering punitive damages, an excess line broker (or a broker utilizing the services of an excess line broker) that places such insurance would violate New York regulations prohibiting excess line brokers from procuring coverage that has been determined by New York courts to be against public policy.²

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Although New York case law does not address whether particular policy language covering punitive damages would comply with New York public policy, the July 1, 2015 ELANY bulletin states that NYDFS has reviewed excess line policies that contain Most Favored Nation language and advised ELANY that such language is not acceptable. Accordingly, the bulletin states that any excess line policy submitted to ELANY that contains similar language “will be suspended and reported to the [NYDFS] for whatever action it deems necessary” (emphasis added).

¹ *Zurich Ins. Co. v. Shearson Lehman Hutton, Inc.*, 84 N.Y.2d 309 (1994); *Home Ins. Co. v. Am. Home Prods. Corp.*, 75 N.Y.2d 196 (1990); *Hartford Accident and Indem. Co. v. Vill. of Hempstead*, 48 N.Y.2d 218 (1979).

² OGC Opinion No. 08-08-09 (Aug. 27, 2008) (NILS).

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Implications

New York insurers and brokers should carefully consider whether their current practices—including use of “Most Favored Nation” language providing punitive damages coverage under various circumstances, or involvement in the placement of punitive damages coverage with out-of-state insurers—could be considered by NYDFS to be an evasion of New York public policy against the insurability of punitive damages liability.

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