New York State Law Digest

REPORTING IMPORTANT OPINIONS OF THE COURT OF APPEALS AND IN SPECIAL SITUATIONS OF OTHER COURTS

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INSURER'S DUTY TO DEFEND

INSURER THAT FAILS TO DEFEND ITS INSURED CAN'T, WHEN LATER SUED BY INSURED WHO PAID JUDGMENT, NOW PLEAD POLICY EXCLUSIONS

Again we have a graphic example of the rule, which we've met many times in the Digest, that a liability insurer's obligation to defend its insured, who has been sued by the allegedly damaged person, is broader than the obligation to indemnify. The corollary is that if there's any even remote possibility, based on the complaint in the underlying action against the insured, of the latter being held at fault, the obligation to defend attaches even if there's ultimately nothing to indemnify, as where the underlying suit, after duly defended by the insurer, fails.

A leading case in point is the Court of Appeals 2004 *Lang* decision (Digest 540), in which one of the points stressed is that where the insurer walks away from the suit – i.e., disclaims – the only thing left open to it afterwards, if the insured has had to paddle alone and loses, is whether the disclaimer was valid. The insurer "cannot challenge the liability or damages determination underlying the judgment".

The Court had a similar but not identical issue before it in the more recent case of *K2 Investment Group, LLC v. American Guarantee & Liability Ins. Co.*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 2475869 (June 11, 2013), where the insurer was trying to get out from under by invoking specific exclusions in the policy. It was now too late for that, too, holds the Court of Appeals in an opinion by Judge Smith; the involvement of "exclusions" may distinguish the case from *Lang*, but it's a distinction without a difference.

> While *Lang* did not involve a situation like the one we have here [writes the Court], we now make clear that *Lang* ... means what it says: an insurance company that has disclaimed its duty to defend [now quoting *Lang*] "may litigate only the validity of its disclaimer".

If the disclaimer is ultimately found no good, the Court says the company must indemnify its insured

> for the resulting judgment, even if policy exclusions would otherwise have negated the duty to indemnify.

Many of the cases we've met on the distinction between the duty to defend and the duty to indemnify were personal injury cases. (See, e.g., the Court's 2000 *Westview* decision in Digest 491.) The same rule about disclaimers applies in commercial cases, as we've also reported in the Digest and as the *K2* case illustrates here.

K2 involved loans secured by mortgages, and included a liability arising out of the failure of the plaintiffs' lawyer to record the mortgages. The insurer involved was the lawyer's malpractice carrier. A peculiarity in the case was that the lawyer retained by the plaintiffs (the lenders) was one of the principals of the borrower. Because of this, notes the Court, the insurer "no doubt had reason to be skeptical of the [malpractice] claim". But this, the Court admonishes, suggests only that the claim may have been

"groundless, false or baseless ... meritless or not covered", all things that relate to the merits of the claim and do "not allow [the insurer] to escape its duty to defend".

What does an insurer do when it harbors this skepticism but doesn't want to defend a case that may cost it large sums of money and much time and effort, all of which it might avoid if not for the risk entailed in a disclaimer it can't be absolutely certain will work?

There is indeed a remedy: a declaratory judgment action. The Court elaborated this in *Lang*, which the Court now cites and quotes in *K2*:

> [A]n insurance company that disclaims in a situation where coverage may be arguable is well advised to seek a declaratory judgment concerning the duty to defend or indemnify the purported insured.

The declaratory action is brought promptly, alongside the subject action, and will hopefully dispose of the disclaimer issue so as to enable the insurer to assess (or re-assess) its course. (See Siegel, New York Practice 5th Ed. § 437.)

Especially in view of this possibility, "[i]t would be unfair to insureds", says the Court,

> and would promote unnecessary and wasteful litigation, if an insurer, having wrongfully abandoned its insured's defense, could then require the insured to litigate the effect of policy exclusions on the duty to indemnify.

The Court does leave the door open to a different determination if the insurer can show that the insured inflicted injury on the plaintiff intentionally, but that poses issues of criminal conduct and public policy in no way involved in this case.

OTHER DECISIONS

HOSPITAL'S DUTIES

Hospital Owes No General Duty to Drunk Patient, Brought in by Friend, to Bar Him from Leaving Hospital

And because there was no duty, there could be no breach of it by the hospital when the patient left the hospital on his own – apparently still drunk – and was hit by a car an hour or so later. Hence there's a summary judgment for the hospital and its personnel in P's suit for damages for negligence and medical malpractice.

This same patient had visited the hospital (D) a month earlier and had been placed on a "one-to-one watch" because he had showed "suicidal thoughts". On that occasion he improved and was discharged. This second time round he was brought in by a friend, once again with severe intoxication, but with no evidence he was suicidal. He was seen by an emergency room doctor, Dr. C., and was accepted into a "Turning Point" detox program.

After waiting four hours for transfer to the program, P removed an IV from his arm and told a nurse (N) he was going home by taxi. She told him to call a friend; he agreed and N went to get Dr. C. When she returned P was gone. N asked Dr. C if she should call the police. He said no, but notified hospital security.

In an opinion by Judge Smith, the Court of Appeals holds that on these facts the defendants had no right to prevent P from leaving the hospital, and therefore could have had no duty to. *Kowalski v. St. Francis Hospital and Health Centers*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 3197637 (June 26, 2013; 5-2

decision). More than that, holds the Court: "[t]o restrain plaintiff on these facts would have exposed defendants to liability for false imprisonment."

Nor could the police have barred P's departure on these facts, holds the Court; hence Dr. C can't be faulted for not calling them.

The Court acknowledges that there are indeed circumstances in which a person "may be retained for emergency treatment", citing Mental Hygiene Law § 22.09(e), but stresses that the statute doesn't apply when the patient comes in voluntarily, as in this case. The statute also requires a showing of a "likelihood" the patient would harm himself, and harm can't be assumed, says the Court, from the suicidal thoughts P had a month earlier.

No one at the hospital on this second round consulted the first round record, a point stressed by Judge Pigott in his two-judge dissent, but the majority is apparently of the view that P's leaving the hospital of his own accord before a record could even be developed suggesting a need to consult the earlier record relieved the hospital of any duty of consultation.

The dissent's view is that a trial is needed in any event to test out "the hospital's own protocols", under which the dissent sees a "common law" duty spelled out for patients' protection.

On that issue the majority cites its 1948 opinion in *Warner v. State*, 297 N.Y. 395, which acknowledges a common law power to restrain someone, but here, too,

> only when necessary to prevent the party from doing some immediate injury either to himself or others and only when the urgency of the case demands immediate intervention.

As the majority in *Kowalski* sees it, there was no such immediacy here.

TIPS TO COFFEE SHOP PERSONNEL

Degree of "Managerial Responsibility" Holds Key to Whether Certain Employees with Mixed Functions Can Share Tips

This case, *Barenboim v. Starbucks Corp.*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 3197602 (June 26, 2013), is another that construes and applies Labor Law § 196-d, which governs the distribution of gratuities (tips) in the payment of wages. We've seen this statute before, in the Court of Appeals 2008 *Samiento* decision (Digest 581), where the Court held that a service charge represented to be in lieu of a tip nevertheless qualifies as a tip under the statute and must be paid over to the employee.

Barenboim involves the Starbucks empire, which, as the Court observes, has "hundreds of outlets in New York". The company has a written policy about tips, involving the placement in each store of "a plexiglass container at the counter" for the collection of tips – apparently paid by customers voluntary – then safeguarded and, at the end of the week, distributed. Each store distributes the tips, in proportion to the hours worked, to two categories of employees: baristas (not to be confused with barristers!) and shift supervisors. There are two other categories as well in the Starbucks world – store managers and assistant store managers, neither of which is included by Starbucks in the distribution of tips.

Two federal actions were brought to contest parts of this distribution policy. In the first, the baristas sued to have the shift supervisors cast out. In the second, the assistant store managers sued to have themselves cast in. Much of the Court's effort is spent analyzing the nature of each group's activities and the extent to which they go beyond the usual waiting and cleanup duties and involve some duties traditionally deemed to belong to higher-ups in the restaurant service industry.

Labor Law § 196-d is basically designed to keep the bosses out of their employees' tips. The *Barenboim* case does battle with how high in the hierarchy of service people one has to be to qualify as a boss in this sense.

In an opinion by Judge Graffeo, the Court sees the issue as boiling down to a question of each category's supervisory responsibility.

It rejects the baristas' contention that "even the slightest degree of supervisory responsibility automatically disqualifies an employee from sharing in tips". The Court adopts instead the view of the Department of Labor (DOL) (amicus in the case) that

> employees who regularly provide direct service to patrons remain tip-pool eligible even if they exercise a limited degree of supervisory responsibility.

These matters, as long as they don't infringe the constitution, are governed by state law. A Massachusetts case also involving Starbucks is found inapposite because it was based on a statute substantially different from New York's.

What about the assistant store managers? They of course wanted to be lumped with the lower-down waiters and argued that they were entitled to be unless they are shown to have "full or final authority to terminate subordinates" – powers they don't have.

The Court responds that there does come a point at which the

> degree of managerial responsibility becomes so substantial that the individual can no longer fairly be characterized as an employee similar to general wait staff within the meaning of Labor Law § 196-d. We conclude that the line should be drawn at meaningful or significant authority or control over subordinates.

This authority would include such things as disciplining subordinates, assisting in evaluations, having some say in hiring or firing, and creating work schedules. "Meaningful authority, not final authority, should be the standard," concludes the Court, and with that it returns the cases to the Second Circuit to apply the standards announced and dispose of the cases on their facts.

Judges Smith and Rivera dissented in part in separate opinions.

MUNICIPAL LIABILITY

In Action Involving City Ambulance Service, Whether "Special Relationship" Existed with City Requires Trial

The plaintiff child (P) suffered an injury after a visiting nurse injected her at home with a medication which, although duly prescribed, brought on a severe allergic reaction. P's mother dialed 911, and a city ambulance responded within minutes, bringing two emergency medical technicians (EMTs) who undertook treatment, which apparently wasn't working. P's mother allegedly requested the EMTs to take P to a nearby hospital but they instead waited for paramedics to arrive, who injected her with a drug to counter the effects of her allergy shock, and then transported her to the hospital. P "survived the ordeal", notes the Court, "but tragically suffered serious brain damage".

P sued the city, which raised once again the difficult question of the city's liability for not properly performing an allegedly governmental function.

The first issue needing decision in such a case, holds the Court in *Applewhite v. Accuhealth, Inc.*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 3185185 (June 25, 2013), is whether the city (or whatever the municipality) "was engaged in a proprietary function or acted in a governmental capacity". If proprietary,

the city is subject to suit like just plain folks under the usual rules of tort liability. If governmental, on the other hand, the plaintiff must meet four requirements in order to hold the city in.

The four were enumerated in the Court's 1989 *Kircher* decision (Digest 355) and involved (and listed) again in the Court's later (2006) *Laratro* decision. We set down the four in our treatment of *Laratro* in Digest 566:

(1) the municipality must have assumed to act in the case;

(2) it must be aware that harm can befall the victim if it doesn't;

(3) there must be direct contact between the municipality's agents and the injured party; and

(4) the victim must be shown to have justifiably relied on the municipality's undertaking to act.

The plaintiff in both those cases faltered on elements 3 and 4 on the list. In the more recent *Applewhite* case, the dispute centered on items 1 and 4.

On item 1, as reviewed by Judge Graffeo in the majority opinion in *Applewhite*, the question is whether the EMTs

> assumed an affirmative duty in deciding to have ... paramedics undertake more sophisticated medical treatment rather than transporting the child to a hospital.

The majority finds the question in need of resolution as an issue of fact, and reaches the same conclusion with respect to item 4, because, it says,

> [i]t is possible that a fact finder could conclude that it was reasonable for [P's] mother to rely on the EMTs' alleged assurances rather than seek an alternative method for transporting [P] to the nearby hospital.

A two-judge concurrence, in an opinion by Judge Smith, sees no issue of a governmental duty here. It says

> the label "proprietary" better suits the activity of the EMTs here, and ... that the doctrine of governmental immunity does not apply to this case.

Judge Abdus-Salaam, writing separately, disagrees with her concurring colleagues; she finds that "[m]erely by undertaking to treat [P], the EMTs assumed an affirmative duty to act on her behalf". Hence she concludes that even if she agreed with the majority "that the EMTs were performing a governmental function" she would find the requisite "special relationship" that the rule then requires.

INSURANCE FOR BROKERS?

In Broker's Suit Against Insurers, Trial Is Required of Broker's Claim That Profits It "Disgorged" Were Not Its Own, But Its Customers'

This issue, though but one of several in *J.P. Morgan Securities Inc. v. Vigilant Ins. Co.*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 2475864 (June 11, 2013), is the major one in the case.

A broker charged with wrongdoing by the Securities and Exchange Commission (SEC) settled for many millions and then sought indemnification from its insurers. The insurers defended based not only on exceptions in their policies, but also on the general justification of "public policy", which prevents a wrongdoer from profiting from its own wrong.

The case involves the "late trading" practice of brokers placing mutual fund orders after the 4 p.m. trading deadline while receiving prices based on what they were at that deadline. The Court describes the practice as allowing traders "to obtain improper profits by using information obtained after the close of trading". That's what the plaintiff did here, generating many millions, and when taken to task by the SEC – while denying any wrongdoing – it settled, also for millions. Then it turned to its insurers to indemnify it for those payments, generating this action when the insurers balked.

Among the insurers' "public policy" defenses was the one that bars coverage for "intentionally harmful conduct". But this exception, notes the Court in an opinion by Judge Graffeo, is

> a narrow one, under which it must be established not only that the insured acted intentionally but, further, that it acted with the intent to harm or injure others.

On the record before it, the Court is unable to resolve this issue "as a matter of law". The issue arose on a motion by the insurers to dismiss under CPLR 3211(a)(7) – failure to state a cause of action – which mandates a trial if there's any doubt on any key fact. Here, says the Court,

> [t]he SEC order, while undoubtedly finding [the plaintiff's] numerous securities laws violations to be willful, does not conclusively demonstrate that [the plaintiff] also had the requisite intent to cause harm.

The appellate division had disagreed; it dismissed the complaint in its entirety on the "public policy" ground at the CPLR 3211 threshold. But the Court of Appeals sees the CPLR 3211(a)(7) apparatus as a barrier, quoting from its 2005 *EBC* decision (Digest 549) to the effect that whether a plaintiff "can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss".

Neither does the Court find in the language of the insurance policies alone a basis for a threshold dismissal.

Perhaps an alternative route to this resolution of the issue would have been a finding of just a wee ambiguity in the insurance coverage, which would have enabled the court to invoke the virtually sacred principle that any ambiguity in an insurance policy is construed against the insurer.

Historically, that principle was of course designed to recognize the uneven field that usually exists between insured and insurer, the little guy versus the big guy. In the *J.P. Morgan* case, however, the plaintiff is no little guy. Perhaps that's why the insurer/ambiguity rule was not made the predicate for the result.

CPLR 3211(a)(1) was also a basis for the insurer's dismissal motion: that documentary evidence alone refutes the plaintiff's claim. The insurer pointed to the SEC order as such evidence, but the Court finds that it does not by itself "decisively repudiate" the plaintiff's allegation, necessitating a trial for that reason, too.

ASSESSING PROPERTY

Lead Paint in Property Won't Diminish Its Value for Tax Purposes If Property Is Rented and the Rentals Continue

In its 1996 *Commerce* case (Digest 444), the Court of Appeals held that environmental contamination must be considered in a municipality's evaluation of its real property for tax purposes, and discussed methods for figuring it. It appears that none of those methods worked for the property owner in the more recent case of *Roth v. City of Syracuse*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 2475867 (June 11, 2013), a proceeding under Article 7 of the Real Property Tax Law.

In such a proceeding, the Court of Appeals points out, the municipality's assessment enjoys a "presumption of validity" which the owner has the burden of rebutting. The Court finds that the owner failed to rebut it in *Roth*. Hence, although lead paint is concededly a contaminant, *Roth* holds that the presence of lead paint in the property will not by itself necessitate reduction by the municipality of its assessment.

The properties involved were "five single-family, five-bedroom houses near Syracuse University used as rental housing for local college students".

All of the attempted showings of the effect of the lead paint on the value of the properties was theoretical only – the testimony of experts on both sides estimating the impact on value based on a mere showing that the properties contained lead paint. To the surprise of absolutely no one, the owner's expert said the properties were worth little – maybe a dollar apiece on the market – while the city's expert said their value was not diminished at all.

The conclusions of both sides may well strike the reader as untenable. Perhaps in a manner of speaking the unreasonableness of both sides' experts neutralizes all of them, leaving in charge the presumption that favors the municipality and imposes on the owner the burden of rebuttal.

That appears to be what happened in *Roth*. The owner argued diminution in value, but didn't offer any proof of it, such as – if we may conjecture – proof that he was having trouble renting. The record showed no such thing.

And there was apparently no proof of any transactions that failed, or faltered, because of the mere presence of the lead paint in the premises.

What about potential cleanup costs as reflecting on market value, as the owner argued for here? In the 1996 *Commerce* case, which involved a "Superfund site", the Court allowed consideration of cleanup costs, though deeming it an "imperfect" measure, but here in *Roth* the Court says there was no evidence that a buyer would have insisted on an abatement of the purchase price because of the lead paint. Should the owner have at least tried to sell the five properties so as to produce evidence of the potential buyer's resistance because of the lead paint?

In an opinion by Judge Rivera finding "unsupported [the owner's] contention that there is a lead paint 'stigma' depressing market value", the Court concludes that in this case, in any event, the owner's "proposed remediation costs are not an appropriate factor to be considered in evaluating the tax assessments".

The existence of lead paint in the buildings, incidentally, was the product of an assumption by the Court. The widespread use of lead paint during the era of construction of properties in the area led the Court to "assume that lead paint was present in the five properties". (Its thinking on that matter appears in footnotes 3 and 4 in the case.)