

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 MAY STILL, WHEN LATER SUED BY INSURED WHO PAID JUDGMENT, PLEAD POLICY EXCLUSIONS

The caption states a proposition in direct conflict with the rule the Court of Appeals pronounced in its decision last year in *K2 Investment*, in which it held that an insurer that fails to defend its insured – in this instance an insured being sued for legal malpractice – cannot, when later sued by the insured on the resulting default judgment, plead policy “exclusions” to avoid an obligation to pay. We did a lead note on the decision in Issue 644 of the Digest.

In a rare occurrence, the Court now entertains reargument in the *K2* case, withdraws its earlier decision, reverses itself, and holds that when a recited “exclusion” in the policy is the issue – rather than an issue of whether there’s any “coverage” of the event at all under the policy terms – an insurer that disclaimed coverage and refused to defend is nevertheless not barred, when now sued by the insured on the judgment, from pleading a policy “exclusion” as a defense. [*K2 Investment Group, LLC v. American Guarantee & Liability Ins. Co.*, 2014 WL 590662 \(Feb. 18, 2014\)](#).

And because it has not yet been heard on its “exclusion” defense, the Court vacates the earlier decision to give the insurer that hearing now.

The decision to vacate and reconsider gets only four votes, however, with Judge Smith writing for the majority and Judge Graffeo writing the dissent.

The endeavor to draw a line between the two situations, which the Court has often tried to do, has come to sound to us like metal scraping against a blackboard. The screech fills the air yet again in the *K2* case. We’ve seen this attempted line-drawing before in, e.g., the Court’s *Servidone* (Digest 307) and *Lang* (Digest 540) decisions. The Court goes back to those cases in the new *K2* decision.

This of course involves the well known rule that the duty to defend an insured is broader than the duty to indemnify, meaning in its simplest terms that if the allegedly insured incident, as pleaded in the complaint, can on any reasonable interpretation be found to fall within the policy terms,

the insurer is required to defend the litigation even if the resulting judgment may ultimately show that the insurer does not have to indemnify the insured.

Servidone, a 1985 decision, held that an insurer, though wrongfully failing to defend, will not be liable for a settlement the insured makes unless coverage under the policy is established. *K2* involved a judgment, not a settlement, but the Court sees no distinction between the two for present purposes. It rules that *Servidone* should have governed the *K2* case originally. It didn't, holds the Court, and that was a mistake, which the Court now rectifies in round 2 of *K2*.

The majority writes that "we must either overrule *Servidone* or follow it. We choose to follow it." The reason why it was not followed to begin with is not elaborated.

The Court suggested in the *Lang* decision that if coverage in a given case is "arguable", the insurer "is well advised to seek a declaratory judgment concerning the duty to defend or indemnify". The declaratory action is brought on the side, while the underlying action against the insured is pending; its use secures the insurer a firm guidepost about its obligations and avoids the ambiguities met in the *K2*-type situation.

If an insurance case can be described as involving an ambiguity, it would invoke yet another related proposition: that in the insurance realm, an ambiguity is always resolved against the insurer. Can "ambiguous" describe the dilemma in *K2*? If so, shouldn't the insurer have lost on that track alone?

It seems to us that the infirmity in this realm is the Court's continuing endeavor to distinguish the two situations: the first, in which there's just no coverage at all for the claimed insured event, and the second, in which "coverage" does exist in first instance but there's also an "exclusion" in the policy that would apply to let the insurer off.

The latter is finally found to be the situation in *K2*. The policy "covered" the case – which by itself required the insurer to defend – but it also contained "exclusions", which the Court summarizes in this case as "insured's status" and "business enterprise". The bottom line of this revised *K2* decision is that the insurer is not foreclosed from relying on those exclusions when sued on the default judgment.

Readers will find helpful the distinctions between "noncoverage" and "exclusions" as discussed in the dissent in *K2*, which also points out that barring "exclusions" from being invoked by the insured in this context provides an additional "incentive" for the insurer to appear and defend the underlying action, which should be the law's aim. The dissent therefore does not go along with a withdrawal of the *K2* opinion on the basis of the *Servidone* case, which it says should be applied "more restrictively".

To us the declaratory judgment suggestion to resolve the need-the-insurer-defend question is the only clear path discernible on this untidy patch of land.

OTHER DECISIONS

INSURANCE DISCLAIMERS

Disclaimer Issued Only After Insurer Made Reasonable Efforts to Contact Its Insured Is Upheld on Noncooperation Grounds

Another case on insurance disclaimers. Here, in [*Country-Wide Ins. Co. v. Preferred Trucking Services Corp.*](#), 2014 WL 590502 (Feb. 18, 2014), the accident occurred when the vehicle, owned by Preferred Trucking and operated by driver Arias, was being unloaded, injuring Gallina, who brought a personal injury action against both.

The only issue in the case concerns whether the defendants cooperated with the insurer, whose counsel tried to get them to participate in a deposition in the case but was unable to get through despite many efforts. Detailing those efforts and finding them diligent, as the law requires before allowing an insurer to disclaim for want of cooperation, the Court of Appeals upholds the disclaimer.

There are various grounds on which an insurer might disclaim coverage, but, recognizing the law's wish to supply injured persons a solvent source of recovery, the Court of Appeals has often shown that disclaiming is not easy.

In its 2003 *First Financial* decision, for example (Digest 529), the Court held that a delay in disclaiming coverage voided the disclaimer when the excuse offered by the insurer did not affect the disclaimer decision. Here in *Country-Wide*, however, the insurer showed a good reason for its delay in disclaiming, and the Court accepts it.

In an opinion by Judge Pigott, the Court recites the insurer's efforts to contact the insureds (both owner and driver), revealing an obvious pattern of noncooperation in which the duly (and often) contacted insureds failed to get back to the insurer. The underlying personal injury action was brought in March 2007, but it wasn't until November of 2008 that the insurer finally issued its disclaimer.

In the meantime the court in the now undefended tort action directed a default judgment against the defendants, and ordered an inquest that produced a damages award of \$2.5 million.

The insurer brought the instant action for a judgment declaring that it was not obligated to pay the judgment or to have defended the action. The suit succeeds; the Court holds that on the record the insurer gave written disclaimer notice "as soon as reasonably possible" – which was when the insurer had "a ground for refusal of coverage". When was that?

A disclaimer based on lack of cooperation is "more complex" than one made on other grounds, the Court observes, quoting from its 2008 *Continental* decision (Digest 591), because

an insured's noncooperative attitude is often not readily apparent ... [and] insurers must be encouraged to disclaim for noncooperation only after it is clear that further reasonable attempts to elicit their insured's cooperation will be futile.

The insurer met that standard here.

Because Arias was the driver, with first-hand knowledge of the facts, cooperation from the owner, Preferred, could have been secured through Arias, which made relevant the insurer's efforts to reach Arias, too. That attempt was in fact a key element, because Arias hemmed and hawed about cooperating, finally deciding not to.

He didn't "care" about the deposition, he said. Until then, the insurer "was still seeking Arias's cooperation in good faith" and could not be obliged to disclaim until that effort – as it finally did – proved futile.

FIRE INSURANCE

If Replacement Cost Covered by Policy Can Only Be Sued for After Replacement Complete, and Completion within Policy's Two-Year Time Limit Was Not Possible, Limit Doesn't Apply

The case, brought in state court but removed to federal court, involved a fire insurance policy with the usual two-year limit on suit measured from the date of loss. But the policy also covered replacement costs if sued for within the two years. The Second Circuit asked the New York Court of Appeals whether the insured is covered even if "the insured property cannot reasonably be replaced within two years". The answer furnished is Yes. [*Executive Plaza, LLC v. Peerless Ins. Co.*](#), 22 N.Y.3d 511, N.Y.S.2d (Feb. 13, 2014).

A key issue was whether the property could reasonably be replaced within two years. The Court may have had some doubt about that, but it finds in the Circuit's certified question the implication that the repairs could not be made within the two years, and so the Court assumes in formulating its answer.

On that assumption, the Court says coverage exists. As the Court recognizes, the parties can agree to a shorter time limit than statute would otherwise impose, as long as the new period agreed to is reasonable. (Here the statutory time limitation would ordinarily be the six years provided for contract claims, but a stipulated reduction to two years has been held to be reasonable in insurance contracts.)

Because the two years agreed to was clearly reasonable, it was not the issue; the issue was when the claim for replacement cost "accrued". A holding that the claim "accrued" – and that the time for suit ran out – before the work could be completed would mean a "nullification" of the claim.

In a unanimous opinion written by Judge Smith, the Court explains that
nothing required defendant to insure plaintiff for replacement cost in excess of
actual cash value, but having chosen to do so defendant may not insist on a "limitation
period" that renders the coverage valueless when the repairs are time-consuming.

Upholding the insurer's position here would mean that "the insured's claim will be time-barred before it comes into existence". While a substitution of two years for the otherwise applicable six is not itself unreasonable, it becomes unreasonable under the impact of the "accrual" feature in this case.

What can an insured do in a situation like this? Here comes the end of the two-year period and the insured is told that suit can't be brought on the replacement cost because it can't yet be figured.

As a matter of fact the insured was on top of the problem and did what it could. On the last day of the two-year time period, the insured brought a declaratory judgment action to establish that the insurer was liable for replacement costs. The insurer removed that action to federal district court, which dismissed it as "premature", an unfair reward for an insured pursuing its rights as best it could under the circumstances.

After the replacement was completed, the insured then brought the present action, which produced the certified question that the Court of Appeals answers as described above, preserving the claim.

WORKERS' COMPENSATION

Third Party Sued by Injured Employee Can't Seek Indemnification from At-Fault Employer Even If Injured Employee Is Undocumented Alien

The employer is immune from such third-party suit by § 11 of the Workers' Compensation Law.

The Court of Appeals made clear in its 2006 *Balbuena* decision (Digest 556) that a worker injured on the job may recover workers' compensation benefits even if the worker is an undocumented alien. That point is not disputed in the Court's more recent decision in [*New York Hospital Medical Center v. Microtech Contracting Corp.*](#), 22 N.Y.3d 501, N.Y.S.2d (Feb. 13, 2014), in which two illegal aliens suffered on-the-job injuries and were duly awarded compensation benefits.

They were employed by M, a contractor that a hospital had retained for a construction project. The issue in *Microtech* was whether the undocumented status of the injured employees could somehow affect contribution rights between the contractor and the hospital. The bottom line, right off, is that it could not.

As is well known, the recovery of workers' compensation substitutes for and completely displaces a common law damages claim the injured employee might otherwise have had against the employer in a tort action, despite a showing of the employer's fault. It insulates the employer from such a claim by the employee. But it doesn't insulate third persons. The issue then arises whether, when such a third party – presumably at fault – is sued by the employee, it may implead the employer for contribution or indemnification.

It may, but only if it's shown either (1) that the employee sustained a "grave injury" as defined by § 11 of the Workers' Compensation Law or (2) that in a written agreement between the third

party and the employer the latter agreed to be subject to such contribution or indemnification. Those are the requirements of WCL § 11 as imposed by the Omnibus Workers' Compensation Reform Act of 1996. The bill's purpose was to re-insulate from tort liability those employers who fulfilled their duty of securing workers' compensation insurance for their employees. Unless one of the two showings can be made, the employer remains in the "safe harbor" that § 11 provides.

Neither showing was made in *Microtech*, so that should have been that. There was one additional element, however: the federal Immigration Reform and Control Act (IRCA), which makes it unlawful to hire an unauthorized alien. That ceased to figure, however, because, as the Court points out, the hospital didn't contend that the IRCA preempts WCL § 11.

On the main issue in the case, the Court of Appeals, in an opinion by Judge Read, reasons that

[i]f the illegality of the employment contract does not defeat the employee's rights under an otherwise applicable state statute, as was the case in *Balbuena*, it is not clear why it would nonetheless annul the employer's statutory rights.

Hence the conclusion is that it doesn't, leaving the employer secure in its safe harbor.

HOSPITAL'S LIABILITY

Hospital Not Liable for Nurse Who Recognized Man Being Treated for Sex Disease as Boyfriend of Her Sister-in-Law, and Warned Her of It

The man (John Doe) was being treated at the hospital for a sexually transmitted disease (STD). When the nurse recognized him as her sister-in-law's boyfriend, she checked the records, verified an STD exam as the reason he was there, and advised her sister-in-law of it while Doe was still awaiting treatment.

In federal district court, Doe sued the hospital for this revelation on a respondeat superior theory, pleading eight grounds of liability and losing on all of them when the district court dismissed the whole case. Doe appealed on five of the grounds and lost on four. But on the fifth – pleading the hospital's "breach of the fiduciary duty of confidentiality" – the Second Circuit saw a possibility of liability under New York law and certified the question to the New York Court of Appeals.

The New York Court of Appeals doesn't share that vision, holds that this fifth ground is also barred under New York law, and so advises in a negative answer to the certified question. [*John Doe v. Guthrie Clinic, Ltd.*](#), 22 N.Y.3d 480, N.Y.S.2d (Jan. 9, 2014; 6-1 decision).

The Court's 2002 decision in *N.X. v. Cabrini Med. Ctr.* (Digest 509) is part of the Court's thinking in *Guthrie*. That case, involving a sexual assault on a patient made by a resident physician, posed the question of whether nurses could have prevented that wrongful conduct, making the hospital liable for their failing to. The Court held that to be a question for the jury.

In *Guthrie*, the plaintiff Doe doesn't get even that far. In an opinion by Judge Pigott, the Court holds as a matter of law that

a medical corporation's duty of safekeeping a patient's confidential medical information is limited to those risks that are reasonably foreseeable and to actions within the scope of employment.

It finds that Doe satisfied neither requirement in *Guthrie*.

The dissent, by Judge Rivera, would have accepted Doe's argument that the hospital is strictly liable for conduct like this. The majority's answer is that imposing strict liability here would not only upset precedent, but also invite unwise results. It uses the example of where the receptionist of a private physician reveals at a social event that a particular person "was in to see the doctor for a particular ailment, perhaps unbeknownst to the patient's family because he did not want to worry them". The dissent's rule, says the Court, would allow as little as that to form the basis for a damages claim.

The holding spares the Court a lot of the explaining it might otherwise have felt obliged to do if it were to impose liability on anyone for what the nurse did here.

Should the nurse here have kept quiet and possibly exposed her sister-in-law to some sexual disease? What the nurse did in this case at least gave the woman (1) a warning to postpone sex with Doe and (2) an opportunity to seek out a more suitable substitute in the meantime.

STATUTE OF FRAUDS

Combination of Papers Enables Auction House to Meet UCC Requirement That Contract for Sale of Goods Over \$500 Be In Writing

The sale here was well over \$500. The requirement, imposed by UCC 2-201(1), is that the writing be "signed by the party against whom enforcement is sought". In the case of auction sales, often conducted by telephone or through the web, that may pose a problem. It did in [*William J. Jenack Estate Appraisers and Auctioneers, Inc. v. Rabizadeh*](#), 22 N.Y.3d 470, N.Y.S.2d (Dec. 17, 2013), when D, with a successful bid of \$400,000, failed to pay. The auctioneer, P, sued to collect it.

For auction sales, § 5-701(a)(6) of the General Obligations Law contains a special statute of frauds accommodation. It provides that the auctioneer can satisfy the writing requirement with a memorandum, including among other things "the name of the purchaser, and the name of the person on whose account the sale was made [i.e., the consignor]".

In an opinion by Judge Rivera quoting from earlier decisions, the Court says that

[i]t is well established that the statutorily required writing need not be contained in one single document, but rather may be furnished by "piecing together other, related writings".

That's what was done in *Jenack*. Among the papers was an "absentee bidder form" furnished by the auctioneer and filled out by D with his name, address, credit card, and other data, including the identification number of the item on which D intended to bid at the auction. Also among the papers was a "clerking sheet" filled out by an auctioneer employee after the auction, recording D's as the winning bid on the subject item.

While perhaps none of the papers individually could satisfy as the requisite memo, their aggregate did, making P's claim clear enough to lend itself to a summary judgment, which the Court, reversing the appellate division, directs.

An incidental point made by the Court and helpful to remember for future auctions is that a number designation for the buyer cannot alone substitute for the statute of frauds requirement of a name. Here a number didn't have to, in any event, because the name emerged from some of the aggregate papers.

Another point relates to the statutory requirement that the memo also include – in auction cases – the name of the consignor. One of the papers in the case – the "clerking sheet" – listed P as the auctioneer, which satisfied that aspect of the statutory requirement because, as the Court acknowledges, "an auctioneer serves as a consignor's agent". This furthers the law's purpose to enable the seller to remain anonymous if he chooses to.

There were amici in the case on the auctioneer's side. They argued, and the Court agrees, that "the auction business is important to New York State", and that it includes honoring the "custom and practice of auction houses to maintain the confidentiality of the seller".

Convinced as it was that D made the bid and then just backed away from paying for it, the Court also comments that the statute of frauds was not meant to enable someone to evade a just obligation, which "is precisely what [D] attempts to do here".

TAX REFUNDS

State Law Requiring County to Pay Real Property Tax Refunds Can't Be Avoided by Switching Burden to Local Taxing Units

Not in the case of Nassau County, in any event, because of the unique history of the provisions involved – constitutional, statutory, and local. A number of these are reviewed in detail by the Court of Appeals in [*Baldwin Union Free School District v. County of Nassau*](#), 2014 WL 590617 (Feb. 18, 2014), including notably the Municipal Home Rule Law.

The MHRL gives governmental units the power "to adopt and amend local laws not inconsistent" with the constitution or any general law concerning, among other things, "the collection of local taxes". In trying to shift the obligation to pay real property tax refunds from itself to its local taxing districts – such as the school district whose name leads off the several complaints in these actions – Nassau County is held to have exceeded its powers.

It took an exhaustive review of provisions in the state constitution as well as in several statutes and local laws to reach that conclusion, but the opinion of the Court, written by Judge Abdus-

Salaam, does not stint on that review, touching on virtually every point raised by the contentious parties, including measurements of the consistency of local laws with statutes, and of statutes with the constitution.

Among the provisions at the forefront of the dispute is Local Law 18 adopted by the county. The Court writes that

[b]y requiring the taxing districts ... to pay real property tax refunds to the taxpayers, relieving the County government of that tax refund burden[,]

Local Law 18 alters the assignment of tax burdens and for that reason cannot stand “unless the State has expressly delegated to the County the power to pass such a local tax law”, which the state has not done in this case.

The Court labels the county’s act “unconstitutional, invalid, unenforceable and void”, i.e., a blight on the landscape.

HELP FROM THE BARN

Analogy to Kindred Situations Often Proves Key Tool for Judiciary

In the course of its opinion in [Baldwin](#), above, the Court of Appeals cites a canon of construction that helps identify a statute’s purpose “by the company it keeps”. And at the conclusion of our treatment of the *Expedia* case in Digest 649 two months back, we had a line about boozers, which had a similar mission. An anonymous wit celebrated this phenomenon in verse:

The Pig

It was the first of May,
A lovely warm spring day.
I was strolling down the street in drunken pride.
But my knees were all a-flutter
And I landed in the gutter
And a pig came up and lay down by my side.

Yes, I lay there in the gutter
Thinking thoughts I could not utter
When a lady passing by did softly say
“You can tell a man who boozes
By the company he chooses”,
And the pig got up and slowly walked away.