INSURANCE LAW

Recent Decisions (Other Than 'K2') On an Insurer's Duty to Defend

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The insurer's duty to defend its insured has recently been a popular topic for legal commentators in this and other publications. Following the June 2013 Court of Appeals decision in *K2 Investment Group v. American Guarantee & Liability Ins.*, 21 NY3d 384, 971 NYS2d 229 (2013), in which the court held that "when a liability insurer has breached its duty to defend its insured, the insurer may not later rely on policy exclusions to escape its duty to indemnify its insured for a judgment against him," numerous articles were written about this important and controversial decision, its meaning and its effects.[1]

This article will not be another in that series because on Sept. 3, 2013, the Court of Appeals, in a fairly unusual move, granted reargument of its earlier decision, and set the case down "for a future session of this Court." 2013 N.Y. Slip Op. 84038, 2013 WL 471158 (2013). It thus can safely be said that we have not heard the last of *K2*, and that further discussion of the existing opinion at this point would be academic, and quite possibly, moot.

Instead, we would like to focus on a string of recent (pre-*K2*) decisions that discussed and explained the insurer's duty to defend in various contexts, leaving for another day the discussion of the consequences of breaching that duty.

General Rule

In *Natural Organics v. OneBeacon America*, 102 AD3d 756, 959 NYS2d 204 (2d Dept. 2013), the court stated that "An insurer's duty to defend 'is liberally construed and is broader than the duty to indemnify' [citations omitted]. The duty to defend 'arises whenever the allegations in a complaint state a cause of action that gives rise to the reasonable possibility of recovery under the policy' [citations omitted]. 'If the allegations of the complaint are even potentially within the language of the insurance policy, there is a duty to defend' [citations omitted]. Moreover, if 'any of the claims against the insured arguably arise from covered events, the insurer is required to defend the entire action' [citation omitted]. An insurer may be required to defend under the contract 'even though it may not be required to pay once the litigation has run its course' [citation omitted]."

> In 'Natural Organics,' the court stated that an insurer's duty to defend 'is liberally construed and is broader than the duty to indemnify.'

Similarly, in *State Farm v. Joseph M.*, 106 AD3d 806, 964 NYS2d 621 (2d Dept. 2013), the court stated that "[A]n insurer's duty to defend is broader than its duty to indemnify, and arises whenever the allegations in the complaint in the underlying action, construed liberally, suggest a reasonable possibility of coverage, or where the insurer has actual knowledge of facts establishing such a reasonable possibility" [citations omitted]. An insurer can be relieved of its duty to defend only 'if it establishes as a matter of law that there is no possible factual or legal basis on which it might eventually be obligated to indemnify its insured under any policy provision' [citations omitted]." See also, *Soho Plaza v. Birnbaum*, 108 AD3d 518, 969 NYS2d 96 (2d Dept. 2013).

Duty Found

In *Natural Organics*, the complaint in the underlying action alleged that the insured corporation engaged in unfair competition pursuant to the Lanham Act (15 USC §1125[a]), when, after wrongfully terminating an exclusive distributorship agreement with another company (Company A), it issued a press release announcing the appointment of a third company (Company B)—a competitor of Company A—as exclusive distributor of its products in the Nordic region, despite the fact that Company A actually remained the sole distributor in that region—which caused a diversion of trade from Company A, as well as harm to its reputation and goodwill.

The court held that the allegations of the complaint against the insured fell within the policy's coverage for "personal and advertising injury liability," defined as injury arising out of "[o]ral or written publication of material that slanders or libels a person or organization" or "[o]ral or written publication of material that disparages a person's or organization's goods, products or services." As explained by the court, the statement that Company B had been appointed the exclusive distributor of the insured's products in the Nordic region could imply that Company A's inventory of the insured's products was unauthorized.

Moreover, the court held that OneBeacon failed to meet its burden of demonstrating that the allegations of product disparagement fell wholly within an exclusion in the policy for personal and advertising injuries arising out of breach of contract, that the exclusion was subject to no other reasonable interpretation, and that there is no possible factual or legal basis upon which it may eventually be held obligated to indemnify the insured under the policy. The court observed that the press release was allegedly false and disparaging to Company A's products without regard to whether the insured breached its contract with Company A. Thus, because the product disparagement clam did not necessarily arise out of the insured's alleged breach of contract, the coverage » Page 12

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Duty

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was not excluded under the policy, and, instead, OneBeacon's duty to defend the insured corporation was triggered.

In *W&W Glass Systems v. Admiral Ins.*, 91 AD3d 530, 937 NYS2d 28 (1st Dept. 2012), the plaintiff general contractor sought a declaration that it was entitled to defense and indemnification from Admiral Insurance in connection with an underlying personal injury action in which an employee of a subcontractor was injured, under a policy issued to the subcontractor, which named the plaintiff as an additional insured. The policy provided that the plaintiff was covered "only with respect to liability caused by [the subcontractor's] ongoing operations performed for that insured [i.e., plaintiff]." The policy further provided that it "does not apply to liability caused by the sole negligence of the person or organization [named as an additional insured]."

Admiral's argument that the "caused by" language in the policy should be narrowly construed was rejected by the court, which held that the phrase "caused by your ongoing operations performed for that insured" does not materially differ from the general phrase "arising out of," citing, inter alia, *Regal Constr. v. National Union Fire Ins. of Pittsburgh*, 15 NY3d 34, 38, 904 NYS2d 338 (2010), where the Court of Appeals held that additional insured status would be extended to an owner or general contractor who was promised additional insured status in a trade contract if the indemnity agreement provided for coverage "arising out" of the named insured's work and the injuries were to a named insured's employee in the course of the work.

The court also held that the language in the additional insured endorsement granting coverage did not require a negligence trigger. Finally, the court noted that "It is immaterial that the complaint against the insured asserts additional claims which fall outside the policy's general coverage or within its exclusionary provisions.... The duty to defend is 'exceedingly broad and an insurer will be called upon to provide a defense whenever the allegations of the complaint suggest...a reasonable possibility of coverage.'"

In *Sumner Builders v. Rutgers Casualty Ins.*, 101 AD3d 417, 955 NYS2d 568 (1st Dept. 2012), there was conflicting evidence on whether the accident victim was injured in the course of his employment, and, therefore, whether an employee exclusion in the subject policy applied. Although the complaint alleged that he was injured in the course of his employment, his amended Bill of Particulars, which contained broader allegations, suggested otherwise. Under those circumstances, the insurer was obligated to provide a defense for the accident victim's claims.

Similarly, in *Essex Ins. v. Vickers*, 103 AD3d 684, 959 NYS2d 525 (2d Dept. 2013), the court stated, "'An insurer's duty to defend is broader than its duty to indemnify, such that an insurer may be obligated to defend its insured even if, at the conclusion of an underlying action, it is found to have no obligation to indemnify its insured' [citations omitted]. 'The duty to defend an insured is not triggered, however, when the only possible interpretation of the allegations against the insured is that the factual predicate for the claim falls wholly within a policy exclusion' [citations omitted]." Because in that case, the court found that the "employee exclusion" upon which the insurer relied, "would 'even potentially' be inapplicable," the court held that the insurer was obligated to defend its insured in an underlying action.

No Duty Found

In *Christ the King Regional High School v. Zurich Ins.*, 91 AD3d 809, 936 NYS2d 680 (2d Dept. 2012), motion for leave to appeal denied, 19 NY3d 806, 950 NYS2d 104 (2012), the court held that the additional insured provision under a liability policy issued to an entity that rented an auditorium and three classrooms for a dance competition in the plaintiff school did not cover the school in connection with an accident involving a woman who was injured while walking on a sidewalk from a parking lot behind the school to the school's front entrance to attend the competition.

The school had argued that coverage was available under a provision in the policy pursuant to which an "insured" was defined to include any organization to whom the named insured was obligated, by virtue of a written contract, to provide liability insurance, "but only with respect to liability arising out of [its] operations." The court held that the portion of the provision limiting coverage to liability "arising out of [the named insured's] operations" requires that there be "some causal relationship between the injury and the risk for which coverage is provided" [citing *Regal Constr.*, supra, and *Worth Constr. v. Admiral Ins.*, 10 NY3d 411, 415, 859 NYS2d 101).

Here, the court concluded, "The plaintiffs failed to demonstrate, prima facie, the existence of such a causal relationship" because the named insured's "operations" consisted of conducting a dance competition in the school auditorium and three classrooms. Bodily injury occurring outside the leased premises, in an area where the named insured had no responsibility to maintain or repair, "was not a bargained-for risk." Rather, as the court explained, the named insured's "operations" at the school "merely furnished the occasion for the accident," much like in *Worth*, where the fact that the named-insured subcontractor installed a staircase on which the injured plaintiff fell, thus furnishing the "situs of the accident," did not demonstrate that the accident, caused by installation of fire proofing on the staircase by another subcontractor, arose from the named-insured subcontractor's "operations."

In *Seneca v. Cimran*, 106 AD3d 166, 963 NYS2d 182 (1st Dept. 2013), the court observed that "'Coverage cannot be afforded on liability for which insurance was not purchased.' While the obligation to defend is broader than the duty to indemnify, it 'does not extend to claims not covered by the policy' [citations omitted]. '[I]f the allegations interposed in the underlying complaint allow for no interpretation which brings them within the policy provisions, then no duty to defend exists' [citations omitted]."

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Here, the policy only provided coverage for injuries arising out of the insured building, namely the 10,000 square feet located on the first, (and at that time, only) floor of the building. Thus, it necessarily did not provide coverage for an additional three floors of an intended four-story structure, nor for the structure that existed during the construction of three additional floors on top of the insured building. Since the subject accident took place on the fourth floor, the insurer was not obligated to defend or indemnify the insured as a matter of law.

In *American Equity Ins. v. A&B Roofing*, 106 AD3d 762, 965 NYS2d 147 (2d Dept. 2013), in the underlying action, Timothy Harris claimed that he was injured while working

for A&B Roofing "in or about July 2002." A&B had secured a policy of insurance from American Equity, which was in effect from March 7, 2002, through March 7, 2003. American Equity provided an initial defense to A&B in the underlying action, but subsequently disclaimed coverage based on various provisions of the policy. At Harris' deposition, he testified that the accident occurred between Halloween 2001 and Nov. 4, 2001. Thereafter, Harris amended his complaint to allege that the accident occurred in or about October or November 2001.

American Equity then brought this action seeking a judgment declaring that it was not obligated to defend or indemnify A&B in the underlying action because the accident occurred before the effective date of its policy. The court found in favor of American Equity and granted its motion for summary judgment declaring that it was not obligated to defend or indemnify, noting that "An insurance company's duty to indemnify 'flows from a contractual relationship'" which did not exist under the facts and circumstances of this case.

In *Jericho Atrium Assoc. v. Travelers Prop. Cas. of Am.*, 106 AD3d 879, 965 NYS2d 537 (2d Dept. 2013), the plaintiff's premises were insured by Travelers under a policy that was effective from May 2007 to May 2008. The policy included provisions calling for Travelers to defend and indemnify the plaintiff against bodily injury claims "caused by an 'occurrence' that takes place in the coverage territory" and "occurs during the policy period." On July 31, 2007, the plaintiff sold the premises and requested Travelers to remove the property from coverage, which it did, effective that date. An accident occurred on the premises 10 days later.

Based upon these facts, the court concluded that Travelers was not obligated to defend or indemnify the plaintiff in the underlying bodily injury action. As the court explained, the duty to defend and indemnify attached only to bodily injury caused by an 'occurrence' that is covered by the policy and occurs during the policy period. Here, the bodily injury occurred after the premises were removed from coverage. The allegation that the accident was caused by a dangerous condition that existed on the premises before it was removed from coverage did not obligate Travelers to defend and indemnify because the policy predicated coverage upon the sustaining of a bodily injury during the policy period, and, thus, it was immaterial that the negligent acts which allegedly caused the occurrence took place while the policy covering the premises was still in effect.

In *State Farm Fire v. Joseph*, supra, the complaint in the underlying action alleged that the plaintiff therein sustained bodily injury due to a sexual assault perpetrated by the insured. The court held that "Since the bodily injuries allegedly sustained by the plaintiff in the underlying action were inherent in the conduct that Joseph M. allegedly engaged in, the alleged sexual assault cannot be construed as an accident within the definition of 'occurrence' for which the plaintiff's policy affords coverage [citations omitted]. Nor may the defendants 'exalt form over substance by labeling the [underlying] action as one to recover damages for negligence.'"

Conclusion

We look forward to reading the Court of Appeals' next decision in *K2*, which will certainly enlighten us all further with regard to the insurer's duty to defend its insured.

1. See e.g., Kohane, Dan D. and Pelper, Steven E, "Draconian Penalty Adopted for Wrongfully Refusing to Defend," NYLJ, June 24, 2013; Booth, Charles A. and Anania, Michael L., "'K2' Ruling on Insurer Refusal to Defend Fits Within Established Law," NYLJ, July 8, 2013; Cohen, Robin L., Sherwin, Elizabeth A., and Winsbro, Jack P., "New Ruling Precludes Insurers From Contesting Indemnity Coverage," NYLJ, July 15, 2013; Schulman, Jeffrey L. and Zola, Jared, "State High Court Reminds Insurers of Risks in Breaching Duty to Defend," NYLJ, July 26, 2013; Gollub, Michael S. and Ziolkowiski, Steven M., "'K2 Investment Group' Ruling: Radical...or Not?" NYLJ, July 31, 2013.