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New York Court of Appeals Opinion on Reconsideration – K2 Investment Group, LLC v. American Guarantee & Liability Insurance Co.

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On February 18, 2014, the New York Court of Appeals released its eagerly-awaited opinion on reconsideration in K2 Investment Group, LLC v. American Guarantee and Liability Insurance Co., vacating its June Decision*, which had shocked the insurance industry by imposing indemnity coverage by estoppel as a consequence of a wrongful failure to defend an insured.

Finding that American Guarantee was "correct" in its challenge to the June Decision as inconsistent with the landmark decision in Servidone Construction Corp. v. Security Insurance Co. of Hartford, 64 NY2d 419 (1985), slip. op at 1-2, the Court acknowledged that it had "erred by failing to take into account [the] controlling precedent" of Servidone in its June Decision and strongly reaffirmed the Servidone doctrine, which had been followed for almost thirty years. Id.

The June Decision had held that an insurer that wrongfully fails to defend its insured forfeits the ability to assert policy exclusions in respect of a judgment that is ultimately entered against its insured. In so ruling, the Court of Appeals relied on dicta in Lang v. Hanover Insurance Co., 3 NY3d 350, 356 (2004), but did not discuss nor cite Servidone. The Court granted American Guarantee's motion for reconsideration of the June Decision, in which American Guarantee argued that the Court had overlooked Servidone and had misapprehended the holding in Lang.

In writing for the four-member majority, Judge Smith, who was the author of the June Decision, stated that "to decide [K2] we must either overrule Servidone or follow it," and the Court chose to follow Servidone. Slip op. at 5. The Court held that its June Decision "cannot be reconciled" with Servidone, slip op. at 6, and rejected K2's argument that Servidone was distinguishable because that case involved a settlement, not a judgment. Id. at 3. The Court also rejected the argument that its decision in Lang v. Hanover Insurance Co., 3 NY3d 350 (2004), effectively overruled Servidone, or had limited Servidone to cases in which the insurer argued that the underlying claim did not fall within the grant of coverage, as opposed to asserting a policy exclusion to bar coverage. Id. at 4-5. The Court

ruled that it saw “no justification for overruling Servidone,” slip op at 5-6, stating:

When our courts decide a question of insurance law, insurers and insureds alike should ordinarily be entitled to assume that the decision will remain unchanged unless or until the Legislature decides otherwise.

Id. at 6. Not only did the Court vacate its June Decision based on Servidone, its ruling strongly reaffirms the validity of Servidone, strengthening that decision against any future challenge to its holding.

Having determined that, under the rule of Servidone, American Guarantee “is not barred from relying on policy exclusions as a defense to this lawsuit,” id. at 6, the Court then considered the applicability of the “insured status” and the “business enterprise” exclusions in the American Guarantee policy. Id. The Court ruled that issues of fact precluded the grant of summary judgment in favor of K2 on those exclusions. Id. The Court therefore reversed the Appellate Division’s order and remanded to the trial court to proceed with discovery with regard to the applicability of American Guarantee’s policy exclusions. Id. at 8.

The majority opinion is a complete reversal of the June Decision as well as a reversal of the Appellate Division’s incorrect ruling on the applicability of the exclusions. The Court strongly reaffirmed its commitment to the rule established in Servidone and limited the application of Lang to cases that involve an attack on an underlying judgment, and not the application of defenses to indemnity coverage “based on policy exclusions.” Id. at 4. In doing so, the Court makes any effective challenge to Servidone unlikely in the foreseeable future, because it stated that “Lang should not be read as silently overruling Servidone.” Id. The decision also balances the rights of the insurer with the rights of the insured by prohibiting the insurer from re-litigating issues decided in the underlying judgment against the insured, while permitting the insurer to assert indemnity defenses that do not attack the underlying judgment. If you have any questions about K2 Investment Group, LLC, please feel free to contact Kevin T. Coughlin (973-631-6001, kcoughlin@cmg.law), Robert J. Kelly, ((212) 612-4984, rkelly@cmg.law), Timothy P. Smith (973-631-6031, tsmith@cmg.law), or Michael S. Chuven (212-612-4992, mchuven@coughlindufy.com).

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