



## NEW AND NOTEWORTHY FOR Insurance Coverage

### **Court of Appeals Decision: Insurer Found to Have Breached the Duty to Defend Loses Right to Rely on Policy Exclusions to Dispute its Duty to Indemnify**

On June 11, the Court of Appeals issued its decision in K2 Investment Group, LLC v. Amer. Guarantee & Liability Ins. Co., 2013, NY Slip Op 4270. The decision announces what must be regarded as a major new rule of New York insurance coverage law. The case addresses the issue of whether an insurer that has breached its duty to defend may nevertheless assert policy exclusions as a defense to the duty to indemnify. The Court began its opinion by stating its holding expressly: “We hold 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 the insured for a judgment against him.”

The Court’s decision was guided by the breadth of the duty to defend. The Court quoted its prior decision in Automobile Ins. Co. of Hartford v. Cook, 7 N.Y.3d 131 (2006), at length: “It is well settled that an insurance company’s duty to defend is broader than its duty to indemnify. Indeed the duty to defend is exceedingly broad and an insurer will be called upon to provide a defense wherever the allegations of the complaint suggest a reasonable possibility of coverage. If, liberally construed, the claim is within the embrace of the policy, the insurer must come forward to defend its insured no matter how groundless, false or baseless the suit may be.”

Before K2, an insurer that breached the duty to defend was obligated to reimburse its insured for its defense costs. However, the insurer was still free to raise exclusions to dispute its obligation to indemnify its insured, so long as those exclusions were otherwise timely raised. In other words, the insurer’s two duties to

its insured - defense and indemnity – were analyzed separately, and a finding of a breach of the duty to defend did not dispose of the separate issue of the duty to indemnify. Under K2, “if the insurer’s disclaimer [on the duty to defend] is found bad, the insurance company must indemnify its insured for the resulting judgment, even if policy exclusions would otherwise have negated the duty to indemnify.”

The Court did not hide the policy considerations behind its holding, noting that “[t]his rule will give insurers an incentive to defend the cases they are bound by law to defend, and thus to give insureds the full benefit of their bargain. It would be unfair to insureds, 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 acknowledged that it might later find exceptions to this new rule, but did not provide any significant guidance with respect to what those possible exceptions might be. Also, the decision casts its holding as not a new rule, but as reaffirmation of the rule stated in Lang v. Hanover Ins. Co., 3 N.Y.3d 350 (2004). This characterization, however, is dubious, as Lang dealt with the separate issue of whether an insurer that issues an invalid disclaimer cannot later challenge liability or damages in the underlying action. Indeed, in another part of the decision, the Court acknowledged that Lang involved a different issue.



In the second part of the decision, the Court, in *dicta*, suggested that a claim for a bad faith denial of the duty to defend, if one exists at all, would not lie absent proof by the insured that had it been provided a defense, it would have avoided liability in the underlying action.

K2 was decided without any concurring or dissenting opinions.

K2 will likely generate significant shifts in the way coverage determinations are reached and litigated in New York. In the coming months and years, the case will also likely generate much case law regarding its reach and application.

If you or your organization have an interest in the K2 decision and how it may affect the liability insurance landscape in New York, the attorneys of KSLN's coverage group would be happy to talk to you.