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COURT OF APPEALS

STATE OF NEW YORK

K2 INVESTMENT GROUP, LLC,

Respondents-Appellants,

-against-

No. 6

AMERICAN GUARANTEE & LIABILITY
INSURANCE CO.,

Appellant-Respondent.

20 Eagle Street
Albany, New York 12207
January 7, 2014

Before:

CHIEF JUDGE JONATHAN LIPPMAN
ASSOCIATE JUDGE VICTORIA A. GRAFFEO
ASSOCIATE JUDGE SUSAN PHILLIPS READ
ASSOCIATE JUDGE ROBERT S. SMITH
ASSOCIATE JUDGE EUGENE F. PIGOTT, JR.
ASSOCIATE JUDGE JENNY RIVERA
ASSOCIATE JUDGE SHEILA ABDUS-SALAAM

Appearances:

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Karen Schiffmiller
Official Court Transcriber

1 CHIEF JUDGE LIPPMAN: We're going to start
2 with number 6, K2 Investment. Counselor?

3 MR. COUGHLIN: Good - - -

4 CHIEF JUDGE LIPPMAN: Would you like any
5 rebuttal time?

6 MR. COUGHLIN: Yes, I'd like two minutes,
7 Your Honor.

8 CHIEF JUDGE LIPPMAN: Two minutes, go
9 ahead, counsel, you're - - - you're up.

10 MR. COUGHLIN: Good afternoon, and Happy
11 New Year. May it please the court - - -

12 CHIEF JUDGE LIPPMAN: Happy New Year to
13 you, counselor.

14 MR. COUGHLIN: May it please the court, my
15 name is Kevin Coughlin and I represent American
16 Guarantee.

17 We appreciate the opportunity to address
18 the court this afternoon on what we believe is an - -
19 - an issue of vital interest to the insurance
20 industry. And that is the K2 decision and its
21 conflict with a - - -

22 CHIEF JUDGE LIPPMAN: What was - - - what
23 was wrong with it? Are you saying there was - - -
24 the decision was wrong on a policy basis or on a
25 legal basis? Where is your - - - your main concern

1 with our earlier decision?

2 MR. COUGHLIN: Your Honor, if by policy,
3 you mean a pub - - - a public policy type of - - -

4 CHIEF JUDGE LIPPMAN: What's right, yeah.

5 MR. COUGHLIN: I - - - I think on both.

6 CHIEF JUDGE LIPPMAN: Go ahead, tell us
7 why.

8 MR. COUGHLIN: And - - - and one on the - -
9 - on the substantive law - - -

10 CHIEF JUDGE LIPPMAN: Right.

11 MR. COUGHLIN: - - - with - - - with utmost
12 respect. Servidone, as we all know, has been the law
13 of this state - - -

14 CHIEF JUDGE LIPPMAN: Does K2 overturn
15 Servidone?

16 MR. COUGHLIN: It does, Your Honor. It - -
17 - the two cases are not reconcilable under any
18 circumstances. The Servidone case, for thirty years,
19 not only is it a bright line standard that insurers
20 and policy holders have followed for thirty years, it
21 also encapsulated the law of New York for more than
22 fifty years.

23 CHIEF JUDGE LIPPMAN: Why is it - - - why
24 is it the better decision, though? Why is Servidone
25 - - - assume you're right that this, in effect,

1 overrules Servidone, why is Servidone something we
2 should stick with?

3 MR. COUGHLIN: For this reason, Your Honor:
4 one, it is tried and true. It remains in the
5 majority of - - - of the states who have dealt with
6 this issue for the last thirty years.

7 JUDGE GRAFFEO: Well, it's certainly in the
8 interest of insurance carriers to be able to assert
9 that there's an exclusion from the policy, but why is
10 it the better public policy? Why shouldn't - - - why
11 shouldn't we determine whether there's a duty to
12 defend for insureds before we get - - - I mean, if -
13 - - if insurance companies refuse to recognize their
14 obligation to defend, why should they be allowed to
15 assert the exemption later on?

16 MR. COUGHLIN: Well - - -

17 JUDGE GRAFFEO: Why shouldn't that issue be
18 decided?

19 MR. COUGHLIN: Because, Your Honor, this
20 state and this court for a long time has recognized -
21 - -

22 JUDGE GRAFFEO: Right, but maybe - - -
23 maybe we recognized that the policy was weighted too
24 far to the side of insurance carriers and against the
25 interest of insureds?

1 MR. COUGHLIN: I - - - I think - - -

2 CHIEF JUDGE LIPPMAN: And let me just add
3 to Judge Graffeo's question, why wouldn't it make
4 insurers think more carefully before disclaiming?
5 Why wouldn't that have a salutary effect?

6 MR. COUGHLIN: Well - - -

7 CHIEF JUDGE LIPPMAN: So answer it all
8 together.

9 MR. COUGHLIN: Thank you.

10 CHIEF JUDGE LIPPMAN: Go ahead.

11 MR. COUGHLIN: What - - - what it does,
12 Your Honor, it throws the concept of a contract
13 upside down. And this court has long recognized, and
14 even in Pavia, they - - - they explained it very
15 well. An insurance contract is still a contract.
16 Both parties have rights. Both parties have
17 bargained for certain cover. Now, the - - - the
18 fundamentals - - -

19 JUDGE GRAFFEO: But we're not - - - but - -
20 - but - - -

21 MR. COUGHLIN: I'm sorry.

22 JUDGE GRAFFEO: - - - we didn't say in K2
23 that you can't apply the exemption or claim the
24 exemption. It's that you'd have to bring the
25 declaratory judgment and get a determination on the

1 extent of the duty to defend before you can rely on
2 that exemption.

3 MR. COUGHLIN: Well - - - well,
4 respectfully, K2 does not mention anywhere bringing a
5 DJ.

6 JUDGE GRAFFEO: Well, Lang does.

7 MR. COUGHLIN: Lang - - - Lang says in
8 dicta, you should bring a DJ, and regrettably, that
9 didn't happen here. But - - -

10 JUDGE READ: But what's wrong with that, I
11 guess is the question? Why not?

12 MR. COUGHLIN: I'm sorry?

13 JUDGE READ: What's wrong with that? Why
14 not bring the DJ?

15 MR. COUGHLIN: Well, there's lots of
16 reasons not to bring a DJ, Your Honor. One is, a DJ
17 potentially puts the insured who's in a piece of
18 litigation in harm's way, because a DJ could develop
19 facts that are detrimental to the insured in defense
20 of that direct liability case.

21 JUDGE SMITH: He's better off.

22 JUDGE PIGOTT: So you're - - - you're - - -
23 you're helping them out by not making a DJ in this
24 case?

25 JUDGE READ: And not - - -

1 MR. COUGHLIN: Well, Judge Pigott, I'm not
2 suggesting that. But - - - but I was asked the
3 question, why not?

4 JUDGE READ: Yeah, what is - - -

5 MR. COUGHLIN: Regrettably, maybe it should
6 have happened here, but it didn't. But - - -

7 JUDGE PIGOTT: But you know what - - - you
8 know what struck me, though, is when - - - when - - -
9 when the lawyer walked away, you know, and then the
10 default happens, et cetera, at that point, the only
11 issue is, do the four corners of the pleading fit
12 within the policy.

13 Once - - - once there is a default and now
14 you're coming down for indemnity, that's a whole new
15 question, and I know - - - I know you're arguing that
16 you have a right to go back and see if that judgment
17 and the proof that supports it, if - - - if any, is
18 covered under your policy. But that initial one is -
19 - - is just the - - - is just the pleading, right?

20 MR. COUGHLIN: Yes. We're - - - the only
21 issue - - - the only issue I would take with that
22 statement, Judge Pigott, is when you lay the policy
23 and the complaint next to each other, it's the
24 potential for coverage that's - - - that is the
25 standard.

1 This court and the majority of courts
2 around the country have recognized on the duty to
3 indemnify, it's a much stricter standard. And
4 Servidone goes into a detailed analysis about that.

5 And one of things that's - - - that's
6 remarkable is K2 is very similar to the Appellate
7 Division decision in Servidone. And when this court
8 got the appeal, it said, among other things, we
9 affirm that the duty to defend and the duty to
10 indemnify are very different standards. And we're
11 here on the indemnity issue, and they said, you must
12 prove an actual claim.

13 But it went on to say - - - because there's
14 actually three principles that are important in
15 Servidone, which we believe K2 overturned. And that
16 is, this is a contract case. The insured should be
17 put back in the place it would have been pre-breach
18 of the duty to defend. Now, this court in Lang does
19 that. And the consequences are clear, and I'll come
20 back to that.

21 But thirdly, and this is, I think, the crux
22 of - - - of the big difference between K2 and
23 Servidone, Servidone said what the Appellate Division
24 did was a penalty. It enlarged the coverage
25 potentially, and they did it, not on a public - - -

1 there's no mention of public policy at all.

2 Servidone was a commercial exclusion, a contractual
3 indemnification exclusion. Nowhere in Servidone do
4 they talk public policy.

5 And in fact, in the - - - the Village of
6 Cedarhurst case, which this court heard, which
7 applied the Servidone principle on a pollution
8 exclusion, again, no mention of public policy.

9 JUDGE SMITH: Well, is it - - - I mean, is
10 that - - - is that good? I mean, if Servidone - - -
11 Servidone didn't discuss the public policy, maybe
12 that's a reason that Servidone should be
13 reconsidered?

14 MR. COUGHLIN: I - - - I think not, Your
15 Honor, because this reason: New York has been at the
16 center of insurance law for thirty years.

17 JUDGE SMITH: I think - - - I don't mean to
18 cut you off, but you're basically saying stare
19 decisis.

20 MR. COUGHLIN: I am, Your Honor.

21 JUDGE SMITH: And I - - - and I - - -
22 believe me, you've got a point. But - - - but stick
23 - - - for a moment, just - - - just for the sake of
24 argument, discuss the question which is the better
25 rule, K2 or Servidone? Doesn't K2 express the wiser

1 policy that - - - that if you want - - - if you want
2 to rely on the exclusions in your policy, all you got
3 to do is come in and defend, and it's not hard to do.

4 MR. COUGHLIN: Well, Lang doesn't say that,
5 Your Honor. And Lang is the only decision used - - -
6 utilized by the court in K2.

7 JUDGE SMITH: I - - - I asked you why it
8 was the better rule? I didn't ask you about the
9 previous cases.

10 MR. COUGHLIN: The better rule is - - - is
11 - - - the better rule is Servidone. Servidone lays
12 out one - - - it protects contractual integrity. And
13 if you want to talk about public policy, it has long
14 been the public policy of the State of New York to
15 uphold the terms and conditions of a contract.

16 JUDGE PIGOTT: Yeah, but - - -

17 JUDGE GRAFFEO: Could I ask you what's the
18 - - - if we agree with you, what's the incentive for
19 insurance companies where there's a close issue on
20 the duty to defend to go in and defend the insured,
21 as opposed to saying, okay, we'll disclaim, and we'll
22 worry about and we'll rely on exclusions later on?

23 MR. COUGHLIN: Judge, this case is the best
24 example of that. The K2 case itself. Because of the
25 breach on the duty to defend, American Guarantee is

1 stuck with a liability judgment that they can't
2 contest, a finding of fact that Mr. Daniels acted as
3 a lawyer in this transaction, that he committed
4 malpractice in this transaction, and the amount of
5 damages is fixed.

6 Now, what - - - what's telling is, every
7 judge who's looked at this case, including this
8 entire court, the Appellate Division, and the Supreme
9 Court, everyone has said there was something about
10 this transaction. There was never any discovery on
11 the transaction - - -

12 JUDGE SMITH: Yeah, but if - - - but if - -
13 - but if you assume - - - assume that Daniels is in
14 good faith the whole time, which you've never really
15 argued otherwise, why should Daniels bear the burden
16 of - - - of this? You - - - you say this is an
17 unjust decision, essentially, that - - - that this
18 malpractice - - - it's ridiculous to hold Daniels for
19 malpractice.

20 Why should the burden fall on Daniels
21 because you failed to defend him?

22 MR. COUGHLIN: I - - - I'm not suggesting
23 that, Your Honor. I'm answering the Judge's question
24 about what consequence befalls the insurer. Well, in
25 this case - - -

1 JUDGE SMITH: Okay, well, okay, but - - -
2 but granted that it's a bad consequence that befell
3 the insurer here, why shouldn't it befall the
4 insurance company, which after all, did write an
5 insurance policy, rather than Mr. Daniels, whose
6 insurer abandoned him. I mean, if you'd - - - if
7 you'd defended or somebody - - - you could have won
8 this case. It's a lousy case.

9 MR. COUGHLIN: That I agree with, Your
10 Honor. It's a lousy case, and Zurich is stuck with
11 those findings. But - - - but the effect - - -

12 JUDGE GRAFFEO: That's why I was trying to
13 ask a more general question beyond just the facts of
14 this case, because at least I'm concerned with - - -
15 is there an incentive for insurance companies to
16 recognize their obligation to defend when there's
17 close cases.

18 MR. COUGHLIN: This case is that example.
19 They are - - - they are risking the inability to
20 control the case - - - recognizing they breached the
21 duty to defend, as Judge Smith was suggesting - - -
22 but they - - - they lost the ability to control the
23 outcome. Everybody who's looked at this case - - -

24 CHIEF JUDGE LIPPMAN: You're saying that's
25 a sufficient penalty, is that your argument?

1 MR. COUGHLIN: I prefer consequence, Your
2 Honor, but it is - - -

3 CHIEF JUDGE LIPPMAN: Is it a sufficient
4 consequence?

5 MR. COUGHLIN: But it is a very big
6 consequence and this case is telling upon that.

7 CHIEF JUDGE LIPPMAN: But you're saying
8 it's - - - it's - - - it's too much to, in effect,
9 penalize you by saying that - - - that this is the
10 end; you can't contest coverage?

11 MR. COUGHLIN: That's not only what we urge
12 on this court; that is what this court said in
13 Servidone.

14 CHIEF JUDGE LIPPMAN: Yeah, yeah, but our -
15 - - but our question is, what should be our rule
16 going forward, not what we did in the past. That's -
17 - -

18 MR. COUGHLIN: But - - -

19 THE COURT: - - - that's what we're trying
20 to get, you know, from you, and what we will from
21 your adversary.

22 MR. COUGHLIN: What - - - what I suggest in
23 - - - what's interesting, too, Judge, is Servidone
24 and Lang have continued to be cited by the Appellate
25 Division around this - - - this state for many years.

1 It's such a bedrock principle today that half the
2 Appellate Division cases that apply the principle
3 don't even cite to Servidone anymore. But - - -

4 JUDGE GRAFFEO: But we also see scores and
5 scores of disclaimer cases as well, where insureds
6 are bringing lawsuits against their - - -

7 MR. COUGHLIN: Well - - -

8 JUDGE GRAFFEO: - - - insurance companies,
9 because they feel the disclaimers were inappropriate.

10 MR. COUGHLIN: Well, Judge, in terms of
11 reported decisions, I'm not aware of scores and
12 scores of them. But the problem is we have a breach
13 of contract. And K2, Judge Smith said, we want to
14 give the insured the benefit of the bargain. And
15 this was the incentive to do that. And what I
16 suggest is, what the Court of Appeals said, we're not
17 just giving the insured the benefit of the
18 contractual bargain; in essence, you are delivering
19 extra-contractual damage to the insured - - -

20 JUDGE PIGOTT: But what - - -

21 MR. COUGHLIN: - - - because - - -

22 JUDGE PIGOTT: I'm sorry; I know your time
23 is almost up. So what you're suggesting is,
24 conceding that there's a breach on the duty to
25 defend, and now there's a judgment, at some point

1 along this - - - this line, not only - - - the
2 advantage goes, in this case, to K2, because they've
3 got - - - there's no defense. They can prove any
4 case they want and they can prove it in the
5 multimillions and you're not there to defend it.

6 In this case it was a default. So what you
7 want to be able to do is say, okay, concede
8 everything, but the damages ought to be what the
9 damages should be, not what they just deign to - - -
10 to prove without any opposition.

11 MR. COUGHLIN: No, no, Judge. May I just
12 answer your question?

13 JUDGE PIGOTT: Yes, please.

14 MR. COUGHLIN: No, that's not what we're
15 urging. We're - - - we're not focused on the damages
16 issue. We're focusing on whether it's a covered
17 claim under the policy itself. And Judge Kaye said
18 it has to be covered.

19 JUDGE SMITH: Well, it's not - - - it's - -
20 -

21 MR. COUGHLIN: That's what we're urging.

22 JUDGE SMITH: But we conceded, however,
23 that it's a covered claim for the purposes of the
24 duty to defend.

25 MR. COUGHLIN: No, Judge, that's - - -

1 respectfully, it's not a covered claim. It has the
2 potential to be a covered claim - - -

3 JUDGE SMITH: Well, well, you - - -

4 MR. COUGHLIN: - - - which is the standard.

5 JUDGE SMITH: Maybe we're just bandying
6 words. But isn't the fact that you - - - that the
7 insured is entitled to a defense on that claim?

8 MR. COUGHLIN: The entitled - - - pardon
9 me. The insured is entitled to a defense - - -

10 JUDGE SMITH: Daniels was entitled to have
11 you defend that claim.

12 MR. COUGHLIN: - - - under the duty to
13 defend standard, which is a possible coverage
14 standard, as opposed to what Servidone said.

15 JUDGE SMITH: Okay, well, whether you say -
16 - - yeah, whether it's a covered claim or not, it's a
17 claim on which Daniels was entitled. Again, assuming
18 all the way that Daniels is not in collusion. I can
19 understand somebody being cynical here, but there's
20 no evidence of collusion. Let's assume that Daniels
21 is complete good - - - good faith.

22 He gets an absolutely horrible malpractice
23 claim, lands on his desk. He sends it to his
24 insurance company. His insurance company wrongly
25 says, I'm not defending it. He then defaults. If

1 he's in good faith, the only reason for him to
2 default is that he can't afford to defend it.

3 He's now stuck with a two-million-dollar
4 judgment. How is that fair?

5 MR. COUGHLIN: Your Honor, in this case,
6 Mr. Daniels gave notes and personal guaran - - - this
7 case is about notes and guarantees. The malpractice
8 default judgment - - - which, by the way, dismissed
9 without prejudice, as we all know, the other counts,
10 without prejudice - - - that's the consequence here.
11 But the duty to defend - - -

12 JUDGE SMITH: Okay, I don't mean - - - I
13 don't mean - - -

14 MR. COUGHLIN: - - - was on the
15 possibility.

16 JUDGE SMITH: - - - to take you this far,
17 but I see your point about Mr. Daniels. Let's - - -
18 let's - - - let's take another - - - a simpler case.
19 An innocent lawyer minding his own business gets one
20 of the worst malpractice cases ever seen. And the
21 insurance company says, this is ridiculous; I don't
22 defend ridiculous cases; I'm not defending it.

23 And we all agree that's wrong. The insured
24 then suffers a default judgment. Are you allowed to
25 - - - to a - - - to rely on a policy exclusion - - -

1 again, does he have to pay the judgment himself?

2 MR. COUGHLIN: Your Honor, policies of
3 insurance are limited risk contracts - - -

4 JUDGE PIGOTT: Yeah, but you - - -

5 MR. COUGHLIN: If there's an exclusion that
6 says, you're not covered for this crazy circumstance,
7 just to use your hypothetical, he does not get
8 coverage for that.

9 JUDGE PIGOTT: But that - - - see that - -
10 - and you're right, it goes back to the duty to
11 defend. But when - - - when you disclaimed, there
12 was a reservation of rights letter that would have
13 allowed the defendant here, or excuse - - - yeah,
14 Daniels to get - - - you should have said, you can
15 get your own independent counsel; we'll pay for it,
16 but you get your own independent, because any lawyer
17 we have is going to try to kick everything out of the
18 malpractice part, and - - - and we don't want that to
19 happen either. You're entitled to - - - to - - - to
20 a lawyer that will represent you fairly. And that
21 didn't happen here. You just walked away.

22 MR. COUGHLIN: That's - - - that's
23 absolutely correct. It didn't happen here. It's a
24 bad - - -

25 JUDGE PIGOTT: So how do you now get to go

1 back and say, as Judge Smith is suggesting, okay,
2 well, now we're going to prove that the - - - that
3 the entire judgment of default is Daniels' fault
4 personally and not as an attorney?

5 MR. COUGHLIN: Well, I'll put it this way,
6 Judge. It's not the - - - I submit the better
7 question is not that it's him personally, but that
8 it's not covered under the policy.

9 CHIEF JUDGE LIPPMAN: Okay, counsel.

10 MR. COUGHLIN: And the - - -

11 CHIEF JUDGE LIPPMAN: Okay, counsel,
12 thanks. You'll have your rebuttal time.

13 MR. COUGHLIN: Thank you.

14 CHIEF JUDGE LIPPMAN: Thank you.

15 MR. HASKEL: Good afternoon, Your Honors.
16 May it please the court, my name is Michael Haskel.
17 I represent K2 and ATAS.

18 CHIEF JUDGE LIPPMAN: Counsel, let me ask
19 you the same question. Why is it - - - on a policy
20 basis, why shouldn't we adhere to our original
21 decision in Servidone and the cases that have cited
22 it? What's wrong with the Servidone principle?

23 MR. HASKEL: Well, Servidone can be
24 distinguished from - - - from this case to begin
25 with. Servidone - - -

1 CHIEF JUDGE LIPPMAN: You don't think they
2 are diametrically opposed?

3 MR. HASKEL: No, not at all, I think they
4 can be recon - - -

5 CHIEF JUDGE LIPPMAN: You don't think we
6 overruled Servidone and over - - -

7 MR. HASKEL: You might have, and I'll get
8 to the policy question.

9 CHIEF JUDGE LIPPMAN: Okay. Go ahead.

10 MR. HASKEL: But before I do that, I'll get
11 to a threshold question. And the threshold question
12 with Servidone is Servidone resolved the facts that
13 led to the obligation, the coverage. And it did not.
14 Servidone was a settlement. And with a se - - - and
15 Servidone specifically said, we can't determine the
16 facts, because some of the facts may within coverage,
17 and some may be without - - - without - - - outside
18 of coverage.

19 So to say that Servidone controls this case
20 - - - it doesn't. Now - - -

21 JUDGE SMITH: Are you suggesting that this
22 - - - that the rule is that in a situation like this
23 settlements are - - - are not covered, but default
24 judgments are?

25 MR. HASKEL: I could say that.

1 JUDGE SMITH: But doesn't that - - -
2 doesn't that produce a very anomalous result, that -
3 - - I mean, it gives - - - it gives someone in
4 Daniels' position an incentive to default. He says
5 if I default, the insurance company pays; if I - - -
6 if I try to get it cheaper, then I have to pay it
7 myself.

8 MR. HASKEL: Well, we're assuming Daniels
9 even had the wherewithal to - - - to pay. That's - -
10 - that's another issue. But - - -

11 JUDGE SMITH: Even - - - even people
12 without wherewithal, I - - - in my experience, would
13 rather have an insured judgment against them than a
14 noninsured one.

15 MR. HASKEL: Well, isn't it really a
16 question of what the insurance carrier should do to
17 begin with, protect in both instances? The question,
18 of course, in a settlement is whether or not the
19 facts have been established. And if the facts
20 haven't been established that lead to coverage, then
21 really under 3420, you don't have a direct action,
22 because there's no determination.

23 JUDGE SMITH: I guess, I don't - - - I mean
24 if you assume that - - - yeah - - - we know that the
25 claim was - - - was within the duty to defend because

1 there was a possibility that it was indeed a - - - a
2 - - - a malpractice claim. And not just that it was
3 indeed a malpractice claim, but that it - - - that
4 the exclusion might not apply. The - - - or at
5 least, it was within the coverage. Did - - - why
6 should - - - yeah, why should it make a difference
7 whether it's a default or a - - - or a settlement?

8 MR. HASKEL: Well, again, I'm not - - -

9 JUDGE SMITH: How - - - how does the
10 default establish - - - I guess is really my question
11 - - - how does the default establish that the
12 exclusions don't apply?

13 MR. HASKEL: Well, the default doesn't
14 establish - - - what the default establishes is - - -

15 JUDGE SMITH: What - - - does anything
16 establish - - -

17 MR. HASKEL: Oh - - -

18 JUDGE SMITH: - - - does anything - - -

19 MR. HASKEL: The fact that they didn't - -
20 - they didn't defend, that's the - - - that's the
21 consequence. So that's - - -

22 JUDGE SMITH: You're - - - you're basically
23 asking for the - - - for the Illinois rule, which
24 says if they didn't defend, then that does establish
25 that the - - - then they're estopped from asserting

1 the exclusions - - -

2 MR. HASKEL: Well - - -

3 JUDGE SMITH: - - - whether they apply or
4 not.

5 MR. HASKEL: Well, I'm saying that there
6 may be exceptions to the Illinois rule. We don't
7 have to go that far. What we have here is - - -
8 well, first let me - - - let me address the - - -

9 CHIEF JUDGE LIPPMAN: What is the rule that
10 you're advocating if we don't have to go that far?

11 MR. HASKEL: Well, I - - - I think if you
12 want to look at it narrowly, you can ask, number 1,
13 are the facts established that - - - that deal or
14 resolve coverage. In Servidone, they were not. In
15 this case, they were. A Supreme Court of - - - of -
16 - - of Nassau County signed a judgment. And that
17 judgment was based upon the facts that placed this
18 claim entirely within the policy.

19 JUDGE PIGOTT: Yeah, well, that was the
20 pleadings, right?

21 MR. HASKEL: It was the pleading, but the -
22 - - but also the judge got affidavits, an
23 affirmation, and frankly, that's a mechanism that
24 didn't exist in Servidone.

25 JUDGE PIGOTT: But don't you agr - - - I

1 mean, this is a strange case. I - - - the idea that
2 this guy was representing both sides of this deal to
3 the tune of two million dollars is - - - you know, I
4 - - - you can understand AGLIC might have some
5 questions.

6 MR. HASSEL: Well, the - - - strange
7 doesn't - - - this is a case where the insurance
8 carrier from the inception had the ability to prevent
9 this from happening. So the insurance carrier in - -
10 - you know, announces, well, you know, in retrospect,
11 this is very weird. Well, it's very weird; why don't
12 you defend at the very beginning and just do a dec
13 action; it's the simplest thing.

14 You know, there's a word "doublespeak", an
15 Orwellian word, and that's really what this automatic
16 liability is all about.

17 CHIEF JUDGE LIPPMAN: The question is,
18 what's - - - what's the consequence of not defending?

19 MR. HASSEL: The consequence - - -

20 CHIEF JUDGE LIPPMAN: What should be the
21 consequence?

22 MR. HASSEL: The consequence should be the
23 loss of exclusions, and this is why. And that may be
24 true of a settlement.

25 CHIEF JUDGE LIPPMAN: Tell us why.

1 MR. HASKEL: Because when you have a - - -
2 an insured paying premiums, premiums that are
3 designed for protection - - - litigation protection,
4 now; this is part of the bargain - - - an insurance
5 contract, policy, is not simply, I'm going to provide
6 for a defense. An insured relies upon the experience
7 of an organization that has - - - deals with these
8 claims all the time. They know how to defend it,
9 they have resources, and this court has said that.
10 They - - - they have resources to deal with the
11 defense.

12 JUDGE PIGOTT: But the flip side of that is
13 once there's a default - - - once - - - once they
14 withdraw their defense, and - - - and - - - and
15 there's no one in the courtroom but you, you have a
16 clear highway to prove anything you want.

17 MR. HASKEL: Although - - -

18 JUDGE PIGOTT: In other words, even if this
19 in the exclusions, if your rule were to apply, and
20 says, it doesn't make any difference, we'll - - -
21 we're just going to prove - - - you can prove it by
22 testimony. Put people on the stand who say, yeah, I
23 - - - you know, this is what happened, and we're out
24 seven million dollars.

25 MR. HASKEL: Right, well, we have to - - -

1 there - - - at least there is a mechanism. The court
2 can question it.

3 JUDGE PIGOTT: True.

4 MR. HASKEL: There could be an inquest. By
5 the way, the carrier has to - - - there's - - - we
6 have to go through an application to get to default,
7 and then the carrier - - - which in this case, not
8 only abandoned before, but even after. They knew
9 about the judgment. They have one year. They could
10 go in under 5015, say, hey, this is not right; I want
11 to open this up.

12 JUDGE PIGOTT: Well, they need an excuse,
13 don't they?

14 MR. HASKEL: Well, I don't know what - - -
15 the point is if they have a meritor - - - I don't - -
16 - I don't - - - the point is they never - - - they
17 didn't even make an effort to do any of this. So
18 this court said that it's really - - -

19 JUDGE GRAFFEO: If the policy benefit is so
20 clear, then why do so many states have the opposite
21 rule?

22 MR. HASKEL: Well, Judge Graffeo, there - -
23 - there are two - - - there are two reasons. Number
24 1, there's a mainstream here. And many of the states
25 have different considerations. How do they treat bad

1 saying is, isn't - - - haven't - - - once we decided
2 Servidone, wasn't the industry entitled to say, okay,
3 Servidone is the law. New York follows the majority
4 rule. If the legislature wants to change it, it can
5 change it, but otherwise we can count on - - - on the
6 Servidone rule.

7 MR. HASKEL: Well, again, putting aside the
8 fact that Servidone was a settlement, putting that
9 aside, Servidone really goes against contract
10 principles. Why? Because a contract of insurance -
11 - -

12 JUDGE SMITH: Let's say Servidone was
13 wrong, but - - - I mean is - - - I mean is it - - -
14 is it enough that it's wrong, that we - - - that we
15 just say, oh, you know - - - it is entitled to more
16 respect than that? Okay, can you just toss away a
17 precedent because you decided you don't - - - you
18 don't think it's right anymore?

19 MR. HASKEL: If - - - if - - - if Lang, as
20 this court held - - - if Lang is the proper approach,
21 Lang should be followed. There's no legislative, you
22 know - - - an enormous mechanism that exists here
23 where the - - - the legislature said this is what you
24 do. There's - - - the policy here, by the way, the
25 standard is supposed to be bring a dec action, and

1 insurance contract doesn't matter anymore?

2 MR. HASKEL: Of course it matters. What
3 does the contract provide for? The benefit of the
4 bargain. This court said, and it's not fair - - -

5 JUDGE SMITH: Well, the theory of the - - -
6 of the majority rule cases, the Massachusetts and
7 Hawaii and whoever, the theory is that you're - - -
8 all you bargained for was a defense. So your remedy
9 is you get your lawyer's fees, but you didn't - - -
10 never - - - you didn't bargain for coverage for this
11 claim that's within the exclusions.

12 MR. HASKEL: I think you did bargain for
13 it. You have an organization that is experienced in
14 handling these claims. This organization has
15 resources. This organization has attorneys. This
16 organization under - - -

17 JUDGE SMITH: But I guess what you're
18 saying is that when - - - when the insurance company
19 breaches its duty to defend, it's conclusively
20 presumed that the damages that result are a
21 consequence of that breach, even if - - - even if the
22 dam - - - even if the underlying facts don't show
23 coverage.

24 MR. HASKEL: I may be saying that, but I'm
25 also saying that the contract - - - when you talk

1 about strictly contract, you're not getting the
2 benefit of the bargain if you don't get defense, at
3 least until it's determined. And that's - - -

4 JUDGE PIGOTT: What - - -

5 MR. HASKEL: - - - such an easy thing to
6 do.

7 JUDGE PIGOTT: What do you do in a
8 situation, very similar to this one, where once
9 there's a default, and I said you have this open
10 highway - - - maybe or maybe not what Daniels did was
11 - - - was legal malpractice. But you can - - - you
12 can fashion - - - I mean, if there was an inquest,
13 you can fashion every single question, and every
14 single exhibit, and every single piece of testimony
15 in favor of a legal malpractice case, right?

16 And you would then get a judgment for legal
17 malpractice. It would be pretty tight.

18 MR. HASKEL: You could do that. And that
19 could happen in almost any case. There could be
20 perjury.

21 JUDGE PIGOTT: Well, what - - - what - - -

22 MR. HASKEL: That's why that the insurance
23 carriers should - - - should - - - should basically
24 do what it has to do. It's a very simple to do.

25 JUDGE SMITH: In this - - - in this case, I

1 - - - what - - - what - - - there must have been some
2 predicate for the default judgment. You don't get -
3 - - you don't get two-million-dollar default
4 judgments without at least putting in an affidavit.

5 MR. HASKEL: Well, there was a predicate,
6 of course, the - - - Daniels was supposed to record
7 mortgages - - -

8 JUDGE SMITH: No, I understand the
9 allegations, but there had to be some proof. On a
10 default, you don't get - - - you don't just get a
11 default on a - - -

12 MR. HASKEL: Well, to - - - there was - - -
13 I - - - Your Honor, at this point, there were
14 affidavits put in and - - - and I think that they're
15 conclusive now, that, you know, that the court has to
16 accept it. Now we're going behind. Isn't this a
17 fundamental rule that you can't go behind the
18 judgment? You can't collaterally attack it? The
19 judgment established these facts. That would be a -
20 - -

21 JUDGE PIGOTT: Right, Judge Smith's point
22 is - - - is - - -

23 MR. HASKEL: - - - very, very sharp detour.

24 JUDGE PIGOTT: There was no testimony. I
25 mean, somebody didn't say there's a default and we'd

1 like a hearing, as to prove our damages.

2 MR. HASKEL: No, that didn't happen here,
3 but again, this is - - -

4 JUDGE PIGOTT: Which is what would happen
5 in a negligence case, because you - - - you've got -
6 - -

7 MR. HASKEL: That - - - that would happen
8 in a negligence case.

9 JUDGE PIGOTT: But this one you say you've
10 got fixed damages, and all you got to do is prove the
11 - - -

12 MR. HASKEL: That's correct. That's
13 correct. But that, again, it's all in the - - - the
14 insurer's can do it. And by the way, we talk about
15 incentive; the incentive here is clear. The
16 incentive is to prevent this from happening. The
17 court said there wasn't a sufficient incentive.

18 American Guarantee did this - - - actually
19 did the right thing; did a dec action in a - - - in a
20 case called Moskowitz. They lost. I guess that
21 wasn't enough incentive in this case, to - - - to do
22 that and at least to defend. They could - - - it's
23 easy to prevent.

24 You have to give the insurer the benefit of
25 the bargain, which is this mechanism. It's - - -

1 dissent?

2 JUDGE PIGOTT: Yeah, yeah, yeah. The
3 Appellate Division dissent.

4 MR. HASKEL: Well, I know it's - - - I
5 thought that under - - - under Lang, indemnity and
6 damages are set. So I'm not sure about what you
7 mentioned - - -

8 JUDGE PIGOTT: I just thought you might
9 have a recollection of what - - -

10 MR. HASKEL: Well, I - - -

11 JUDGE SMITH: Yeah, but I - - - I think
12 this may relate to what - - - what I was going to ask
13 you, which is, assuming hypothetically that we don't
14 agree with you and we think - - - we think they can
15 litigate the exclusion, you want to argue in the
16 alternative for a minute that you should still win?

17 MR. HASKEL: Yes. I would, of course. And
18 my light just went on, so now I'm really in trouble.

19 CHIEF JUDGE LIPPMAN: Go ahead, you still
20 have time. Answer the question.

21 MR. HASKEL: The Appellate Division
22 certainly was correct in - - - in what they did. It
23 is long established - - -

24 JUDGE SMITH: Why - - - why - - - maybe
25 just to make the question more specific, why is it

1 clear as a matter of law on this record that Daniels'
2 role as a manager of these companies had nothing to
3 do with this claim?

4 MR. HASKEL: It didn't have to have
5 anything to do - - - that's - - - that's a red
6 herring issue. It's not what - - -

7 JUDGE SMITH: Well, whether - - - whether
8 the claim arose out of his - - - his status.

9 MR. HASKEL: Because the - - - the claim
10 itself was not based on Daniels being the attorney
11 for Goldan. It was based on his being the attorney
12 for K2 and ATAS. That was clear. That's part of the
13 pleadings. This was the entire case. The - - -

14 JUDGE SMITH: Yes, but isn't - - - isn't -
15 - - isn't the policy language - - - am I getting it
16 wrong - - - arises out of in whole or in part, his
17 capacity or status?

18 MR. HASKEL: A claim, Your Honor. A claim.
19 The claim had nothing to do with that. That was just
20 a - - - you know, that was the background, and the
21 Appellate Division, the majority got it right, and
22 they said, this claim is not based on him being the
23 attorney for - - - for Goldan.

24 JUDGE SMITH: You - - - you use "based on"
25 and "arising out of" as synonyms.

1 MR. HASKEL: Oh, sure, because it's
2 exclusively based on the - - - I said, well, maybe
3 there could have been motivations; there could have
4 been reasons for it, but this claim is based on these
5 facts. That he's K2/ATAS' attorney; that he
6 committed malpractice to K2/ATAS. The damages were
7 to them, and that's the way, you know, that the claim
8 - - -

9 CHIEF JUDGE LIPPMAN: Okay, counsel.

10 MR. HASKEL: And - - -

11 CHIEF JUDGE LIPPMAN: Okay. Finish your
12 sentence, go ahead.

13 MR. HASKEL: The bottom line is that the
14 insurance carrier has the ability to prevent this
15 from happening. This is not automatic. All they
16 have to do is to come in and defend, and now we'll
17 getting blamed, and it was said, well, you should
18 have proven this, you should have proven that.

19 CHIEF JUDGE LIPPMAN: Okay, counsel.

20 MR. HASKEL: Thank you, Your Honors.

21 CHIEF JUDGE LIPPMAN: Thank you.

22 Counsel, your adversary says that you had
23 the opportunity to avoid this.

24 MR. COUGHLIN: Your Honor, I wish it hadn't
25 happened. Let me address, if I may, Judge Pigott.

1 I believe, Your Honor, you were talking
2 about the dissent in the Appellate Division that said
3 we should send this back, because there was no
4 discovery below as to the application of the
5 exclusion. And a fundamental disagreement between K2
6 and Zurich on this appeal is my adversary wants to
7 parse out the exclusions from, what I'll call, the
8 basic cover that appears in an insurance grant. And
9 you can't do that.

10 This court dealt with that back in the
11 Schiff case, going back into the '70s.

12 JUDGE PIGOTT: But if I understand his
13 point, and you - - - when you've got an insured as
14 Daniels is, and - - - and you originally - - - not
15 that it makes a big difference - - - but there was a
16 lawyer there.

17 And then all of a sudden what he thinks is
18 covered, and he's being defended for, is all pulled
19 back, and now he's got to hire a lawyer; he's got to
20 figure out where in the world he's going to go from
21 this, because the insurance he thought he had, he
22 didn't get.

23 And it seems to me when I read it that - -
24 - that maybe what should have happened here is that
25 he - - - there should have been a reservation of

1 rights, and an - - - and an attorney appointed of his
2 choice, so that the case could go forward and be
3 defended, and then - - - and then, you would have
4 your rights and remedies thereafter.

5 None of that happened, and I think your
6 opponent's arguing, he's saying, why does that fall -
7 - - as I think Judge Smith suggested too - - - to
8 Daniels?

9 MR. COUGHLIN: Well, here's - - - here's -
10 - - and very briefly, my light's on, but - - -

11 CHIEF JUDGE LIPPMAN: Go ahead, you have
12 time.

13 MR. COUGHLIN: - - - very briefly. The - -
14 - the issue about the exclusions doesn't even come
15 into play unless you have a finding that there was
16 legal malpractice, because exclusions, by definition,
17 take away something that was given. It's excluded.
18 That issue - - - and Judge Smith talked about the
19 arising out of language, which this state and this
20 court has read very broadly in lots of different
21 cases. That hasn't even been tested, because there
22 is no discovery.

23 Now, very quickly. The absolute indemnity
24 that K2 burdens the insurance industry with, is - - -
25 is actually, when you look at Pavia, the preeminent

1 case on bad faith in this jurisdiction, and this
2 court's pronouncement there, Pavia said - - - and I
3 believe it was Judge Kaye; I'm not a hundred percent,
4 but I think it was Judge Kaye - - - the court said in
5 that opinion, mere negligence or mistake is not
6 enough for extra-contractual damages.

7 There is nothing in this record that
8 demonstrates a pattern, malicious conduct. This
9 record is muddied because of the transaction, and
10 frankly, Mr. Daniels' letter, which is in the record,
11 saying, I never represented him.

12 JUDGE SMITH: Well, you say they're extra-
13 contractual damages. What about my theory that when
14 you've breached your duty to defend, and there's been
15 a judgment against the insured, we're - - - we're
16 simply presuming that one led to the other. The - -
17 - we - - - we're - - - the - - - the Illinois rule,
18 if you like, they call it an estoppel, but maybe it's
19 just an irrebuttable presumption, that when the
20 insurance company breaches its duty to defend, it
21 cannot challenge the - - - the effect - - - that the
22 judgment is a result of the breach, because it could
23 - - - even - - - you know, even if you're right that
24 the exclusions apply, the judgment could be a result
25 of the breach, because if you defended, you could

1 have defeated the claim.

2 MR. COUGHLIN: For thirty - - - possibly,
3 Your Honor. But for thirty-plus years, this court
4 has said, we do not accept penalties, and we are not
5 going to give a policy holder more than they
6 purchased, and this comes back to my final comment,
7 because of my adversary's comments about public
8 policy.

9 JUDGE SMITH: But all he's saying is I
10 purchased a right to a defense, and you admit he
11 purchased the right to a defense. He says, if you'd
12 given me that, I wouldn't have a dime of liability,
13 because I would have won the case.

14 MR. COUGHLIN: No, Judge, that - - - he
15 can't say that, because there was no record that that
16 would have happened. This is a case about three
17 million dollars' worth of notes, of guarantees, that
18 hit right before the recession. Those are the
19 realities of this case. The malpractice was a
20 separate and additional issue here.

21 CHIEF JUDGE LIPPMAN: Okay, counsel. Thank
22 you both. Appreciate it.

23 MR. HASKEL: Thank you.

24 MR. COUGHLIN: Thank you.

25 (Court is adjourned)

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C E R T I F I C A T I O N

I, Karen Schiffmiller, certify that the foregoing transcript of proceedings in the Court of Appeals of K2 Investment Group, LLC v. American Guarantee & Liability Insurance Co., No. 6 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.



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