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Expert Analysis

Judgment Is Within Policy Limits But Insurer Believes Part Is Outside Coverage

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"Undertaking." What does that mean in the liability trial context? Perhaps most practitioners do not have to worry about the vagaries of the appellate process—but at times even the trial lawyer is required to know the ropes of what some would call an "appeal bond" but New York classifies as an "undertaking."

This article considers a hypothetical lawsuit that a New York liability insurer has defended where the judgment does not exceed the policy limits but the insurer has a sound basis—though not yet a judicial declaration in its favor—for asserting that part of the judgment is excluded from coverage.

In these circumstances, can the insurer obtain a stay of enforcement pending appeal without court order only by filing an undertaking pursuant to CPLR 5519(a)(2) in the full amount of the judgment against the insured, including that portion as to which coverage is disputed? This situation frequently arises in circumstances such as those discussed in *Prashker v. U.S. Guar. Co.*, 1 N.Y.2d 584 (1956), where the insurer has reserved its rights but must await the outcome of the liability trial before seeking a declaratory judgment apportioning the result between its insured and uninsured parts.

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According to 12 Weinstein-Korn-Miller 2d, N.Y. Civ. Practice CPLR, §5519.11, "the standard liability policy provides that the insurer will pay the cost of an appeal bond to secure a judgment up to the limits of the policy," and thereby obtain a stay of enforcement pending appeal. This analysis of the "standard" New York CGL policy may be more problematic than when written 50 years ago, but it tracks a separate CPLR provision, §5519(b), under which an insurer whose liability to the insured "is less than the amount of [the] judgment" can obtain a stay of enforcement of the insurer's portion of the judgment without court order by filing an undertaking to the extent of its limits and it is up to the insured to give an undertaking for the balance of the judgment.

It is tempting to analogize from one circumstance to the other and posit that because the insurer is obliged by CPLR 5519(b) to provide an undertaking only to the extent of the insurer's coverage when the judgment exceeds the policy limits, therefore the insurer similarly is required to provide an undertaking only to the extent of the policy coverage when the limits have not been reached but part of the judgment apparently is excluded from coverage.

But this analogy presents various problems under New York law.

All the New York commentaries and cases concur that the better practice is to post a full undertaking. *Timal v. Kiamzon*, 164 Misc. 2d 159, 162

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(Qu. Sup. Ct. 1995), holds that where "there is no claim by the insurer that the claim exceeds the policy limits, CPLR 5519(b) is inapplicable, and CPLR 5519(a) controls." *Maharan v. Berkshire Life Ins. Co.*, 948 F. Supp. 261, 262, 263 (W.D.N.Y. 1996), comments: "When the amount of the judgment does not exceed the value of the policy, section 5519(a)(2) applies," and requires that an undertaking be posted "in the full amount of the judgment." See also Siegel, Practice Comm. C5519.2 to McKinney's CPLR: "Under paragraph 2" of CPLR 5519(a), "involving the ordinary money judgment, the amount of the judgment fixes the amount of the undertaking."

Only one commentator speaks to the extent of the insurer's obligation under the "current" CGL policy form to pay for and secure an appellate undertaking of the type contemplated by CPLR 5519(a)(2) when a portion of the judgment appears to be excluded from coverage. In his 2005 ABA presentation "Post Judgment Coverage Issues," Texas attorney John Tollefson traced the evolution of the typical CGL Supplementary Payments wording from 1940 when it obligated the insurer "[to] furnish supersedeas and appeal bonds to stay all executions on all judgments, not in excess of the limits of liability of the Company under this policy," to 1966 when the revised wording required the insurer to pay "all premiums on bonds to release attachments [and] all premiums on appeal bonds … but without any obligation to apply for or furnish any such bonds," to 1996 when further revision mandated only that the insurer pay "the cost of bonds to release attachments, but only for bond amounts within the applicable limit of insurance. We do not have to furnish these bonds."

Although other portions of the CGL form have since undergone further modification, this 1996 language remains. Virtually all of these various CGL forms have also included "cost of defense" wordings in the Supplementary Payments provisions.

According to Tollefson, although "[c]hanges in the form have steadily eroded the benefits provided," courts and commentators have not considered "[w]hether the deletion of the reference to the term 'appeal bond' or 'supersedeas bond' is indicative of a deletion of this benefit." Tollefson's bottom line is that a "cost-benefit analysis" must be employed "when the carrier has defended under a reservation of rights, based on the belief that some, but not all damages are covered, and issues of coverage for all or part of the judgment remain after trial," and "[t]he insurer must … weigh the strength of its coverage defenses against the damage to the insured that will be wrought by execution."

> At least in New York, an insurer that is arguably required by its liability policy or case law to pay the cost of the undertaking to secure a judgment against its insured up to the policy limits acts at its own risk in failing to do just that—even if the insurer is convinced that parts of the judgment are excluded from coverage and has properly reserved its rights.

Research in New York has uncovered no exception to the rule that, where the policy limits exceed the amount of the judgment, the insurer must file a full undertaking—even when the insurer has timely reserved its rights and can argue in good faith that a portion of the judgment is outside the policy's coverage. Indeed, *Imber v. Consol. Indem. & Ins. Co.*, 147 Misc. 758 (App. T. 1st Dep't), aff'd, 240 A.D. 820 (1st Dep't 1933); *McDermott v. Concord Cas. & Sur. Co.*, 148 Misc. 323 (App. T. 1st Dep't 1933); and *Materazzi v. Comm. Cas. Ins. Co.*, 157 Misc. 365 (N.Y. Sup. Ct.), aff'd, 248 A.D. 522 (1st Dep't 1935), all hold that partial undertakings will not stay execution.

Suppose that, after considering the question, the insurer declines to provide an undertaking in excess of the portion of the judgment it believes is covered. Since no stay of execution would be in effect because of the insurer's failure to bond the entire judgment, the judgment creditor would have the right under Insurance Law §3420, 30 days after notice of entry, to file a direct action against the insurer for that portion of the judgment remaining unpaid. *Lang v. Hanover Ins. Co.*, 3 N.Y.3d 350 (2004).

Inasmuch as the insurer provided a complete defense to the insured at trial, the insurer could raise all of its coverage defenses in opposing the judgment creditor's lawsuit. *K2 Investment Grp. v. Am. Guar. & Liab. Ins. Co.*, 21 N.Y.3d 384 (2013). So far, so good. But what if, before going after the insurer, the judgment creditor collected as much as it could from the insured, including portions of the judgment

that indisputably were covered by the policy, and forced the insured out of business? Or what if the judgment creditor's collection efforts put the insured into bankruptcy for its inability to pay portions of the judgment that it turns out were covered by the insurer's policy? Is this a worthwhile risk for the insurer to take in lieu of bonding the entire judgment for appeal?

Even if the insured remains in business in the face of the judgment, cases such as *McDermott*, supra, and *E.M. Upton Cold Storage Co. v. Pacific Coast Cas. Co.*, 162 A.D. 842 (4th Dep't 1914), warn that the insurer that does not supply a full undertaking for a judgment falling under CPLR 5519(a)(2) may expose itself to the risk that, if an execution against the insured for the amount of the judgment exceeding the undertaking eventuates before the appeal is decided, the insured too may sue the insurer and argue successfully that one consequence of the partial execution against the insured was to damage or destroy its ability to conduct business.

On the other hand, the insurer also puts itself at risk by paying the full undertaking, as, according to *Smith v. 167th St. & Walton Ave.*, 177 Misc. 507, 509 (Bx. Sup. Ct. 1941), and *Kreitzer v. Chamikles*, 107 Misc. 2d 398, 399 (N.Y. Sup. Ct. 1980), the insurer thereby "relinquishes any defenses to liability it may have had under its policy and relies solely upon the errors assigned under the appeal."

Upon the reasoning of this line of cases, once the insurer has posted the full undertaking, it can no longer use coverage defenses to avoid paying the undertaking over to the judgment creditor on affirmance of the judgment. The insurer's only remedy in these circumstances will be to sue its insured in an effort to recoup that portion of the insurer's payment that is excluded from coverage—a dubious proposition at best.

Even outside the New York state courts, only two contemporary cases discuss the issue posed by this article. In *Wiegert-Stathes v. Am. Family Mut. Ins. Co.*, 2009 WL 3381578, *7-8 (Neb. App. Oct. 20, 2009), decided under the 1996 wording, the court held that when the insurer's "policy limits are exhausted or 99 percent exhausted" and "virtually no coverage remained in comparison to the size of the judgment being appealed," the insurer is not required to post a supersedeas bond as, in such circumstances, the "bond would not be a defense cost, but, rather, an expansion of the policy limits."

But the Nebraska court also suggested, id. at *7, that, as in the earlier case of *Johnson v. Maryland Cas. Co.*, 171 N.W. 908 (Neb. 1919), it would be proper to require the insurer to post a supersedeas bond as a "cost of defense" covered by the Supplementary Payments portion of the CGL policy "where the appealed judgment is less than the policy limits and the insured justifiably expects to be protected from levy while the adverse judgment is on appeal." This analysis is certainly not helpful to the New York liability insurer.

The only other decision arguably on point is *Hatfield v. 96-100 Prince St.*, 972 F. Supp. 246, 247 (S.D.N.Y. 1997). In that matter, Judge Jed Rakoff held that because the policy did not require the insurer to post an undertaking and "most of the judgment from which plaintiff seeks to appeal relates to matters as to which the Court has already held there is no duty to defend, it would be grossly inequitable to impose such a requirement." This holding has no obvious application to circumstances where the policy may require the insurer to post the undertaking or the insurer is enjoined by the case law from commencing a declaratory judgment action prior to the outcome of the liability trial.

Accordingly, at least in New York, an insurer that is arguably required by its liability policy or case law to pay the cost of the undertaking to secure a judgment against its insured up to the policy limits acts at its own risk in failing to do just that—even if the insurer is convinced that parts of the judgment are excluded from coverage and has properly reserved its rights. At the same time, prudence would require that, during the appeal, the insurer commence a separate declaratory judgment action against its insured seeking confirmation that a portion of the judgment is not covered and requesting appropriate relief. Yes, another lawsuit!