UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

THE CITY OF NEW YORK,

Plaintiff,

-v-

CROTHALL HEALTHCARE, INC.,

Defendant.

17 Civ. 3198 (JSR)

MEMORANDUM ORDER

JED S. RAKOFF, U.S.D.J.

This case raises an arcane, but important, question of first impression: is a commercial contractor that is under a duty to procure insurance for a counterparty, and that self-insures the first layer of coverage, subject to New York State insurance statutes that limit the grounds under which coverage can be disclaimed, where the contractor agrees to use its self-insured retention to provide "the same defense. . . as an insurer would be obligated to provide?" For the reasons that follow, the Court answers this question in the negative, grants defendant Crothall Healthcare, Inc.'s motion to dismiss the complaint for failure to state a claim, and directs the entry of judgment.

By way of background, on March 23, 2017, plaintiff, the City of New York (the "City"), filed the instant action in state court seeking to force defendant Crothall Healthcare, Inc. ("Crothall") to defend it in a state-court personal injury

action. See Verified Complaint ("Compl."), Ex. A to Notice of Removal, ECF No. 1, ¶¶ 18-23. The complaint also seeks reimbursement of defense costs that the City has incurred in defending the action. Id. ¶¶ 24-28. On May 1, 2017, Crothall removed the action to federal court. See Notice of Removal. On May 8, 2017, Crothall filed moving papers on a motion to dismiss. See Defendant's Memorandum in Support of Motion to Dismiss ("Def. Mem."), ECF No. 6. On May 30, 2017, the City filed answering papers. See Plaintiff's Memorandum of Law in Opposition to Defendant's Motion to Dismiss ("Plf. Mem."), ECF No. 11. On June 6, 2017, Crothall filed reply papers. See Defendant's Reply Memorandum in Further Support of its Motion to Dismiss ("Def. Reply"), ECF No. 13. On June 27, 2017, the Court held oral argument. See Transcript dated June 27, 2017.

"To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007)). In reviewing a motion to dismiss, the Court "accept[s] the complaint's factual allegations as true and draw[s] all reasonable inferences in the plaintiff's favor." Brown Media Corp. v. K&L Gates, LLP, 854 F.3d 150, 156-57 (2d Cir. 2017).

The relevant allegations are as follows. The City is a municipal corporation organized under the laws of New York State. Compl. ¶ 2. Crothall, headquartered in Pennsylvania, is a provider of healthcare support services. Id. ¶ 3. In November 2011, the City, acting through the New York City Health and Hospitals Corporation (the "Corporation"), entered into a contract with Crothall under which Crothall agreed to perform various "housekeeping" (i.e., janitorial) services at City hospitals. Id. ¶ 6; see Contract between New York City Health and Hospitals Corporation and Crothall Healthcare, Inc. (the "Contract"), Ex. A to Affidavit of Robert J. Denicola in Support of Defendant Crothall Healthcare, Inc.'s Motion to Dismiss Plaintiff's Complaint Pursuant to FRCP 12(b)(6) ("Denicola Aff."), ECF No. 7.[1]

The Contract principally concerned the provision of these housekeeping services, but it also included several insurance-related provisions. In particular, the Contract required Crothall to procure and maintain insurance covering Crothall, the Corporation, and the City alike. Compl. ¶ 7; see Contract §§ 6.3.1-6.3.2. Crothall was permitted to "self-insure" the first $1 million of coverage, provided it used such self-insured

[1] Although the City did not attach the Contract to the complaint, the Court may consider it on a motion to dismiss because it is integral to the complaint. See Cortec Indus., Inc. v. Sum Holding L.P., 949 F.2d 42, 47 (2d Cir. 1991).

retention ("SIR") to "provide the same defense of any suit against the Corporation and the City as an insurer would be obligated to provide." Contract § 6.3.3(B). The Contract mandated that parties report to one another any potential legal claims relating to the Contract within fifteen days of a claim's initiation.[2] The Contract further provided that parties must "strictly compl[y]" with all such notice requirements.[3]

On December 22, 2015, the summons and complaint in a personal injury action captioned Sosa v. City of New York, No. 162932/2015 (N.Y. Sup. Ct. 2015) was served on the City. Compl. ¶¶ 1, 11-13. More than three months later, on March 30, 2016, the City tendered a defense of the Sosa action to Crothall by serving notice of the summons and complaint on Crothall. Id. ¶ 16. The defendant denied the tender on April 25, 2016. Id. ¶ 17. This suit followed.

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[2] See Contract § 9.3.4 ("Each party shall report to the other party in writing within fifteen (15) working days of the initiation by or against the Contractor or Corporation, as applicable, of any legal action or proceeding in connection with or relating to performance of services under this Agreement (or such shorter notice period as many be necessary in light of the circumstances in order for a party to be able to respond to any such legal action or proceeding.").

[3] See Contract § 9.3.1 ("No action at law or proceeding in equity against either party shall lie or be maintained upon any claims based upon this Agreement or arising out of this Agreement or in any way connected with this Agreement unless the applicable party shall have strictly complied with all requirements relating to the giving of notice and information with respect to such claims, all as herein provided.")

Against this background, the dispositive question is whether the Contract is, by statute or by contractual agreement, an "insurance contract." If the Contract is not an insurance contract, then the notice of claim provision must be strictly enforced, and the City's affirmative allegation that it noticed the Sosa action almost three months late dooms its claim. See Gutierrez v. State, 871 N.Y.S.2d 729 (2d Dep't 2009) ("[G]iving timely notice of an event giving rise to an indemnification claim is a condition precedent to Compass' obligation to defend as well as to indemnify the State."). If, however, the Contract is an insurance contract, then, under New York State insurance law, the City arguably has two defenses to its late notice of claim: Crothall's failure to show prejudice flowing from the City's late notice, see N.Y. Ins. Law § 3420(a)(5), and Crothall's untimely disclaimer of coverage, see N.Y. Ins. Law § 3420(d)(2). Crothall makes no effort to argue that it was prejudiced by the City's late notice or that Crothall's own disclaimer was timely.

New York law draws a basic distinction between, on the one hand, insurance procurement and indemnity contracts, and, on the other hand, true insurance policies. See Inner City Redevelopment Corp. v. Thyssenkrupp Elevator Corp., 913 N.Y.S.2d 29 (1st Dep't 2010) (distinguishing between defendant's "contractual obligation" to procure insurance for a counterparty

and a separate "insurance policy" actually insuring the risk). This difference is principally fleshed out in duty to defend cases much like the instant one. For procurement/indemnity contracts, the basic rule is that the contractor need only defend or indemnify as expressly provided by the contract, narrowly construing the instrument to avoid forcing the promisor to cover claims beyond its bargained-for duty. See id. ("As defendant Thyssenkrupp is not an insurer, its duty to defend its contractual indemnitee is no broader than its duty to indemnify."); see also Dresser-Rand Co. v. Ingersoll Rand Co., No. 14-cv-7222 (KPF), at *7 (S.D.N.Y. July 14, 2015) ("Outside the context of insurance policies, contractual defense obligations are generally treated like any other contractual provision. That is to say, such provisions must be strictly construed to avoid inferring duties that the parties did not intend to create." (internal quotations omitted)).

For insurance contracts, the rule is otherwise. An insurer (by which the Court means a party promsing to insure its counterparty, not a business entity that is primarily in the insurance business) has, by law, a more expansive duty to defend any claim that is arguably within its coverage. See, e.g., Atl. Cas. Ins. Co. v. Value Waterproofing, Inc., 918 F. Supp. 2d 243, 252 (S.D.N.Y.) ("The duty to defend is broader than the duty to indemnify."), aff'd sub nom. Atl. Cas. Ins. Co. v. Greenwich

Ins. Co., 548 F. App'x 716 (2d Cir. 2013) (summary order). In evaluating such claims to coverage, courts evaluate the insurer's duty to defend solely on the face of the complaint, illustrating the heavy burden that applies to an insurer seeking to avoid providing coverage. See id. ("In order for an insurer to be relieved of the duty to defend, there must be no possible factual or legal basis on which an insurer's duty to indemnify under any provision of the policy could be held to attach." (internal quotation marks omitted)).

New York law also has experience with insurance procurement contracts with a deductible to be paid by the party under the duty to procure the policy. The rule there is, presently, that the insured party is entitled to a defense for claims within the deductible, although this principle was not always so clear. See Thyssenkrupp Elevator, 913 N.Y.S.2d 29. This rule avoids the prospect of a gap in coverage caused by the counterparty's disclaimer of coverage within the deductible for some technical reason not available to the insurer. Critically, however, New York law has never gone further and found that the deductible is functionally an insurance policy in its own right, and hence subject to the comprehensive regulatory scheme of which Section 3420 forms one very small part.

Applying these principles, the Court finds that the Contract falls within the procurement/indemnity class of

contracts and is not a true insurance contract. To begin with, it is worth observing that the Contract, on its face, is plainly not an insurance policy, because it mainly obliges Crothall to provide housekeeping services at City hospitals. See Contract, Ex. A to Denicola Aff. Also, it is common ground that Crothall itself is not in the insurance business. See Plf. Mem. at 7-8; Def. Reply at 1. Although these factors are not dispositive, they place the City's claim to coverage at a disadvantage from the very start.

It is true, however, that the Contract includes multiple risk-transfer provisions that might conceivably convert this otherwise garden-variety janitorial services contract into an insurance contract. These provisions bear closer inspection, but ultimately confirm that the Contract is of the procurement and indemnity variety.

The first risk-transfer mechanism in the Contract is an indemnity provision. See Contract § 6.2.1 ("Contractor shall hold harmless and indemnify the Corporation and the City from liability upon any and all claims for damages on account of such injuries to or death of any such person or damages to such property to the extent sustained due to any negligent act of commission or omission or intentional misconduct of Contractor . . . ."). Crothall relies upon this provision to argue that Crothall is a "commercial indemnitor" and that the agreement in

issue is an indemnity contract, rather than an insurance contract. For its part, the City disclaims reliance upon this provision for present purposes. But, in any event, it is plain that the presence of such an indemnity provision supports the conclusion that the Contract is not an insurance contract. See Thyssenkrupp Elevator, 913 N.Y.S.2d 29.

The second risk-transfer mechanism in the Contract is Crothall's duty to purchase an insurance policy covering Crothall, the Corporation, and the City. In particular, Crothall is required to "procure and maintain" comprehensive general liability insurance with a $10 million per occurrence limit, see Contract §§ 6.3.1-6.3.2, and must "include[] as additional insureds," inter alia, the City and the Corporation, see id. § 6.3.4.1. These provisions unambiguously place the Contract in the insurance procurement vein and outside the reach of Section 3420. Those defenses, therefore, apply, if at all, only if the parties contractually agreed to as much.

The final risk-transfer mechanism, standing alone, forms the primary basis of the City's claim to coverage. The Contract, immediately after creating Crothall's duties to indemnify the City and to procure insurance covering the City, provides that Crothall "has a self-insured retention of $1,000,000" that "shall protect the Corporation and the City and the Contractor from claims for property damage and/or bodily injury, including

death, which may arise from any of its operations under this Agreement." Contract §§ 6.3.3, 6.3.3(A). As the City acknowledges, Crothall's $1 million SIR functions much like a deductible that must be exhausted before the insurance policy that Crothall is obligated to procure can be reached. See Plf. Mem. at 8 (describing the SIR as "the City's first bargained-for $1 million of defense coverage"). The Contract further provides that Crothall, "through its self-insurance program, shall provide the same defense of any suit against the Corporation and the City as an insurer would be obligated to provide under the laws of New York for claims that would be covered in whole or in part under the SIR." Id. § 6.3.3(B).

The City argues that Crothall's duty to "provide the same defense . . . as an insurer would be obligated to provide under the laws of New York" implies a corollary duty to comply with Section 3420 of the New York Insurance Law governing insurance contracts. In other words, as the City sees it, Crothall's $1 million SIR, by agreement of the parties, is effectively a standalone policy of insurance issued by Crothall to the City, with all the attendant regulatory overlay that entails. Under this view, Section 3420 does not apply of its own force, but simply because the parties agreed to abide by it.

The Court is not persuaded. For one thing, the import of the City's position is that one portion of the Contract

(Crothall's duty to defend as an insurer would be obligated to defend), by implicitly adopting New York insurance regulations, overrides two express and unambiguous provisions of the Contract: the 15-day notice of claim period and the requirement that such notice provisions be strictly enforced. See Contract §§ 9.3.1, 9.3.4. This proposed reading violates the core principle of contract interpretation that all portions of the contract be given effect. See Int'l Multifoods Corp. v. Commercial Union Ins. Co., 309 F.3d 76, 86 (2d Cir. 2002) ("Under New York law an interpretation of a contract that has the effect of rendering at least one clause superfluous or meaningless . . . is not preferred and will be avoided if possible." (internal quotation marks omitted)); see also S. Road Assocs., LLC v. Int'l Bus. Machs. Corp., 4 N.Y.3d 272, 277 (2005) ("It is also important to read the document as a whole to ensure that excessive emphasis is not placed upon particular words or phrases."). Indeed, even if Crothall correctly reads the Contract, and these two portions of the Contract conflict, the City provides no principled basis by which to choose which provision overrides the other. After all, if the Section 3420 defenses apply at all, it is not as a matter of substantive insurance law - in which case the statute would plainly control - but as a matter of private agreement. In these circumstances,

the more natural resolution would be to give effect to the express notice of claim provisions.

In any event, the City's reading of the Contract is incorrect. Crothall's duty to "provide the same defense . . . as an insurer would be obligated to provide" does not, by implication, import a raft of New York insurance regulations into the Contract. Instead, this provision merely responds to a feature of New York law under which contractual duties to defend entered into by non-insurers are construed more narrowly than insurers' duties to defend. In particular, as noted supra, whereas "[a]n insurer's duty to defend is liberally construed and is broader than the duty to indemnify," the "breadth of a non-insurer's contractual defense obligations is defined solely by the terms of the contract, strictly construed." See Dresser-Rand Co., 2015 WL 4254033, at *7 (emphasis omitted). The provision at issue, therefore, merely serves to align the scope of coverage provided by Crothall's "deductible" with the scope of coverage provided by the insurance policy that Crothall is required to procure and that sits atop its "deductible." While appellate authority subsequent to the Contract appears to confirm that a party in Crothall's position automatically has a duty to defend as broad as the insurer's, see Thyssenkrupp Elevator, 8 N.Y.S.3d 314, at that the time the Contract was entered, the parties were required to expressly expand the duty

to defend by contract. Thus, the provision does no more and no less than respond to the gap in coverage concern addressed supra.

Against all this, the City cites no authority applying the New York Insurance Law provisions to a commercial agreement such as the Contract, nor any authority finding that a contractual expansion of the duty to defend triggers the New York State insurance regime. The City's cases are all consistent with the conclusion that the SIR merely functions as a deductible and does not, itself, convert the Contract into an insurance contract or otherwise nullify a notice of claim provision. For example, in the City's most superficially similar case, the First Department held that a non-insurer defendant who entered an insurance procurement contract with a $1.25 million deductible had a duty to defend any liability within the deductible and that the defendant could not strictly enforce a notice of claim provision against the plaintiff. See Thyssenkrupp, 913 N.Y.S.2d 29. However, in that case, the notice of claim provision was in a third-party carrier's insurance policy, and not in the defendant's own procurement/indemnity contract. In other words, in that case, the defendant sought to avoid its contractual duty to defend by relying on a notice of claim provision in another contract entirely. No argument was

raised that a failure to comply with defendant's own contractual notice of claim provision (if any) defeated coverage.

For its final argument, the City protests that it never would have permitted Crothall to self-insure a portion the coverage owed to the City if the City had known that the coverage was illusory. See Plf. Mem. at 8; see also Transcript dated June 27, 2017. This argument misses the mark. The fact that the Contract is not subject to Section 3420 does not mean that the City is not covered under the SIR. It merely means that the City, in order to obtain the benefits of that coverage, must strictly comply with the notice of claim provision. See Contract §§ 9.3.1, 9.3.4. Here, if there is a gap in coverage, it is simply because the City failed to do so. See Compl. ¶¶ 11, 16. In another case, however, if the City were to give appropriate notice, Crothall would be obligated to defend the City to the full extent of the Contract.

For the foregoing reasons, the Court finds that the Contract is not subject to Section 3420 of the New York Insurance Law. Accordingly, the City's complaint is dismissed with prejudice. Clerk to enter judgment.

SO ORDERED.

Dated: New York, NY
July 7, 2017

JED S. RAKOFF, U.S.D.J.