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NY Slams Door On 'Unavailability Of Insurance' Exception

By **Scott Seaman** (March 28, 2018, 3:24 PM EDT)

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The New York Court of Appeals delivered a significant victory to insurers in the latest battle in the long-tail insurance coverage wars. On March 27, the New York Court of Appeals issued a unanimous decision in the KeySpan case rejecting the so-called "unavailability of insurance" exception to the general rule that policyholders are responsible for periods of time that insurance is unavailable for purchase in the marketplace under a pro rata allocation. This victory comes on the heels of what most consider to be a policyholder victory before the New York Court of Appeals in the Viking Pump case.[1]

In this article, we examine the New York Court of Appeals decision in KeySpan rejecting the "unavailability of insurance" exception. In essence, this is Part III of our expert analysis on "Door Closing On 'Unavailability' of Insurance Exception." In Part I, we discussed the general rule in pro rata jurisdictions that the unavailability of insurance coverage in the market does not absolve policyholders of responsibility for self-insuring and explored the genesis of the limited "unavailability of insurance" exception.[2] In Part II, we addressed the limited nature of the "unavailability of insurance" exception and considered the prospect of the exception being even further limited.[3] We now discuss how the New York Court of Appeals slammed the door shut on policyholders seeking to hoist upon their insurers losses for periods in which insurance is unavailable in the marketplace.

The Issue of "Unavailability Of Insurance" Placed in Context

Although several states employ an "all sums" allocation, the trend of decisions and the distinct majority rule continues to be that long-tail losses are allocated on a pro rata basis. There are a variety of ways in which losses may be prorated, but the time-on-the-risk and time-and-limits methodologies are the most commonly followed at least where an allocation cannot be made based upon evidence showing the amount of injury or damage actually taking place during the respective time periods. A pro rata allocation offers several advantages over the "all sums" fiction.[4]

One important feature of a pro rata allocation is that policyholders are required to participate in the allocation by accepting the consequences associated with periods of self-insurance. Specifically, courts require policyholders to bear the financial responsibility for those periods of no insurance, self-insurance, insufficient insurance, insurance issued by insolvent insurers or insurance that does not respond because of noncompliance with policy conditions or application of policy exclusions.

Overwhelmingly, courts applying a pro rata allocation have recognized that the responsibility for uninsured periods rests squarely on policyholders regardless of whether or not insurance for the particular risk was available for purchase in the market at the time.[5] However, resourceful policyholders continue their quest for a "second bite" at the allocation apple in pro rata allocation jurisdictions and the "unavailability of insurance" exception is a way for policyholders to attempt to mitigate the adverse financial consequences they may experience from a pro rata allocation.

The New York High Court Rejects the "Unavailability of Insurance" Exception

The New York Court of Appeals added its imprimatur to the issue of the impact on insurance unavailability on allocation of long-tail losses in its March 27, 2018, decision in KeySpan v. Munich Re. Although the court referred to the unavailability "rule," we refer to it in this analysis as the "unavailability of insurance exception" because, when applied, it actually operates as a limited exception to the logical consequences of a pro rata allocation that the policyholder bears responsibility for any period in which it does not have insurance for whatever reason.

The New York Court of Appeals began its decision by noting "we once again venture into the complex realm of long-tail insurance claims," and concluded that the policyholder, not the insurer, "bears the risk for those years during which such coverage was unavailable."

The liability underlying the coverage dispute in KeySpan emanates from environmental contamination caused by coal tar constituents from three manufactured gas plants owned and operated by KeySpan's predecessor, Long Island Lighting Company, dating back to the late 1800s. The court opinion states that, between 1953 and 1969, Century issued multiple excess liability insurance policies to Long Island Lighting Company covering property damage.

KeySpan did not dispute that it is responsible for damages in years in which property damage insurance was available, but not purchased by its predecessor. KeySpan argued, however, that Century's pro rata share should not be reduced by factoring in the years in which property damage liability insurance was unavailable in the market for pollution risks. Accordingly to KeySpan, such insurance was not available in the market for utilities prior to 1925 or after 1970 when the "sudden and accidental pollution exclusion" was generally included in general liability policies.

The trial court granted Century's motion for summary judgment in part, holding that liability should be allocated to KeySpan for the years in which it elected to self-insure and from 1971 to 1982 (the period during which the legislature mandated inclusion of a pollution exclusion in liability policies under former New York Insurance Law § 46 [13], [14]). However, the trial court denied the motion with respect to those years in which insurance coverage was otherwise unavailable in the marketplace. This essentially absolved the policyholder for the years before 1953 and after 1986. The Appellate Division reversed in part, holding that Century was not obligated to indemnify KeySpan for losses that are attributable to time periods when liability insurance was unavailable in the marketplace. The Appellate Division certified the question of whether its order was correct to the New York Court of Appeals.

The New York Court of Appeals described New York Law on allocation as follows:

> In New York, we have not adopted a strict pro rata or all sums allocation rule. Rather, the method of allocation is governed foremost by the particular language of the relevant insurance policy (see Matter of Viking Pump, 27 NY3d at 257). Thus, applying principles of contract interpretation, we held in Consolidated Edison Co. of N.Y. v Allstate Ins. Co. that policy language restricting an

> insurer's liability to all sums incurred and occurrences happening "during the policy period" generally supports a pro rata allocation (98 NY2d at 224). As we explained, the policies at issue there contained such language providing "for liability incurred as a result of an accident or occurrence during the policy period, not outside that period," and we concluded that "[p]roration of liability … acknowledges the fact that there is uncertainty as to what actually transpired during any particular policy period" (id.). We subsequently distinguished the policy language in Consolidated Edison from that presented in Matter of Viking Pump, Inc. and held, in the latter case, that the presence of noncumulation and prior insurance provisions "plainly contemplate that multiple successive insurance policies can indemnify the insured for the same loss or occurrence" and, therefore, require all sums allocation (27 NY3d at 261). Such provisions are inconsistent with pro rata allocation because "the very essence of pro rata allocation is that the insurance policy language limits indemnification to losses and occurrences during the policy period," such that no two insurance policies indemnify the same loss or occurrence absent overlapping or concurrent policy periods.

The summary serves as useful guidance on New York allocation law and reinforces the reality that New York remains a presumptive pro rata allocation.

The New York Court of Appeals recognized that courts applying a pro rata allocation require the policyholder to participate in the allocation to some extent with respect to periods of noncoverage. It noted courts are divided with regard to whether a policyholder should be held responsible for those periods of time when the relevant coverage was not offered for sale on the market. The court pointed out that the applicability of the unavailability of insurance exception is a matter of first impression in New York.

Importantly, the New York high court agreed with Century that: (1) the unavailability rule is inconsistent with the policy language that mandates pro rata allocation in the first instance; and (2) the imposition of liability on an insurer for damages resulting from occurrences outside the policy period would contravene the very premise underlying pro rata allocation.

The court reiterated its holding in Consolidated Edison that, although the insurance policies do not speak directly to allocation in the context of long-tail claims, each of the policies contains language limiting the insurer's liability to losses and occurrences happening "during the policy period" and that pro rata allocation — rather than all sums allocation — was more consistent with such policy language because "the policies provide indemnification for liability incurred as a result of an accident or occurrence during the policy period, not outside that period."

The court pointed out the utter lunacy of the "unavailability of insurance" exception. First, it is inconsistent with the very notion of a pro rata allocation. As the court stated:

> The unavailability rule is inconsistent with the contract language that provides the foundation for the pro rata approach – namely, the "during the policy period" limitation – and that to allocate risk to the insurer for years outside the policy period would be to ignore the very premise underlying pro rata allocation ... . Indeed, such an approach could, once a policy is triggered, impose liability in perpetuity (or retroactively to periods prior to coverage) on an insurer who issued insurance coverage for only a limited number of years, thereby eviscerating much of the distinction between pro rata and all sums allocation. In the context of continuous harms, where the contamination attributable to each policy period cannot be proven and we draw from the

> contract language to distribute the harm pro rata across the policy periods, it would be incongruous to include harm attributable to years of noncoverage within the policy periods.

Second, the court recognized that the "unavailability of insurance" exception distorts the economics of insurance. As the court aptly stated, the application of such an exception:

> to an insurance policy that directs pro rata allocation, either expressly or under our interpretation in Consolidated Edison would effectively provide insurance coverage to policyholders for years in which no premiums were paid and in which insurers made the calculated choice not to assume or accept premiums for the risk in question. Fundamentally, an insurer "is free to select its risks" and to exclude certain risks. Vander Veer v Continental Cas. Co., 34 NY2d 50, 52 [1974]).

Third, the court noted the unavailability exception contravenes the reasonable expectations of the average policyholder that would not expect to receive coverage without regard to the number of years for which it purchased applicable insurance.

The thread of continuity running through the New York Court of Appeals' insurance law jurisprudence in general and on allocation-related issues in particular has been reliance upon enforcing insurance contract language and not using notions of public policy to override insurance contract language.

In evaluating decisions that address the "unavailability of insurance" exception, the court stated that those courts that have adopted the unavailability exception in the pro rata context have relied heavily on public policy concerns and a desire to maximize resources available to claimants against the policyholder. By contrast, courts rejecting the unavailability exception generally focus on the policy language that serves as the foundation for pro rata allocation.

Not surprisingly, the New York Court of Appeals sided with the reasoning of the Seventh Circuit in Sybron Transition Corp., [6] and the Massachusetts Supreme Court of Appeals in Boston Gas [7] in rejecting the unavailability exception. It noted the Seventh Circuit "declined to require an insurer who furnished coverage during a specific period of time before the magnitude of a risk was recognized "to furnish, for nothing, an additional period of high-price coverage" outside of the policy period because the insured, not the insurer, created the risk of loss and there was no contractual basis to impose the consequences of that risk "on an underwriter unlucky enough to insure an early slice of the risk." Likewise, the Massachusetts Supreme Court of Appeals rejected the unavailability exception as contravening the limitation of coverage for damage during the policy periods.

The New York Court of Appeals expressly concurred with the Appellate Division decision that the spreading of risk through insurance is accomplished through the setting and payment of premiums for insurance, consistent with the parties' forward-looking assessment of what that risk might entail. In the absence of a contract requiring such action, spreading risk should not by itself serve as a legal basis for providing free insurance to a policyholder.

The court rejected KeySpan's argument that it is inequitable to allocate the risk to the policyholder for years when coverage was unavailable. It noted that, even those courts that have adopted the unavailability of insurance exception have recognized that, "[f]rom an equitable standpoint, either party can justifiably be assigned responsibility for ongoing [injuries arising after policy exclusion]. The policyholder is the one who allegedly caused the injury and, therefore, who ultimately will be financially responsible should insurance prove insufficient."[8]

The New York Court of Appeals stood resolute in resisting the re-writing of insurance policies based upon policy concerns, noting:

> this [C]ourt may not make or vary the contract of insurance to accomplish its notions of abstract justice or moral obligation" (Breed v Insurance Co. of N. Am., 46 NY2d 351, 355 [1978]). Ultimately, because "the very essence of pro rata allocation is that the insurance policy language limits indemnification to losses and occurrences during the policy period" (Matter of Viking Pump, 27 NY3d at 261; see Consolidated Edison, 98 NY2d at 224), the unavailability rule cannot be reconciled with the pro rata approach. We, therefore, reject application of the unavailability rule for time-on-the-risk pro rata allocation."

The unanimous decision sends a strong message that unavailability of insurance regardless of whether in the early years or later years of a coverage block does not provide the policyholders with an opportunity to hoist upon insurers responsibility for injuries or damages taking place outside their respective policy periods.

The Door Appears to be Closing on the "Unavailability of Insurance" Exception

The New York Court of Appeals' decision in KeySpan represents a significant victory for insurers. It also lends muster to the proposition that the door appears to be closing more generally on the "unavailability of insurance" exception to the general rule in pro rata jurisdictions that policyholders are responsible for periods of no insurance regardless of whether or not insurance of particular risks is available for purchase in the marketplace.

There are a couple of cases pending before state supreme courts that may address the "unavailability of insurance" exception. The New Jersey Supreme Court, which gave birth to the "unavailability of insurance" exception through its decision in Owens Illinois [9], may address the scope of the exception in Continental Insurance Co. v. Honeywell International Inc. In granting review in that case, the New Jersey Supreme Court will have the opportunity to consider whether a policyholder may bear responsibility for periods beyond which insurance is "available" for a risk based upon principles articulated by the New Jersey Supreme Court in Owens-Illinois and its progeny, including assumption of risk, incentivizing responsible conduct by companies, simple justice and exceptional circumstances.

In seeking review, the insurers argued that Honeywell should be held liable regardless of whether the plaintiffs' claims involve pre-1987 exposures because Bendix (the Honeywell predecessor manufacturing and selling asbestos-containing brake and clutch parts) continued to manufacture and sell asbestos-containing products until 2001 knowing that it did not have insurance coverage. By inflexibly relieving the policyholder of responsibility post-1987 when asbestos coverage ceased to be available to Honeywell, the insurers contend the appellate division violated other principles articulated in Owens-Illinois such as incentivizing responsible conduct, discouraging irresponsible risk taking and pricing products to reflect their true costs.

The Connecticut Supreme Court will have the opportunity to address the "unavailability of insurance" exception adopted by the intermediate appellate court in the R.T. Vanderbilt case.[10] The battle over the impact of insurance unavailability wages on.

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[1] In re Viking Pump, Inc., 52 N.E.2d 3d 1144 (N.J. 2016)

[2] "Door Closing on "Unavailability of Insurance" Exception: Part 1," Law360, New York (January 9, 2017)

[3] "Door Closing on "Unavailability of Insurance" Exception: Part 2," Law360, New York (January 10, 2017)

[4] "Why Pro Rata Allocation Is The Majority Rule." Law360 (October 16, 2014).

[5] S. M. Seaman & J. R. Schulze, Allocation of Losses in Complex Insurance Coverage Claims (6th Ed. Thomson Reuters 2017-2018) at Chapter 4 (collecting and discussing cases).

[6] Sybron Transition Corp. v. Security Insurance of Hartford, 258 F.3d 595 (7th Cir. 2001.

[7] Boston Gas Co. v. Century Indem. Co., 910 NE2d 280, 315 (Mass. 2009).

[8] R.T. Vanderbilt Co., Inc., 171 Conn App at 134, 156 A3d at 579-580.

[9] Owens-Illinois, Inc. v. United Ins. Co., 650 A.2d. 974 (N.J. 1994).

[10] R.T, Vanderbilt Co., Inc. v. Hartford Acc. and Indem. Co., 156 A3d 539, 577 (Conn App Ct 2017), cert granted 171 A3d 63 (Conn. 2017).