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Door Closing On 'Unavailability' Insurance Exception: Part 1

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Law360, New York (January 9, 2017, 6:01 PM EST) --

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Although several states employ an “all sums” allocation, the trend of decisions and the distinct majority rule is 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 taking place during the respective time periods. As we pointed out in our prior expert analysis, a pro rata allocation offers several advantages over the “all sums” fiction. See “Why Pro Rata Allocation Is The Majority Rule.” Law360 (October 16, 2014).

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.

A distinct minority of courts in pro rata jurisdictions recognize a limited exception in the context of asbestos and environmental claims and absolve policyholders from participating in the allocation in later years where insurance coverage was unavailable for such risks in the market. This limited exception for periods in which insurance is “unavailable” has its genesis in a sentence from the New Jersey Supreme Court’s landmark decision in Owens-Illinois.[1]

Over the past 20 years, policyholders across the country have sought fervently to use an “unavailability of insurance” exception to undo the logical consequences of a pro rata allocation for the purpose of limiting policyholders’ participation in the allocation. Notwithstanding their extensive efforts, the “unavailability of insurance” exception has not garnered much support from courts in pro rata

jurisdictions. Nor have courts expanded the scope of this very limited exception to the general rule requiring policyholders to bear responsibility for periods of self-insurance whatever its cause.

Many believe that the application of an “unavailability of insurance” exception has proven to be improvident. Recent activity suggests that the “unavailability of insurance” exception may be losing support even in the couple of jurisdictions with decisions that have recognized the exception. First, in New York, the recent Keyspan case[2] — which marks the first time a New York state appellate court has addressed the issue — held there is no “unavailability of insurance” exception under New York law to allow the policyholder to avoid responsibility for uninsured periods. Second, a recent Sixth Circuit decision[3] demonstrates the limited utility of the exception to policyholders. Finally, on Dec. 12, 2016, the New Jersey Supreme Court granted review in Continental v. Honeywell[4]. Although there is little reason to suspect the court will abandon the “unavailability of insurance” exception altogether, the case affords the court an opportunity to clarify the circumstances under which a policyholder may avoid the consequences of its risk retention and transfer decisions even where insurance may be unavailable in the market. At this point, it is fair to ask whether the door is closing on the “unavailability of insurance” exception.

In Part I of this article we discuss 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 explore the genesis of the limited “unavailability of insurance” exception. Part II will address the limited nature of the “unavailability of insurance” exception and consider the prospect of the exception being even further limited.

The General Rule: The Unavailability Of Insurance Does Not Absolve Policyholders Of Responsibility For Self-Insuring

The vast majority of decisions applying a pro rata allocation methodology require policyholders to contribute for “bare” periods regardless of whether applicable insurance was “available” or “unavailable.” Stated differently, most pro rata decisions simply do not consider whether or not insurance coverage was available to cover particular risks after any point in time — where there is no insurance for any reason the policyholder bears the financial responsibility. S. M. Seaman & J. R. Schulze, Allocation of Losses in Complex Insurance Coverage Claims (5th Ed. Thomson Reuters 2016) at Chapter 4 (collecting and discussing cases). [5]

When urged by policyholders to carve out an “unavailability of insurance” exception to limit the period in time in which losses are allocated to policyholders, courts applying a pro rata allocation generally have declined to do so. A couple of decisions illustrate the point.

The first decision is Sybron Transition Corp. v. Security Insurance of Hartford, 258 F.3d 595 (7th Cir. 2001), which involved a single asbestos bodily injury claim for which one of Sybron’s insurers, Security Insurance Company, paid $1.3 million to resolve. Applying New York law, the Seventh Circuit held that the claim implicated periods of coverage from 1969 through 1988. Security issued coverage to Sybron for the period of 1969 through 1971. Because Sybron self-insured after 1971, the issue presented in the

case was how much of the $1.3 million settlement could be spread on a pro rata basis to the policyholder for years after 1971 and, in particular, the period of 1986 to 1988 when Sybron argued that insurance for asbestos-related risks was "unavailable."

In refusing to interpose an "unavailability of insurance" exception, the Seventh Circuit noted "we do not know what it means (or could mean) to say that coverage for a particular risk is "unavailable." Unavailable at what price?" 258 F.3d at 599 (emphasis in original). After analyzing the various options available to Sybron to acquire some form of insurance coverage for its asbestos-related liabilities, the Seventh Circuit concluded that the "availability" analysis is inherently flawed and unworkable. The court found that, instead of using such terms, "it is better to say that Sybron did not in the late 1980s have an economically attractive opportunity to participate in a pool in which the risks of asbestos-related casualties were spread among similar firms." Id.

In concluding that Sybron should contribute for periods through 1988, the court stated:

> To require Security to pay extra because Sybron did not find it cost-effective to purchase coverage during 1986 to 1988 would be the economic equivalent of requiring Security to furnish free coverage during 1986-88 (for Sybron does not propose to pay for the going premium retroactively). Why an underwriter who furnishes low-price coverage during a period before the magnitude of the risk became apparent should be required to furnish, for nothing, an additional period of high-price coverage escapes us. After all, it was Sybron, not Security, that created the risk of loss. And the consequences of that risk should fall on its creator, not on an underwriter unlucky enough to insure an early slice of the risk.

258 F.3d at 600.

The second illustrative case is Boston Gas Co. v. Century Indem. Co., 910 N.E.2d 290 (Mass. 2009). In this case, the Massachusetts Supreme Judicial Court declined to adopt the "unavailability" exception because to do so would contravene the limitations in the subject policies to liability attributable to property damage during the policy periods. The Massachusetts high court reasoned:

> [T]he unavailability exception 'effectively provides insurance where insurers made the calculated decision not to assume risk and not to accept premiums. In effect, because the policyholder could not buy insurance, it is treated as though it did by passing those uninsurable losses to insured periods.' This would not be equitable to insurers if the insured purchased coverage for only a few years where there was protracted damage.

910 N.E.2d at 315. [6]

The Genesis Of The "Unavailability" Exception

Policyholders seeking refuge in the "unavailability" exception invariably point to the New Jersey Supreme Court decision in Owens-Illinois Inc. v. United Insurance Co., 650 A.2d. 974 (N.J. 1994). In Owens-Illinois, the court rejected the "all sums" or "joint and several" approach and adopted pro rata allocation. The New Jersey Supreme Court expressly recognized "when periods of no insurance reflect a

decision by an actor to assume or retain a risk, as opposed to periods when coverage for a risk is not available, to expect the risk-bearer to share in the allocation is reasonable." Id. at 995. It is the "when coverage for a risk is not available" language that policyholders cease upon.

The New Jersey Supreme Court, unlike most courts determining that a pro rata allocation represents the proper allocation method, did not base its decision in whole or in part upon policy language. Indeed, the court flatly stated it "was unable to find the answer to allocation in the language of the policies." Instead, it relied upon "public interest factors" to guide its determination that a pro rata allocation is required.

The New Jersey Supreme Court explained that the theory of insurance is one of "transferring risks" and any allocation rule must take this into account:

> Our job, however is not just to solve today's problems, but to create incentives that will tend to minimize their recurrence. "[T]o send the correct signals to the economic system, a judge must appreciate the consequences of legal decisions on future behavior"… Future actors would know that if they do not transfer to insurance companies the risk of their activities that cause continuous and progressive injury, they may bear that untransferred risk.

Id. at 992.

The court also noted:

> [M]anufacturers and distributors of defective products can best allocate the costs or injuries resulting from those products. The premise is that the price of the product should reflect all its costs, including the cost of injuries caused by the product. Those manufacturers and distributors can incorporate the cost in the price of the product. The cost of the product will thus be borne by all those who profit from it, including manufacturers and distributors who profit from its sale, and buyers who profit from its use. The policy considerations underlying those principles include the relative bargaining power of the parties and the allocation of the loss to the better risk-bearer in a modern marketing system.

Id.

Additionally, the court placed primary importance on other considerations such as efficient use of resources. Id.

In some circumstances, it is possible to apply a limited "unavailability of insurance" exception in a manner that does not do violence to the other policy considerations articulated by the court. However, the text of the Owens-Illinois decision as well as the public interest factors and rationale for the Owens-Illinois decision provide solid support for insurers to argue that the "unavailability of insurance" exception must yield in particular factual contexts. The New Jersey high court has not yet had occasion to address circumstances in which absolving a policyholder of responsibility for years in which insurance is not available encourages irresponsible behavior and otherwise undermines the public interest factors the court recognized. As discussed below, such a case may now be before the court.

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

[2] Keyspan Gas East Corp. v. Munich Reinsurance America Inc., 143 A.D.3d 86 (N.Y. App. Div. 2016).

[3] Continental Casualty Co. v. Indian Head Industries Inc., 2016 WL 7321362 (6th Cir. Dec. 16, 2016) (applying Michigan law).

[4] Continental Insurance Co. v. Honeywell International Inc., 2016 WL 3909530 (App. Div. July 20, 2016), certification granted (Dec. 12, 2016).

[5] See, e.g., In re Wallace & Gale Co., 385 F.3d 820, 832-33 (4th Cir. 2004), as amended, (Nov. 15, 2004) (applying Maryland law) (holding that "it is neither equitable nor fair to require an insurance company to pay for coverage during a period for which no effective coverage is in force"); Pennsylvania Nat. Mut. Cas. Insurance Co. v. Roberts, 668 F.3d 106, 118-19 (4th Cir. 2012), cert. denied, 133 S. Ct. 191 (2012) (applying Maryland law) (affirming that an insurer is obligated to pay no more than its pro rata share of a judgment because "[t]o place the entire judgment on the insurer would be chaotic, rewarding those who decline to purchase adequate coverage and ultimately punishing those who do"); Porter v. American Optical Corp., 641 F.2d 1128 (5th Cir. 1981) (applying Louisiana law); Ray Industries Inc. v. Liberty Mut. Insurance Co., 974 F.2d 754, 23 Envtl. L. Rep. 20145 (6th Cir. 1992) (applying Michigan law); Commercial Union Insurance Co. v. Sepco Corp., 918 F.2d 920 (11th Cir. 1990) (applying Alabama law) (finding the policyholder must share in defense costs allocated to years in which it lacked coverage); Uniroyal Inc. v. Home Insurance Co., 707 F. Supp. 1368 (E.D.N.Y. 1988) (applying New York law) ("A firm that fails to purchase insurance for a period ... is self-insuring for all the risk incurred in that period; otherwise it would be receiving coverage for a period for which it paid no premium. Self-insurance is called 'going bare' for a reason"); Insurance Co. of North America v. Forty-Eight Insulations Inc., 451 F. Supp. 1230 (E.D. Mich. 1978), aff'd, 633 F.2d 1212 (6th Cir. 1980), decision clarified on reh'g, 657 F.2d 814 (6th Cir. 1981) (holding that the policyholder "must bear its share of the liability risk for those years in which it had no insurance"); H.B. Fuller Co. v. U.S. Fire Insurance Co., 2011 WL 2884711 (D. Minn. 2011) (holding that policyholder must be allocated its share of losses attributable to periods in which policies are unable to respond because they were issued by insurers that are now insolvent); IMCERA Group Inc. v. Liberty Mut. Insurance Co., 50 Cal. Rptr. 2d 583 (App. 2d Dist. 1996), as modified on denial of reh'g, (Mar. 29, 1996), review granted and opinion superseded, 917 P.2d 1164 (Cal. 1996) and review dismissed, and cause remanded, 939 P.2d 746 (Cal. 1997); Security Insurance Co. of Hartford v. Lumbermens Mut. Cas. Co., 826 A.2d 107, 127 (Conn. 2003) (ruling that, for "long latency loss claims that implicate multiple insurance policies, the pro rata method of allocating defense costs applies for purposes of allocating costs to the insured for periods during which it was uninsured or has 'lost or destroyed its policies'"); AAA Disposal Systems Inc. v. Aetna Cas. & Sur. Co., 821 N.E.2d 1278, 1290 (Ill. App. 2005), appeal denied, 829 N.E.2d 786 (2005) (holding that "it would be unfair to allocate the damages occurring during the uninsured period to an insurer that did not agree to provide coverage during that time"); Outboard Marine Corp. v. Liberty Mut. Insurance Co., 670 N.E.2d 740 (Ill. App. 1996), as modified on denial of reh'g, (Sept. 16, 1996) (holding that the policyholder is responsible for uninsured years); Norfolk Southern Corp. v. California Union Ins. Co., 859 So. 2d 167, 198 (La. Ct. App. 2003), writ denied, 861 So. 2d 579 (La. 2003) (requiring the policyholder to contribute to the pro rata allocation for any "period in which no insurer is on the risk"); Mayor & City Council of Baltimore v. Utica

Mut. Insurance Co., 802 A.2d 1070, 1101-02 (Md. 2002) (holding that “an insured who elects not to carry liability insurance for a period of time, either by electing to be self-insured, or by purchasing a policy which withholds coverage pursuant to a particular exclusion ... will be liable of the prorated share that corresponds to periods of self-insurance or no coverage”); Boston Gas Co. v. Century Indem. Co., 910 N.E.2d 290, 315–16 (Mass. 2009) (“the policyholder is responsible for any periods that it went without insurance.”); Domtar Inc. v. Niagara Fire Insurance Co., 563 N.W.2d 724 (Minn. 1997) (“Policyholders who chose to ‘go bare’ or underinsure must sustain the burden of those choices. Likewise, policyholders are required to underwrite the risk of insurer insolvency or bankruptcy.”).

[6] See also Crossmann Communities of North Carolina Inc. v. Harleysville Mut. Insurance Co., 717 S.E.2d 589 (S.C. 2011) (holding that employing an “unavailability” exception would “exceed the trial court's authority, as the effect is to shift losses from one policy period to another in order to create coverage where none was purchased”); Midamerican Energy Co. v. Certain Underwriters at Lloyd's London, 2011 WL 2011374 (Iowa Dist. Ct. 2011) (ruling “the availability of coverage is not to be a factor in allocating damage; the plaintiff will be responsible for those years in which damage has found to have occurred in which there is no insurance coverage, regardless of the reason that no coverage was obtained or available”); Bradford Oil Co., Inc. v. Stonington Insurance Co., 54 A.3d 983 (Vt. 2011) (rejecting the unavailability exception and determining that “the reason for the absence of effective insurance is not determinative” and that such an exception “is not consistent with a pure time-on-the-rise methodology”); AAA Disposal Systems Inc. v. Aetna Cas. & Sur. Co., 821 N.E.2d 1278, 1290 (Ill. App. 2005), appeal denied, 829 N.E.2d 786 (Ill. 2005) (“Because the policy periods contained in the American Employers’ insurance policies do not include the years plaintiffs went uninsured, we fail to understand why American Employers should have to bear the costs from that period ... We understand that insurance coverage was not available for the period at issue, but intervenors cannot shift responsibility for the uninsured years to American Employers.”)

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