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Expert Analysis

'Viking Pump': Changing The Allocation Landscape

By **Howard B. Epstein**

And **Theodore A. Keyes**

As Benjamin Franklin famously stated, there is nothing certain in this life but death, taxes and that New York is a pro rata allocation state.[1] Well, this is true no more. In *In re Viking Pump*, the New York Court of Appeals applied an all sums allocation to a long-term asbestos bodily injury case, catching New York insurance practitioners by surprise and uprooting the long-held understanding that New York is a pro rata jurisdiction.[2]

All Sums v. Pro Rata

Nationwide, courts have long wrestled with the appropriate approach to allocating loss in insurance coverage cases concerning continuous bodily injury or property damage that takes place over many years. In trying to resolve this issue, judges face a number of significant obstacles. First, the policy language in the general liability policies that are usually implicated does not squarely address allocation, in part, because most of these occurrence-based policies were issued many years before long-term environmental damage became a widely understood phenomenon. Second, it is rarely possible to ascertain, even with the assistance of experts, what portion of the exposure causing bodily injury or of the property damage—for example, groundwater contamination—took place in a given year within the period of years at issue.

> The Court of Appeals did not overrule its prior pro rata allocation decisions but made sure to dispel the widely held notion that New York was ever a "pro rata state."

Courts typically, either based on policy language or public policy, or some combination of both, end up applying one of two approaches: (i) the pro rata allocation approach, in which liability for injury or property damage is divided over the applicable period of years, with an equal portion of the damages allocated to each policy year; or (ii) the all sums approach, in which the insured can recover the entire amount of damages, subject to policy limits, from any one policy, and the insurer may then seek contribution from the other insurers that issued policies during the applicable time period.

New York as a 'Pro Rata State'

Until May 3, 2016, it was commonly understood that New York was a pro rata state. In fact, as recently as March 21, 2016, in *Liberty Mutual v. Fairbanks*, Judge John G. Koeltl of the Southern District of New York issued a decision applying a pro rata allocation to Liberty Mutual occurrence policies, finding that under "well-established principles of contract interpretation under New York law and New York case law on allocation of indemnity, the Liberty policies should be construed as providing for pro rata allocation of indemnity."[3] The court explained that under "*the New York pro rata approach*, liability is spread across the different insurers and policies for the time on the risk."[4]

Koeltl cited to numerous New York state and federal district court cases which upheld the long-standing New York precedent of pro rata allocation, including the leading decision by the Court of Appeals in *Consolidated Edison v. Allstate Insurance*. In that case, the insurance policy provided coverage, typical of occurrence policies, for "all sums which the insured shall be obligated to pay by reason of the liability" for "occurrences" that happen "during the policy period." The Court of Appeals adopted pro rata allocation, explaining that "[m]ost fundamentally, 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 noted that the all sums approach was "not consistent" with the policy language because it required the insurance policy to respond to occurrences or damage that took place outside the policy period.[5]

HOWARD B. EPSTEIN *is a partner at Schulte Roth & Zabel.* THEODORE A. KEYES *is a special counsel at the firm.* SAMI B. GROFF, *a senior associate at the firm, assisted in the preparation of this column.*

The U.S. Court of Appeals for the Second Circuit had previously issued a similar decision in *Olin Corporation v. Insurance Company of North America*, also adopting pro rata allocation and finding it to be consistent with the policy language and public policy.[6] The court observed that "shoehorning all damages into one policy period" under the all sums approach is "intuitively suspect" and that the pro rata approach correctly shifts the burdens associated with recovering from multiple other insurers, insolvent insurers and self-insured periods on to the policyholder rather than to one insurer selected by the policyholder.[7] Given these two cases as precedent, numerous New York State and federal cases applied pro rata allocation and New York State insurance practitioners proceeded secure in the knowledge that pro rata was the law of the land.

Challenging the Status Quo

In *Liberty Mutual*, the insureds attempted to differentiate the Liberty Mutual policy, arguing that an all sums allocation should apply because the policy language at issue differed from policies in prior cases in that: (1) the definition of "occurrence" did not state that an occurrence must happen during the policy period (although the insured conceded that the definition of bodily injury required that the bodily injury occur during the policy period); and (2) the policy contained a non-cumulation clause which prevents an insured from obtaining coverage under more than one Liberty Mutual policy even if the same injury happened in more than one policy period.[8]

As support for their all sums argument, the insureds cited to a Delaware Chancery court case called *Viking Pump v. Century Indem. Co.*, that had applied all sums to similar policies (including the same Liberty Mutual policies) purportedly under New York law.[9]

In *Viking Pump*, insureds Viking Pump and Warren Pumps had acquired the pump manufacturing businesses of Houdaille in the 1980s, which later subjected them to claims for bodily injury as a result of asbestos exposure related primarily to Houdaille's products. Houdaille had substantial insurance coverage, including a primary layer of $17.5 million and an umbrella of $42 million from Liberty Mutual. Houdaille also carried over $400 million in excess coverage from varied insurers, most of which followed form to the Liberty Mutual policies or contained similar provisions. Once the Liberty Mutual coverage was approaching exhaustion, litigation ensued among the excess carriers over issues of allocation.

The court stated that when it first adopted a pro rata allocation approach in 'Con Edison,' it did not, contrary to popular belief, adopt "a blanket rule" or "a strict rule mandating" pro rata allocation but instead relied on general principles of contract interpretation to construe insurance policies by giving a fair meaning to the language employed by the parties, leaving no provision without effect.

Viking Pump argued that an all sums approach should be applied because the policies contained non-cumulation and prior insurance provisions which provided that if an occurrence happened within more than one policy period, only one policy limit would respond to that occurrence. The Delaware Chancery Court agreed, finding that this policy language provided a basis to distinguish *Viking Pump* from prior New York case law and evidenced a clear intent for an all sums allocation. The case was transferred to the Delaware Superior Court and then appealed to the Delaware Supreme Court.[10] The Delaware Supreme Court certified to the New York Court of Appeals the question of whether the non-cumulation clause is consistent with pro rata allocation.

The Liberty Mutual court, however, was not swayed by these Delaware decisions. Given how well established the pro rata allocation approach was in New York, Judge Koeltl summarily dismissed *Viking Pump* as having "limited persuasive value" and cited to prior New York case law in which a district court rejected just such an argument, based on similar policy language.[11] Little did the Liberty Mutual court know, things were about to change.

'Viking Pump'

On May 3, 2016, the Court of Appeals issued an unexpected decision in *Viking Pump*, explaining that "pro rata allocation is inconsistent with non-cumulation and non-cumulation/prior insurance provisions" and holding "that all sums allocation is appropriate in policies containing such provisions…."[12]

The Court of Appeals did not overrule its prior pro rata allocation decisions but made sure to dispel the widely held notion that New York was ever a "pro rata state." The court stated that when it first adopted a pro rata allocation approach in *Con Edison*, it did not, contrary to popular belief, adopt "a blanket rule" or "a strict rule mandating" pro rata allocation but instead relied on general principles of contract interpretation to construe insurance policies by giving a fair meaning to the language employed by the parties, leaving no provision without effect.[13]

In *Viking Pump*, the Court of Appeals explained, the non-cumulation clause and prior insurance provisions in the Liberty Mutual policies, and the excess policies following form, differentiated the policy language from the policies at issue in *Con Edison*. The court noted that these provisions "present the very type of language that we signaled might compel all sums allocation in *Consolidated Edison*."[14]

Whether or not the court's original "signal" was heard by any, the court's signal now is loud and clear. Citing to a number of decisions from courts outside of New York, the Court of Appeals reasoned that pro rata allocation is inconsistent with non-cumulation provisions because, under a pro rata allocation, each policy only covers loss that occurs within its specific policy period, while non-cumulation provisions recognize that a policy can pay for loss outside the policy period.

Specifically, the court explained that non-cumulation provisions "plainly contemplate that multiple successive insurance companies can indemnify the insured for the same loss or occurrence," while "[b]y contrast, the very essence of pro rata allocation is that the insurance policy language limits indemnification to losses and occurrences during the policy period—meaning that no two insurance policies, unless containing overlapping or concurrent policy periods, would indemnify the same loss or occurrence."[15]

The court explained that "pro rata allocation is a legal fiction designed to treat continuous and indivisible injuries as distinct in each policy period as a result of the 'during the policy period' limitation, despite the fact that the injuries may not actually be capable of being confined to specific time periods. The non-cumulation clause negates that premise by presupposing that two policies may be called upon to indemnify the insured for the same loss or occurrence."[16]

Applying pro rata allocation to a policy with a non-cumulation clause, the court reasoned, would render the non-cumulation clause surplusage, which is inconsistent with New York principles of contract interpretation that require the court to give effect to all provisions in a contract and would conflict with prior case law holding that non-cumulation clauses are enforceable.

Viking Pump's excess insurers argued that some courts have reconciled non-cumulation clauses and pro rata allocation. For example, in *Olin Corporation v. American Home Assurance Co.*, the policy expressly provided coverage for damages that continued after the end of the policy period.[17] The Second Circuit held that the insurer was liable for property damage that occurred during the policy period as well as any property damage that continued during the period thereafter, explaining that the general pro rata allocation rule does not preclude the insurer from including policy terms that specifically address the issue by providing for coverage outside the policy period.[18] The Olin court then applied a modified pro rata allocation. As the Viking Pump court explained, the Olin court "divided up the damages for each year as if allocating them on a pro rata basis, but then swept the shares attributable to the years outside the policy period back into the earlier periods."[19]

The Viking Pump court rejected the excess insurers' argument that the Olin approach "harmonized" the non-cumulation provision with pro rata allocation. Instead, the court found that the Olin allocation more "closely resembles an all sums allocation," but theorized that the Olin court felt "foreclosed from utilizing all sums allocation" because of existing New York State and federal precedent. The court also dismissed the excess insurers' citations to other cases, including *Liberty Mutual*, finding that none of the authorities cited by the excess insurers satisfactorily reconciled non-cumulation clauses with pro rata allocation.

The court then ordered that an all sums allocation should be applied.[20]

Back to 'Liberty Mutual'

Based on the Viking Pump ruling by the Court of Appeals, counsel in *Liberty Mutual* immediately filed a motion for reconsideration. On Aug. 8, 2016, Judge Koeltl granted the motion as to the Liberty Mutual umbrella policies, which contain non-cumulation clauses, explaining that based on the "intervening change in law" as set forth in *Viking Pump*, an all sums allocation must be applied to such policies.[21] In a footnote, though, Koeltl noted that the practical effect of this ruling is that Liberty Mutual will be potentially liable for periods of time when the insured was uninsured or underinsured and for any years in which there was a gap in coverage, such as years during which coverage was provided by insolvent carriers.[22]

Looking Forward

As Victor Frankenstein observed, "Nothing is so painful to the human mind as a great and sudden change. The sun might shine, or the clouds might lour: but nothing could appear to me as it had done the day before."[23] *Viking Pump* has completely changed the landscape of allocation law in New York. As insurance practitioners work to come to terms with this new reality, it remains to be seen how future decisions might expand or restrict this holding based on the facts of future cases. The one thing that is certain is that insurers' counsel can no longer reassure their clients that "New York is a pro rata state."

1. Not an exact quote, but Franklin did say something close to that.
2. *In re Viking Pump,* 27 N.Y.3d 244 (2016).
3. *Liberty Mutual Ins. Co. v. The Fairbanks Co.*, Nos. 13-cv-3755, 15-cv-1141 (JGK), 2016 WL 1169511 (SDNY March 21, 2016).
4. Id. at *5 (emphasis added).
5. *Consolidated Edison Co. of N.Y. v. Allstate Ins. Co.*, 98 N.Y.2d 208, 224 (2002).
6. *Olin Corp. v. Ins. Co. of North America,* 221 F.3d 307, 322-23 (2d Cir. 2000).
7. Id.
8. *Liberty Mutual,* 2016 WL 1169511 at *7.
9. *Viking Pump v. Century Indem. Co.,* 2 A.3d 76, *107-08, 114-119, 130 (Del. Ch. 2009).
10. See *Viking Pump*, 27 N.Y.3d at 254.
11. *Liberty Mutual,* 2016 WL 1169511 at *7.
12. *Viking Pump*, 27 N.Y.3d at 264.
13. Id. at 257.
14. Id. at 258-59.
15. Id. at 261.
16. Id.
17. *Olin Corp. v. Am. Home Assur. Co.,* 704 F.3d 89 (2d Cir. 2012).
18. Id.
19. *Viking Pump*, 27 N.Y.3d at 263.
20. Id.at 263-64. The court also ruled that vertical exhaustion applies, so that an insured need not horizontally exhaust all primary layers of coverage before triggering excess policies. Id. at 266.
21. *Liberty Mutual Ins. Co. v. The Fairbanks Co.,* Nos. 13-cv-3755, 15-cv-1141 (JGK), 2016 WL 4203543, *2 (S.D.N.Y. Aug. 8, 2016).
22. Id. at *1-2.
23. Mary Shelley, Frankenstein 146 (Dover thrift edition 1994) (3d ed. Colburn and Bentley 1831).

Schulte Roth&Zabel
Schulte Roth & Zabel LLP
919 Third Avenue, New York, NY 10022
212.756.2000 tel | 212.593.5955 fax | www.srz.com
New York | Washington DC | London