Keyspan & Vanderbilt: Contract Enforcement Meets Judicial Gerrymandering In Allocation

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In insurance coverage disputes involving long-tail exposure, the majority of courts today apply pro rata allocation to determine the extent of each parties' liability for a claim. Where the injury is continuous and indivisible, it is spread over all of the years during which the injury occurred and each party on the risk bears their allocable share. This method is consistent with the contract language present in most occurrence-based general liability policies, which limits coverage to injury or damage occurring "during the policy period." Where there is no insurance during a particular time period, policyholders often argue that insurers outside that time period should pay for the injury or damage that occurred in it. They argue that if they can prove insurance was not available during that time period (often coined the "unavailability exception"), then an insurer who did not insure that time period must pay for the injury or damage in it. Such an approach, however, requires one to not only ignore, but to alter the contract. It is also directly contrary to the very rationale behind pro rata allocation because it requires insurers to cover injury or damage for which they never agreed and never received a premium. Two recent decisions, *Keyspan* and *Vanderbilt*, show the right and wrong answer to this argument.

In *Keyspan Gas E. Corp. v. Munich Reins. Am., Inc.*, 143 A.D.3d 86 (1st Dep't 2016), New York's Appellate Division, First Department, rightly allocated the insured's liability for environmental contamination across the entire period during which it occurred, and rejected the policyholder's "unavailability exception" argument. The insurance contracts at issue only covered damage "during the policy period." The Court recognized that the "during the policy period" limitation was perfectly consistent with pro rata allocation and inconsistent with an "unavailability exception." The Court understood that there were no other contractual provisions that would justify a judicial, artificial moving of damage from an uninsured period to an insured period. Doing so would, in violation of the contract terms, force an insurer to pay for damage that did not occur during its policy period. As the Court held:

> Unavailability is an exception to time on the risk, since it allocates responsibility for periods of time when no insurance was purchased and it is, therefore,

> inconsistent with policy language restricting coverage to the policy period. There is no other additional contractual language in the policy justifying this exception. There are no express contract provisions requiring the insurer to cover damages outside of the policy period when insurance is otherwise unavailable in the marketplace. *Id.* at 96.

The Appellate Division in *Keyspan* also took the opportunity to point out the inequity of creating an "unavailability exception." As the Court recognized, it would expose the insurer "to risks beyond those contemplated by the parties when the policies were purchased, as evidenced by the plain language of the policies." *Id.* The Court also rejected the argument that public policy should somehow overcome and require a rewriting of the contracts for equitable reasons.

The Appellate Division appreciated that insurers, like policyholders, are parties to a contract and the terms of their relationship should not be later altered to force insurers to pay for damage that occurred in periods they did not insure and for which they were paid no premiums. As the Court said:

> [T]he spreading of industry 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 an insured. *Id.* at 97.

Keyspan is a sensible decision, which applies the contract terms and equitably allocates the damage over the period during which it occurred. In contrast, in *R.T. Vanderbilt Co., Inc., v. Hartford Acc. & Indem. Co.*, Nos. AC 36749, AC 37140-51 (Ct. App. Ct. March 7, 2017), the Court rejected the application of the policies' terms and forced insurers to pay for damage that did not occur during their policy periods. The insurance contracts limited coverage to injury or damage that occurred "during the policy period." The insurers argued, perfectly consistent with the contract terms, that they should only have to pay for asbestos injuries to the extent they occurred during their policy periods because that is what they insured under the contract terms. The Court, however, refused to allocate the damage pro rata and instead chose to move damage about under the heading of an "unavailability exception". In so doing, the Court subtly reversed the well-settled rule that it is in fact the insured's burden to prove that actual damage occurred during the policy period, and decided it was not in violation of the contract terms if it "structured" the allocation of damage based purely on the purported hardness of insurance markets at particular times. The Court stated:

> One important distinction is that progressive injuries caused by asbestos are indivisible and cumulative. This means that it is impossible to identify what portion of a claimant's bodily injury actually occurred during which policy period. Many of our sister courts, applying an all sums theory, have concluded that the indivisible nature of progressive injuries means that any insurer on the risk for

> any period of time can be called upon, at the discretion of the policyholder, to cover the entire claim. Connecticut has adopted a more insurer friendly pro rata allocation system, one that operates on the legal fiction that asbestos related disease occurs in equal increments commencing at the time of initial exposure and cumulating with the manifestation of disease. But this legal convention does not mean that the policy terms are somehow violated or coverage impermissibly broadened if the allocation rules are structured to (1) encourage policyholders to obtain the broadest possible insurance pool to respond to long-term claims but (2) not punish those policyholders who, through no fault of their own, are unable to maintain a continuous chain of coverage.

The Court then listed several public policy considerations in support of its holding that it would not allocate the injury over the entire period it occurred, but would instead compress it into a period where there was insurance. First, that application of an "unavailability exception" it said would have the effect of maximizing resources available to respond. Maybe, but altering contracts can always increase available insurance, and where does that end. Second, it said that it would somehow incentivize insurers to continuously identify and investigate unknown risks, creating public safety benefits. Frankly, the opposite is true; judicial expansion of obligations under insurance contracts has always lead to a tightening of contract terms, with the movement from the qualified pollution exclusion to the absolute pollution exclusion being just one example. Moreover, it is the insureds – not the insurers – who create and control the risks and by freeing insureds of their allocable share of the liability for those risks the court is in fact incentivizing a lack of public safety by those who have it in their power to create public safety. Third, that having insurers pay for damage they did not insure somehow best comports with the insured's reasonable expectations, even though the contracts the insured entered into by their plain words only cover injury "during the policy period." Another fundamental principle of law – intent is gleaned from the contract terms – is left in the dust. And fourth, that insurers are more equipped to manage such risks, which, putting aside the reality that policyholders are often larger entities than their insurers, only makes one wonder why contracting parties should have contracts at all.

The fundamental flaw with the *Vanderbilt* court's application of an "unavailability exception" is that it is divorced from the policy language and principles of equity. Simply put, an "unavailability exception" alters the parties' contract. As a basic principle, it is the insured's burden to prove injury or damage during the policy period. Courts applying pro rata allocation allocate the continuous injury or damage equally over the entire period during which it occurred to ease that burden, a substantial benefit provided to the insured (not the insurer as *Vanderbilt* wrongly suggested). The contracts only insure the injury or damage that occurs "during the policy period", which conspicuously and unambiguously limits the insurance. Take the case of *Continental Ins. Co. v. Atlantic Cas. Ins. Co.*, 603 F.3d 168 (2nd Cir. 2010). There, due to the heightened risk of the exposure, the insured roofer was only able to procure a policy that covered cold (*i.e.*, chemical) roofing applications and not hot roofing applications. The insured, however, used a torch on a job, which resulted in a fire loss that was not covered. Should the Court have moved the loss to an earlier period where an insurer had no such exclusion for hot roofing work to make that insurer pay for the damage that occurred in a later period where the insurer refused to cover it? Of course not. There is no logical or contractual distinction between damage that occurs in an instance and damage that occurs over time allowing, in the case of the latter, a judicial shifting around of the damage to create coverage for uncovered loss. Quite to the contrary, an “unavailability exception” is a judicial artifice – finding no legislative support – that forces a contracting party who insured only injury or damage occurring during a certain period to pay for injury or damage that did not occur during that period. Such an “exception” is entirely inconsistent with the very reasons that pro rata allocation applies in the first instance and the contracts.

An “unavailability exception” to pro rata allocation is also contrary to equitable principles. Such an exception alters the allocation and creates a windfall in favor of the insured and the plaintiffs’ bar. It provides free insurance covering a risk the policyholder never paid for. It also forces an insurer to cover risks it explicitly declined to cover (by not offering the insurance), never agreed to cover, and never received premiums for. It is contrary to what the parties agreed to, bargained for, and reasonably expected and is inequitable. The point is insurers chose not to write a certain risk, but now judicial gerrymandering is forcing them to pay for that very risk without even so much as the premiums they should have received years ago.

In addition, public policy is against application of an “unavailability exception” to the pro rata allocation rule. Holding an insured responsible for its allocated share of liability during periods when insurance is unavailable will incentivize the insured to discover unknown risks that could cause injury or damage; encourage the insured to limit the potential for injury or damage from its operations; and discourage the insured from risk-taking and irresponsible behavior. Further, while certainly a subject worthy of its own article, what is “unavailable insurance” can be a very complex question adding another dynamic to the case. Policyholders argue, for example, that asbestos exclusions and absolute pollution exclusions were prevalent by 1987, but certainly we have seen many instances of available insurance products providing coverage for asbestos and pollution claims long after those dates.

In sum, the policyholder proposed “unavailability exception” calls for a re-drawing of the contracts in direct contradiction of the parties’ agreement and principles of equity. Arguments for an “unavailability exception” should be rejected. *Keyspan* upholds the contract language, rule of law, and equity.

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