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New York High Court Issues Much-Anticipated *Viking Pump* Ruling

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Insurance

In re Viking Pump, Inc. & Warren Pumps, LLC, Insurance Appeals, No. 59 (N.Y. May 3, 2016) ("*Viking Pump*"), heralds a major development in New York insurance law to the benefit of policyholders facing claims that trigger multiple years of liability coverage as a result of continuous and progressive damage -- *i.e.*, "long tail" claims. In answering certified questions from the Delaware Supreme Court concerning the proper allocation method to apply to such claims, New York's highest court adopted the "all sums" rule and held that each excess carrier whose coverage was triggered could be required to pay the policyholder's entire liability, subject only to a policy's monetary limits. In so holding, the Court rejected views advanced by the insurance industry that the court should adopt "pro rata allocation" to the disadvantage of policyholder interests. Although the opinion relies on the particular "non-cumulation" clauses and "prior insurance" provisions at issue in the case, the decision gives policyholders ample firepower to argue that similar provisions in their own policies mandate the all sums rule, potentially allowing policyholders substantially greater recoveries, particularly where their solvent and/or recoverable insurance is concentrated in relatively few years of the period triggered by a long-tail loss.

The *Viking Pump* Decision

Viking Pump came to the New York Court of Appeals on certified questions from the Delaware Supreme Court. At issue were two rulings of the lower Delaware courts: (1) that the language in the policyholders' insurance policies allowed them to recover their entire liability from a single policy period, with insurers then potentially able to seek contribution from additional insurers that insured the policyholder in other periods -- the all sums rule; and (2) that the policyholders were obligated to exhaust all primary coverage before any excess policy was obligated to respond -- so-called "horizontal exhaustion." The second question had not previously been before the Court of Appeals; the first had been, in *Consolidated Edison Co. of New York v. Allstate Insurance Co.*, 98 N.Y.2d 208 (2002), where the Court rejected all sums in favor of a "pro rata" approach in the context of coverage for indemnity loss (*i.e.*, judgments or settlements paid to underlying claimants). The pro rata approach takes different forms but generally divides a policyholder's total liability across all policies on the risk and assigns each policy period a divisible share of the loss, sometimes requiring the policyholder to bear the risk of uninsured periods or periods when the coverage purchased is no longer solvent or involves significant retentions or deductibles.

All Sums vs. Pro Rata. Recalling its 2002 precedent, the Court in *Viking Pump* explained that it "did not reach [its] conclusion [in *Consolidated Edison*] . . . by adopting a blanket rule . . . that pro rata allocation was always the appropriate method of dividing indemnity among successive insurance policies." *Viking Pump*, slip op. at 11. "Rather, we relied on our general principles of contract interpretation, and made clear that the contract language controls the question of

allocation." *Id.* at 11-12. Thus, in *Consolidated Edison*, the Court's pro rata ruling applicable to indemnity (as opposed to defense) coverage rested on analysis of the policy provisions requiring an insurer to indemnify for "all sums" that occurred as a result of damage or an occurrence taking place "during the policy period." The Court held that a pro rata methodology, "*while not explicitly mandated by the policies*," was at least consistent with the "during the policy period" language. *Id.* at 13-14.

The policyholders in *Viking Pump* argued that the language in their policies was different from the language at issue in *Consolidated Edison* and consistent only with an all sums methodology. Specifically, the policyholders relied on the "non-cumulation" clauses[1] and the "continuing coverage" clauses[2] in their excess policies.

The Court agreed, finding that "[t]he policy language [in *Viking Pump*], by inclusion of the non-cumulation clauses and two-part non-cumulation and prior insurance provisions, is substantively distinguishable from the language that we interpreted" in *Consolidated Edison* and "present[s] the very type of language that we signaled might compel all sums allocation." *Id.* at 14. Non-cumulation clauses "were purportedly designed to prevent any attempt by policyholders to recover under a subsequent policy . . . for a loss that had already been covered by the prior . . . policy." *Id.* at 15. The Court held that such non-cumulation clauses are inconsistent with pro rata allocation because the non-cumulation clause on its face applies to injury that occurs partly within and partly without the policy period. Had the intent of the policy been to prorate the loss solely based on a policy's "time on the risk," the non-cumulation clause would be superfluous. Thus, the "legal fiction" that underlies the pro rata regime -- that continuous and indivisible injuries can be treated as distinct in each policy period -- cannot coexist with non-cumulation clauses. *Id.* at 18-19.

In explaining its result, the Court also pointed to the continuing coverage clauses found in certain of the policies, which "expressly extend[] a policy's protections beyond the policy period for continuing injuries." This language could not be reconciled with a pro rata allocation, because under that methodology "no policy covers a loss that began during a particular policy and continued" thereafter "because that subsequent loss would be apportioned to the next policy period as its pro rata share." Accordingly, the Court held that this language "further compels an interpretation in favor of all sums allocation." *Id.* at 19-20.

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[1] A typical example, as quoted in the opinion:

> If the same occurrence gives rise to [injury or damage] which occurs partly before and partly within any annual period of this policy, the each occurrence limit and the applicable aggregate . . . limits of this policy shall be reduced by the amount of each payment made by [the insurer] with respect to such occurrence, either under a previous policy or policies of which this is a replacement, or under this policy with respect to previous annual periods thereof.

[2] The typical example the Court quoted:

> [I]n the event that personal injury or property damage arising out of an occurrence covered hereunder is continuing at the time of termination of this Policy the Company will continue to protect the [Insured] for liability in respect of such personal injury or property damage without payment of additional premium.

Vertical v. Horizontal Exhaustion. The *Viking Pump* Court separately addressed the "vertical v. horizontal exhaustion" debate that had not previously been before the Court. In brief, under the vertical exhaustion rule, an excess policy must respond once underlying policy limits written for the same time period are exhausted. Under the horizontal exhaustion rule, an excess insurer may avoid its duties until *all* primary limits are exhausted, no matter in what year. The Court held that only vertical exhaustion is consistent with the all sums allocation scheme. The Court rejected, as have many other courts in New York and elsewhere, the insurers' argument that the "other insurance" language in the policies required exhaustion of all primary coverage in all triggered policy periods. As the Court explained, "other insurance" clauses apply only "when two or more policies provide coverage during the *same* period" and "have nothing to do with successive coverage." *Id.* at 25-27 (citations omitted).

Other Coverage Issues

Defense Costs. *Viking Pump* strengthens a policyholder's ability to recover 100% of its defense costs from its insurers. For policies with a duty to defend, *Viking Pump* reinforces existing New York authority requiring the targeted insurer to provide a complete, indivisible defense under standard policy language obligating insurers to "defend any suit" potentially covered by the policy. Such language is inconsistent with the notion of compelled proration of defense costs, just as the *Viking Pump* policy language was inconsistent with the notice of compelled proration of indemnity costs. For policies that cover defense costs but do not provide an affirmative duty to defend, or if the policyholder has the right to independent counsel due to a conflict with the insurer, the targeted insurer should likewise pay 100% of the policyholder's defense costs (subject to applicable policy limits, if any) under the "all sums" framework of *Viking Pump*.

Contribution and Settlement Credits. Although not directly analyzed in the *Viking Pump* ruling, an insurer designated under the all sums approach should be able to seek contribution from other insurers in other periods, but only if certain conditions are met. For example, the targeted insurer -- *after* it has paid its all sums obligation -- could be limited to seeking contribution only from other insurers: (a) whose polices are triggered by the same claim, (b) that are not insolvent, (c) that provide actual coverage as opposed to fronting coverage or other arrangements where the insurer does not take on the financial risk, and (d) that have not settled with the policyholder. Where a targeted insurer would otherwise have a valid contribution claim against a settled insurer, the targeted insurer might be entitled to a pro tanto settlement credit up to the settlement amount the insured actually received, if necessary to avoid a double recovery. While these questions are left for another day, it seems that any use of insurer contribution rights in a manner that would financially disadvantage the policyholder would be inconsistent with the overall tenor and holding of *Viking Pump*.

Conclusion

Policyholders had long insisted that, in the Court of Appeals' own words at the time, *Consolidated Edison* was not meant to be the "final word" on allocation of indemnity losses under New York law. *Viking Pump* vindicates this position and reaffirms the Court's rule that the specific policy language at issue must be evaluated on its own and that it is the policy language, as opposed to the insurance industry's public policy arguments for pro rata allocation, that controls in New York. In policies with non-cumulation or continuing coverage provisions similar to those in *Viking Pump*, the all sums rule is now the settled law of New York.

In light of the frequency of one or both of these clauses (or similar clauses) in general liability policies over the past half century, policyholders should closely review their coverage and reject

the standard insurer label that New York is a "pro rata state." Depending on the nature of the coverage program and type of loss, *Viking Pump* may substantially increase policyholders' recovery by allowing them to allocate their losses to the year or years with the most viable coverage, rather than having to absorb a share of losses in those years with missing, insolvent, or otherwise unfavorable coverage.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Insurance practice group:

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