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Second Circuit Debunks the 'Legal Fiction' of Pro-Rata Allocation

By Robert M. Horkovich and Mark Garbowski

The Second U.S. Circuit Court of Appeals handed down a decision in July that reflects the movement of New York's highest court — and state and federal courts nationwide — toward all sums joint and several liability of insurance companies for long-tail claims and away from pro rata allocation, which it called a "legal fiction." The most recent decision in *Olin Corp. v. OneBeacon America Insurance Co.* — a litigation that has been ongoing more than 30 years — decidedly favored the policyholder on issues concerning allocation, prior insurance clauses and stacking, and the expected or intended provision.

Regarding allocation, the Second Circuit found it necessary to revisit a few of its many prior decisions due to the New York Court of Appeals decision in *Viking Pump*.

The circuit court noted that *Viking Pump* confirmed that New York law and decisions before *Viking Pump* did not mandate pro rata allocation on a universal basis, but rather that courts applying New York law are required to determine the proper allocation in each case based on the specific language of the relevant policies. In doing so, the Second Circuit adopted the NY Court of Appeals' label of "legal fiction" and applied that term when rejecting the "pro rata" approach to allocation.

Further, the Second Circuit rejected a hybrid approach suggested by the insurance companies of using pro rata under some policies and all sums joint allocation for others. Specifically, it was not persuaded by OneBeacon's argument that the primary layer had to be fully exhausted under a horizontal pro rata method because the primary policies lacked the prior insurance clauses that necessitated all sums allocation in the OneBeacon policies above them.

This case also offered a positive development for policyholders on the expected or intended language in commercial general liability policies. The Second Circuit ruled that the key issue is whether the policyholder expected or intended the property damage solely during the policy period, which in this case was 1970. It is irrelevant whether the policyholder came to expect or intend property damage at some later

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time. The court noted that the Olin policies contained no language suggesting that coverage for ongoing property damage that takes place after the policy period must remain "unexpected" or "unintentional," and the court refused to add a condition to coverage into the policy that could reduce coverage years after the policy period was over.

The best news for the insurance company (albeit qualified) was the ruling that the Olin clauses, which expressly applied to "any other excess policy," were not limited to prior excess policies sold by the same company. Based on those particular clauses, the Second Circuit ruled that the insurance companies tapped by the policyholder to pay under all sums joint and several could get a reduction for amounts already paid in settlement for the same loss. The Second Circuit immediately blunted the effect of this ruling however, by ruling that those insurance companies have the burden of proving recovery for the identical loss under prior policies. In this specific case — as in many cases — that is a tough burden to meet. Consistent with their usual preferences, the excess insurance companies who previously settled with Olin did not allocate settlement payments to specific sites and instead simply paid for the broadest, most general release that Olin would provide. The court refused to presume that any of the payments already made by those settled companies were for the specific sites at issue in this phase of the litigation, and remanded the case back to the District Court to further develop the record and rule on that issue, with repeated emphasis that OneBeacon can only take advantage of the prior insurance provision if it meets this burden.

As the earlier settlements were reached during phases of the litigation that concerned different sites, that should be difficult. Similar difficulties will be present in any multi-site environmental case. In mass tort cases involving hundreds and even many thousands of claimants that burden could prove insurmountable. Nonetheless, the discovery insurance companies will begin seeking from one another will be of interest and could assist policyholders. Further, the court also noted that an insurance company's first form of relief in such situations is contribution from other companies. It may be that a pro rata exhaustion scheme never can be awarded in a noncomprehensive declaratory judgment filed by an insurance company against its policyholder, as it is not possible to allocate losses to non-parties who do not get a chance to defend themselves.

The *Olin* decision from the Second Circuit is the latest in a string of decisions favorable to policyholders seeking coverage for long-tail liabilities under state laws across the country. The Second Circuit is moving in sync with the trend toward a broad application of all sums apportionment of insurance company liabilities, while leaving an opening for policyholders to recover from different insurance companies in multiple policy years.

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