

New York Court of Appeals Addresses Annualization of Limits and “Stub” Policies

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On February 22, 2011, New York’s highest state appellate court addressed the annualization of aggregate limits to a multi-year liability policy, including whether a two-month extension of the policy period provided the insured with a new limit.

In *Union Carbide Corp. v. Affiliated FM Ins. Co.*, the Court of Appeals reversed the lower court and held that an excess umbrella liability policy provided separate annualized aggregate limits. The question, however, of whether a two-month extension of the policy period provided an additional aggregate limit could not be decided as a matter of law.

Union Carbide sought to recover defense and indemnity costs for personal injury claims arising from its sale of asbestos. Continental Casualty Company (“Continental”) and Argonaut Insurance Company (“Argonaut”) each subscribed to a \$5 million quota share of Union Carbide’s fifth layer excess umbrella policy, with a policy period of December 1, 1973 to December 1, 1976 (the “Excess Policy”). The Excess Policy was a brief “subscription form policy” including the following clause:

Subject to the declarations set forth below, the Companies signatory hereon agree with the Insured named below that the Insurance afforded by this agreement shall follow all of the terms, insuring agreements, definitions, conditions and exclusions of [the] underlying . . . Policy issued by Appalachian Insurance Company.

The declarations referenced in the follow-the-form clause cited above stated: “Limitation of liability: \$30,000,000 each occurrence and in the aggregate in excess of \$70,000,000. Umbrella Liability.”

The underlying Appalachian policy, also a three year policy, contained the following Condition: “The limit of liability . . . set forth as ‘aggregate’ shall be the total limit of the company’s liability under this policy for ultimate net loss . . . during each consecutive 12 months of the policy period.”

Union Carbide argued that the Excess Policy’s aggregate limits were annualized, based on the follow-the-form clause of the Excess Policy and the Condition in the underlying Appalachian policy, resulting in available limits of \$90 million in the aggregate for the three year period. Conversely, Continental and Argonaut argued that the follow-the-form clause did not apply to the policy limits because that clause was “subject to the declarations,” which they asserted provided for a single, non-annualized aggregate limit of \$30 million.

Although the Court noted that Continental’s and Argonaut’s reading of the term “aggregate” in the Excess Policy’s Declarations “might be plausible in many contexts,” it nevertheless held that the follow-the-form clause controlled, reasoning that follow-the-form provisions “serve the important purpose of allowing an insured . . . that deal with many insurers for the same risk to obtain uniform coverage, and to know, without a minute policy-by policy analysis, the nature and extent of that coverage.” The Court also reasoned that it was “implausible” that Union Carbide, with its large and complicated insurance program, “would have bargained for policies that differed, as between primary and excess layers, in the time over which policy limits were spread,” and found it “unlikely” that the parties intended a situation

where Union Carbide “could (and in fact did) reach the second and third years of its excess policies with the full limit of its primary coverage in place, but with its fifth-layer excess coverage exhausted.” After holding that the aggregate limits of the Excess Policy applied on an annualized basis, the Court then addressed whether an endorsement extending Continental’s participation for an additional two months created a fourth aggregate period with respect to Continental. The Court noted that that Continental provided the two-month extension “as an accommodation,” and that that the parties might not have reasonably expected such an accommodation to provide a fresh set of policy limits. Accordingly, the Court could not find in favor of a new set of limits as a matter of law, and remanded for further proceedings.

Should you have any questions regarding this decision, or want additional information, please do not hesitate to contact us.