

13 October 2014

Practice Groups:
Insurance Coverage
Toxic Tort

IMO Industries Tackles New Jersey Law on Host of Insurance Coverage Issues

New Jersey Insurance Coverage and Toxic Tort Alert

By Donald W. Kiel, Robert F. Pawlowski, and Ashley L. Turner

INTRODUCTION

On September 30, 2014, New Jersey's Appellate Division ruled on a bevy of insurance coverage issues in the long-tail liability context, including exhaustion of primary policies, application of policy limits to multi-year and "stub" policies, the interplay of self-insured retentions and erosion of limits, reasonableness of underlying settlements, coverage for the defense of ultimately uncovered claims, and the right to a jury trial. Since it addresses so many issues relevant to coverage for long-tail losses, *IMO Industries, Inc. v. Transamerica Corporation, et al.*¹ is an important decision for policyholders and insurance companies alike. Moreover, it is worth monitoring since an appeal to the Supreme Court may be imminent.

THE APPELLATE DIVISION'S DECISION

At issue in *IMO Industries* is the extent to which \$1.85 billion in insurance purchased by the policyholder, IMO Industries, Inc. ("IMO"), covered IMO's defense of, and liabilities for, asbestos bodily injury claims. The Appellate Division applied standing precedent to issues familiar to New Jersey courts, and also addressed several issues not yet decided by New Jersey's highest bench. Central to the court's opinion is the Supreme Court of New Jersey's decisions in *Owens-Illinois* and *Carter-Wallace*² adopting the "continuous trigger" theory for long-tail losses and a modified pro-rata allocation model based both on a carrier's time on the risk and the limits of coverage. The stated goal of these decisions was to implement a fair allocation scheme in the face of exceedingly complex and often times irreconcilable policy language. Importantly, the court in *IMO Industries* also relied on the Supreme Court's decisions in *Spaulding Composites* and *Benjamin Moore*³ that a court may displace policy terms contrary to this model or simply "drop [them] out of the policy."

Factual Background

By way of brief factual background, IMO began manufacturing "turbines, pumps, gears, and other machinery with industrial and military uses" in 1901 as the Delaval Steam Turbine Company. In 1963, Transamerica Corporation acquired Delaval, which operated under various names as a Transamerica subsidiary over the years. Some of the products manufactured by IMO's predecessors, from the 1940s to the 1980s, contained asbestos.

¹ ---A.3d---, 2014 WL 4810047 (N.J. Super. App. Div. Sept. 30, 2014).

² *Owens-Illinois, Inc. v. United Insurance Co.*, 138 N.J. 437 (1994) and *Carter-Wallace, Inc. v. Admiral Insurance Co.*, 154 N.J. 312 (1998)

³ *Spaulding Composites Co. v. Aetna Cas. & Sur. Co.*, 176 N.J. 25 (2003); *Benjamin Moore & Co. v. Aetna Cas. & Sur. Co.*, 179 N.J. 87 (2004).

IMO Industries Tackles New Jersey Law on Host of Insurance Coverage Issues

After a spin-off in 1986, Delaval's successor became IMO. At that time, IMO was a third-party defendant in three asbestos liability lawsuits; subsequently, many more asbestos plaintiffs sued IMO. Although IMO's primary insurance companies funded IMO's defense and indemnification, pursuant to negotiated interim defense and indemnification funding agreements, disputes arose when one of those carriers claimed its policy was exhausted and another refused to continue funding IMO's defense. IMO filed a coverage action and the trial court ruled on a number of important coverage issues recently affirmed by the Appellate Division in *IMO Industries*.

Exhaustion of TIG's Fronting Policies

The Appellate Division affirmed the trial court's decision that a primary insurance company's duty to defend ends upon allocation of indemnity losses regardless of actual payment.⁴ Under some of the primary policies at issue, the insurance company, TIG Insurance Company, agreed to defend IMO and the payment of defense costs was not to erode the limit of liability of the policies. The TIG policies also contained a provision stating that TIG will "not be obligated to pay any claim or judgment or to defend any suit after the applicable limits of the company's liability has been exhausted by payment of judgments or settlements."⁵ IMO argued that this provision required TIG to show exhaustion by actual indemnity payments before its defense obligation ended. IMO also argued that policyholders actively seek insurance coverage that provides for payment of defense costs greatly exceeding indemnification limits and that allowing exhaustion by allocation of indemnity losses, rather than actual payment, would defeat policyholders' expectations.⁶

Recognizing that this holding is likely inapplicable to liability coverage outside the long-tail context, the Appellate Division affirmed the trial court's holding that allocation of indemnity losses exhausted the TIG policies, rather than actual payment of claims.⁷ The Appellate Division's decision relied heavily on the premise that policy terms inconsistent with the allocation scheme established by the New Jersey Supreme Court in *Owens-Illinois, Inc. v. United Insurance Co.*,⁸ which requires "allocation proportionate to the risks transferred to the insurer," must be disregarded.⁹ To construe the TIG policy language in a manner that was consistent with both the Court's holding in *Owens-Illinois* and the reasonable expectations of the parties, the Court held that indemnity losses, rather than actual payments, operated to exhaust TIG's policies and terminate its defense obligations.¹⁰

Coverage Limits of Multi-Year Policies

The Appellate Division affirmed the trial court's holding that the policyholder could recover a full policy limit for each year that various multi-year policies were in effect. The carriers had argued that a single policy limit should apply to each policy, regardless of how many years the policy covered. The court admittedly deviated from the "plain language" of these policies,

⁴ *IMO Indus., Inc.*, 2014 WL 4810047, at *9.

⁵ *Id.*

⁶ *Id.* at *9, *12.

⁷ *Id.* at *13.

⁸ 138 N.J. 437 (1994).

⁹ *IMO Indus., Inc.*, 2014 WL 4810047, at *12, *15.

¹⁰ *Id.* at *16.

IMO Industries Tackles New Jersey Law on Host of Insurance Coverage Issues

which would have imposed per-occurrence limits on a term instead of an annual basis.¹¹ In doing so, the Appellate Division noted that “*Owens-Illinois* changed the ground rules and classified all asbestos claims made in a year as a single occurrence.”¹² And despite the policy language, the court rationalized that “[b]ecause the imposition of per-occurrence limits in the multi-year policies contravenes the goals of the pro-rata methodology established in *Owens-Illinois*, such limits are unenforceable as specifically written.”¹³

“Stub Policies” (Partial-Year Coverage)

The Appellate Division affirmed the trial court’s holding that it would not prorate the limits of a policy with a term less than a year. Although an insurance policy typically carries a policy period of one year, policyholders often will cancel a policy early, extend a policy beyond one year, or simply elect to purchase less than one year of coverage. But, unless the policy specifically states that coverage is prorated, such “stub” policies carry full limits. “Treating a stub policy as providing a pro-rated limit would result in the loss allocated to the policy being reduced twice, once by its time on the risk and a second time by the pro-rating of the policy limit.”¹⁴

SIRs as Outside the Limits of Policies

The Appellate Division held that IMO’s policy limits were not eroded by its self-insured retention (“SIR”).¹⁵ The Court noted that while deductibles do reduce policy limits, SIRs are different and insurance coverage does not trigger until after a SIR has been paid—essentially treating it as an excess insurance policy, sitting above the policyholder’s SIR.¹⁶

Challenges to Coverage for Underlying Claims Settlements

In many long-tail coverage disputes, excess carriers attempt to second guess the policyholders’ and primary insurers’ decisions to settle underlying claims, often trying to argue that such settlements were unreasonable. The Appellate Division in *IMO Industries* expressly rejected such attempts and held that excess carriers cannot challenge the reasonableness of previously settled claims in long-tail coverage cases in the defense of which the excess carriers failed to participate.¹⁷ Although the Court recognized that the policyholder typically bears the burden of proving that claims fall within an insurance policy’s scope of coverage, the Court determined that allowing coverage challenges by excess carriers would destroy the goal established in *Owens-Illinois* of providing “efficient and equitable allocation of losses.”¹⁸ In this case, IMO notified its excess carriers of claims against it and the excess carriers chose not to participate in the defense of the claims.¹⁹ Both the trial court and the Appellate Division once again relied on *Owens-Illinois* to hold that

¹¹ *Id.* at *17–18.

¹² *Id.* at *18.

¹³ *Id.*

¹⁴ *Id.* at *21.

¹⁵ *Id.*

¹⁶ *Id.* at *22.

¹⁷ *Id.* at *23.

¹⁸ *Id.* at *24.

¹⁹ *Id.* at *23.

IMO Industries Tackles New Jersey Law on Host of Insurance Coverage Issues

once a primary or an excess insurer declines to participate in the defense of claims against its policyholder, it is bound by those settlements and cannot “re-litigate the settled claims.”²⁰

Duty to Defend Uncovered Claims

Two insurance companies argued that the ultimate net loss provisions in their policies means that they need only indemnify IMO for defense costs if there was an actual covered claim at issue.²¹ The Appellate Division disagreed, affirming the trial court’s holding that defense costs are allocable even if some of the defense costs are attributable to claims in which no indemnity payments are made by the insurer.²² According to the court, a covered “occurrence” triggers the excess carriers’ defense obligations, rather than a covered claim. An “occurrence,” for purposes of asbestos liability, is “the decision to manufacture asbestos-containing products, not the exposure of a specific claimant to an asbestos product.”²³ The Appellate Division also noted *Owens-Illinois*’ goal of reducing litigation costs and increasing efficiency in allocation cases supports this outcome.

Right to a Jury Trial

The Appellate Division also affirmed the trial court’s denial of a trial by jury. More specifically, the court held that because IMO’s claims were primarily for specific performance of future obligations and a declaration of its rights pursuant to several insurance policies, IMO has no right to a jury trial.²⁴ In New Jersey, a party typically may have a trial by jury in a civil action at law, but not in equity. By its claims, IMO predominantly sought the equitable remedy of specific performance of insurance policies and were distinguishable from claims of policyholders seeking “money for damages already incurred,” which do trigger a right to a jury trial.²⁵ Thus, the primary relief sought was in equity and the Appellate Division determined that the trial court did not err in denying IMO a jury trial.²⁶

IMPLICATIONS OF THE *IMO INDUSTRIES* DECISION

Again, policyholders should familiarize themselves with *IMO Industries* and the Supreme Court cases upon which it relies to help navigate the often murky waters of long-tail coverage litigation. Of particular interest to policyholders no doubt will be *IMO Industries*’ clear rejection of excess carriers’ common practice of attempting to re-litigate actions and second-guess settlements they could have participated in from the outset.

²⁰ *Id.* at *24–25.

²¹ *Id.* at *25.

²² *Id.* at *27.

²³ *Id.*

²⁴ *Id.* at *30.

²⁵ *Id.* at *31.

²⁶ Where a case involves legal claims and equitable claims, the court can assume jurisdiction over the legal claims, or, if the legal claims are not essential to the equitable claims, the court can sever the legal claims for trial by jury. *Id.* at *29.

IMO Industries Tackles New Jersey Law on Host of Insurance Coverage Issues

Authors:

Donal W. Kiel

donald.kiel@klgates.com

+1.973.848.4064

Robert F. Pawlowski

robert.pawlowski@klgates.com

+1.973.848.4032

Ashley L. Turner

ashley.turner@klgates.com

+1.973.848.4018

K&L GATES

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt
Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Moscow Newark New York Orange County Palo Alto Paris
Perth Pittsburgh Portland Raleigh Research Triangle Park San Francisco São Paulo Seattle Seoul Shanghai Singapore Spokane
Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates comprises more than 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit www.klgates.com.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

© 2014 K&L Gates LLP. All Rights Reserved.