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NY Asbestos Ruling Could Change Insurers' Approach

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Although many companies that historically used asbestos in their products have gone bankrupt, there are still many that have managed to survive. How? In some — perhaps many — cases, the answer may be due in no small part to insurance.

But insurers looking to reduce their asbestos coverage obligations by demanding that policyholders contribute to defense and settlement costs may be shooting themselves in the foot if their policyholders can't handle the financial burden.

In Liberty Mutual Insurance Co. v. Jenkins Bros., the New York Supreme Court recently held that Liberty Mutual had to pay 100% of all settlements against its bankrupt and dissolved insured, Jenkins Bros., even though its policies were in force for only part of the asbestos exposure alleged in the relevant underlying asbestos lawsuits.

The court held that Liberty was a real party-in-interest in the asbestos lawsuits because it agreed to defend and indemnify Jenkins Bros. when it issued the relevant liability insurance policies, and it was Liberty that appeared and negotiated asbestos settlements on behalf of its bankrupt and dissolved insured in those lawsuits.

As the real party-in-interest, the court reasoned Liberty could not pay only a pro rata portion of settlements based on the time Liberty's policies were on the risk, leaving the plaintiffs to swallow the orphan share. And, in any event it, it was estopped from doing so because it was the one that actually negotiated the settlements.

The court, however, did not stop there. Perhaps more importantly and of broader application, the court stated that regardless of whether Liberty was a real party-in-interest in the underlying asbestos lawsuits, the pro rata allocation methodology would never be appropriate when the allocation would result in an orphan share being allocated to a tort victim due to gaps in coverage and a bankrupt defendant.

In such instances the all-sums, or joint and several allocation, methodology would apply, which would also result in Liberty paying 100% of settlements for Jenkins Bros.' asbestos liability.

Finally, and also noteworthy, the court adopted the 2000 ruling of the New York Appellate Division, First Department in In re: Liquidation of Midland Insurance Co., which held that the trigger of coverage in a long-tail asbestos claim is the inhalation of asbestos fibers, or exposure — not manifestation of the disease or exposure in-residence, e.g., the period between last exposure and manifestation of the disease.

Not all asbestos defendants are global corporations that can be viably reorganized in bankruptcy. The Jenkins Bros. decision sheds light on what might ultimately happen when an asbestos, or other long-tail tort, defendant goes out of business and is eventually dissolved and wound up, or becomes completely defunct.

Consider the situation where a manufacturer is sued hundreds of times per year for injuries allegedly caused by exposure to asbestos in products it made decades ago. The cost to defend these lawsuits is substantial, as is the cost to pay settlements or, in some cases, judgments.

But this manufacturer has insurance coverage under its old occurrence-based general liability policies and the issuing insurers have stepped up — as they should — to provide the manufacturer a full defense and indemnity. In turn, the manufacturer is able to stay in business.

What happens if the insurers grow weary of their coverage obligations and seek to shift a portion of the cost to defend and settle cases to the manufacturer?

For example, assume one of the participating insurers is ordered into liquidation or the insurers wish to capitalize on a perceived advantageous development in the applicable law addressing how to allocate defense and settlement costs when the alleged asbestos exposure occurs partly outside the insurers' policy periods.

Now our manufacturer must either sue to maintain a full defense and indemnity or negotiate a cost sharing arrangement where it must contribute to some degree. Either scenario will be a material drain on its financial resources.

Focusing on New York law for the moment, insurers and policyholders tend to take a very different view of how to allocate legacy asbestos liabilities when the alleged exposure occurred partly within viable policy periods and partly without.

Insurers typically argue the pro rata allocation method applies to both the duties to defend and indemnify except in a relatively narrow set of circumstances, such as when a policy contains a noncumulation or prior insurance clause. That means the insurers would only have to pay their fractional share of a loss that occurs during their policy periods compared to the entire period of loss, which can be lengthy, and the policyholder must pay for the remainder.

On the other hand, policyholders typically argue the all-sums allocation method applies, which means if an insurer's policy is triggered, it must fully defend and indemnify the insured for the entire loss until its policy is exhausted, with no contribution from the insured — though contribution may be available from other insurers.

At minimum, an insurer must fully defend asbestos lawsuits even if settlements or judgments can be allocated pro rata among insurers and the policyholder.

Given these differing viewpoints, one can easily see that in practice businesses with legacy asbestos liabilities are put in a tough financial position when their insurers don't agree to provide full coverage.

The court dockets in New York are replete with expensive, drawn-out fights between insurers and policyholders on these issues. On the other hand, if insurers contribute only a fraction to pay for asbestos liabilities, the business may not be able to afford the remainder.

The court's ruling in Jenkins Bros. should make insurers think twice before looking to shed some of their asbestos coverage obligations.

If their policyholders go out of business, declare, or are forced into, bankruptcy, or eventually dissolve and wind up, the insurers may be left holding the bag — either as a real party-in-interest because orphan shares can't be allocated to tort victims, or because the plaintiffs obtain an unsatisfied judgment against the defunct policyholder and sue directly under New York Insurance Law Section 3420.

Even worse, insurers could find themselves defending cases without the benefit and buffer of a viable business as the direct defendant — yikes.

The point is, even if there is a real dispute over how to allocate long-tail losses — and I favor the policyholder position — the Jenkins Bros. ruling should encourage insurers to meaningfully protect their policyholders and find a sustainable path forward — the way insurance is supposed to work.

As a corollary, the Jenkins Bros. decision may impact the mergers and acquisitions space for entities shouldered with legacy asbestos liabilities. Acquiring companies often see asbestos liability as anathema and may steer away from an otherwise strategic acquisition.

In short, they don't want to be left answering the phone if the target goes belly up due to its asbestos liability — setting aside the actual likelihood and validity of this fear coming true. This sometimes knee-jerk reaction may be ameliorated if the entity that would ultimately be left answering the phone is the target's old insurance company pursuant to Jenkins Bros.

However one chooses to view Jenkins Bros., it's an interesting decision that could have far-reaching effects.

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