IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE VIKING PUMP, INC. AND WARREN PUMPS LLC INSURANCE APPEALS	) No. 518, 2014) No. 523, 2014) No. 525, 2014) No. 528, 2014)) CASES BELOW:)) SUPERIOR COURT OF) THE STATE OF DELAWARE IN) AND FOR NEW CASTLE COUNTY,) Consolidated C.A. No. N10C-06-141FSS [CCLD]) -and-) COURT OF CHANCERY OF THE) STATE OF DELAWARE,) Civil Action No. 1465-VCS	PUBLIC VERSION FILED: November 21, 2014

APPELLANT VIKING PUMP, INC.'S OPENING BRIEF ON APPEAL

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NATURE OF PROCEEDINGS

Viking Pump, Inc. ("Viking") appeals from the Superior Court's ruling that Viking cannot access any of its excess insurance for any year until it has exhausted all primary and umbrella insurance for every year. This ruling contravenes the plain language of the insurance contracts at issue, each of which expressly provides that it applies upon exhaustion of the directly underlying insurance coverage, and none of which requires exhaustion of primary or umbrella policies in other policy periods. This ruling is also inconsistent with the Court of Chancery's earlier "all sums" allocation ruling, which permits Viking to select a "tower" of insurance for a particular policy period and proceed up that tower as losses exhaust lower-level policies. Nor is the ruling required by New York law, which specifies that insurance policies, like other contracts, must be interpreted according to their plain language, which has never created a per se rule without regard to the contract language to require exhaustion of insurance in other time periods, and which has never interpreted the contract language at issue here.

The Superior Court's ruling also converts an asset that is supposed to be shared by two co-insureds into an asset that one insured can access but the other cannot. Viking and Warren Pumps LLC ("Warren") are insured under the same insurance policies for a 14-year period, from 1972 to 1985, when the two companies were owned by a common parent. Viking and Warren are no longer

affiliated. Both companies have been the targets of asbestos-related litigation. In 2005, Viking filed this lawsuit in the Court of Chancery because the number and severity of asbestos claims against Warren had increased dramatically, and Warren was "draining" an ever-larger amount of this shared insurance due to significant payments for its asbestos claims.[1]

Throughout this litigation, defendants below—the insurers that issued excess-layer policies during the 14-year period of shared coverage (the "Joint Excess Insurers")—have asserted a myriad of defenses against both Viking and Warren, including arguments that Warren and Viking have not fully and properly exhausted the primary- and umbrella-layer coverage available to them. Despite asserting the same coverage defenses against both policyholders, the Joint Excess Insurers paid tens of millions of dollars on Warren's behalf under reservations of rights while altogether refusing to pay anything to Viking. Because the shared policies have finite limits, every dollar consumed by Warren is a dollar that is no longer available to Viking.

The Joint Excess Insurers attempt to justify this disparate treatment on the ground that Viking has some (although ever-dwindling) unexhausted primary insurance coverage for some years before 1972 and one year after 1985. Yet these

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[1] Ex. 1, 10/31/13 Op. at 7; *see also* JA0914.

policies do not cover any part of the 14-year period covered by the Joint Excess Insurers' policies. Moreover, although Warren presented evidence at trial—and the Superior Court subsequently held—that its other insurance coverage is exhausted, the Joint Excess Insurers disputed these contentions before and during trial but nevertheless made payments to Warren while refusing to pay Viking. The jury found that the Joint Excess Insurers' duties of good faith and fair dealing prevented this disparate treatment, a verdict that those defendants did not challenge in post-trial motions.

In light of the forgoing, Viking files this brief to address a single, narrow issue: the Superior Court's ruling that Viking "must exhaust its primary and umbrella insurance layers before tapping the excess,"[2] a ruling codified in the Final Judgment.[3] The Superior Court's "horizontal exhaustion" ruling requires a policyholder to exhaust *all* of its primary and umbrella insurance in *every* policy year before *any* of the Joint Excess Insurers in *any* policy year must pay—even if the primary and umbrella policies directly underlying a Joint Excess Policy are fully exhausted. Despite agreeing that the language of the Joint Excess Policies

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2 Ex. 1, 10/31/13 Op. at 61.

3 Ex. 2, 6/9/14 Final Judgment ¶ 5.

supported a vertical exhaustion rule,[4] where a policyholder may access its excess insurance as long as the immediately underlying primary and umbrella insurance in the same policy year has been exhausted, the Superior Court erroneously believed that New York law compelled application of a horizontal exhaustion rule regardless of the policy language.[5]

The Superior Court's horizontal exhaustion ruling perpetuates the disparity that originally prompted Viking to file this suit: Viking is unable to obtain coverage under the Joint Excess Policies even while Warren obtains coverage for the very same type of claims under the very same insurance policies.

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[4] Ex. 1, 10/31/13 Op. at 60 ("there is policy language supporting Plaintiffs' argument for vertical exhaustion").

[5] Viking also joins Warren's appeal with respect to the issue of whether defense costs exhaust the limits of certain of the Joint Excess Insurers' policies. *See* Warren App. Br. § III.

SUMMARY OF ARGUMENT

This Court should reverse the Superior Court's horizontal exhaustion ruling and issue an order, consistent with the plain language of the policies, that each of the Joint Excess Policies is triggered once the directly underlying insurance policies in the same policy period are exhausted:

1. The plain language of the Joint Excess Policies requires application of vertical exhaustion.

A. Under New York law the terms of the insurance contract govern insurance coverage disputes.

B. The Superior Court acknowledged that the language of the Joint Excess Policies supports vertical exhaustion. Specifically, the Joint Excess Policies provide that their coverage obligations are triggered once the directly underlying insurance is exhausted.

2. The Superior Court's horizontal exhaustion rule is inconsistent with the Court of Chancery's "all sums" allocation ruling.[6]

A. Allocation methodology and exhaustion rules are inherently intertwined. This Court has described the all sums allocation method in terms that are inconsistent with horizontal exhaustion. Specifically, the Court has noted that

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[6] JA0960-61.

the all sums rule adopted below allows an insured faced with a multi-year occurrence to select a single "tower" of insurance, and vertically "proceed[] up the tower from the first layer of coverage . . ."— a vertical exhaustion rule.[7]

B. The Court of Chancery's all sums ruling contemplated vertical exhaustion, noting, for example, that Viking would be permitted to access its 1979 excess insurance once "the Primary and Umbrella Policies for 1979 have been exhausted"[8]—an observation inconsistent with a horizontal exhaustion rule.

3. The Superior Court committed reversible error in ruling that New York law required it to apply horizontal exhaustion to the primary and umbrella policies, despite policy language that the court agreed supports application of vertical exhaustion.

A. The Superior Court erroneously held that New York has adopted a horizontal exhaustion rule as a matter of law.

B. The Superior Court's ruling was based on New York opinions addressing contribution disputes among insurers concerning losses within a single policy period, not allocation rules in coverage disputes between a policyholder and its insurers that involve multiple policy periods. Those cases did not address the

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[7] *Stonewall Ins. Co. v. E.I. du Pont de Nemours & Co.*, 996 A.2d 1254, 1259-60 (Del. 2010).

[8] JA0960.

question of horizontal versus vertical exhaustion—an issue implicated only by losses spanning multiple policy periods. No New York court has held that a policyholder must horizontally exhaust all primary and umbrella coverage in every policy year before accessing any of its excess insurance.

C. The cases relied on by the Superior Court recognize that contract language is controlling and interpreted contract language that is not at issue here and therefore does not support the court's ruling, which failed to give effect to the controlling contract language.

STATEMENT OF FACTS

I. ASBESTOS CLAIMS AGAINST VIKING AND WARREN

Viking has owned and operated a pump manufacturing business since 1911. VA220; JA1895 ¶ 14. Houdaille Industries, Inc. ("Houdaille"), a diversified manufacturing company, owned both Viking and Warren for a period of time. In 1985, Houdaille spun off Warren as a separate entity (JA1894-95 ¶¶ 6-8), and in 1988, Houdaille sold Viking to IDEX Corporation (JA1896 ¶ 17), "leaving Viking and Warren as separate, independent entities." Ex. 1, 10/31/13 Op. at 6. Viking and Warren have no current legal or other relationship. VA145. Viking remains a wholly-owned subsidiary of IDEX. JA1896 ¶ 18.

Since the early- to mid-1990s, Viking has been named as a defendant in more than 30,000 asbestos-related personal injury lawsuits in multiple U.S. jurisdictions. VA147; VA149; JA1900 ¶ 45. Claimants typically seek recovery for bodily injuries REDACTED

VA146; VA216-19; JA1900-01 ¶ 46. Claimants generally allege exposures REDACTED implicating multiple years of liability insurance coverage. VA216-17. While certain aspects of the Superior Court's trigger ruling are in dispute, all parties agree that under that ruling

significant exposure during a particular policy year triggers, at a minimum, the policies in force during that policy year.

Through October 2012, Viking had resolved REDACTED claims without payment and only 364 with payment, for a total of REDACTED in settlement payments. VA150-51; VA221; VA325. Viking's settlement payments averaged REDACTED per claim. VA151. REDACTED there have been no judgments against Viking. VA150-51; VA214-15.

Warren, by comparison, has paid REDACTED on account of asbestos claims. In 2004 new claims against Warren peaked, with a high-water mark of approximately REDACTED new lawsuits alleging asbestos-related injuries. VA167-68. As of October 2012, Warren had been targeted in REDACTED asbestos claims and had paid more than REDACTED to settle REDACTED of them—an average of REDACTED per claim. VA166-67; VA169; VA172-74.

II. INSURANCE COVERAGE AVAILABLE TO VIKING

The excess insurance policies that cover Viking include (1) policies issued from 1972 to 1985 to Viking's former parent, Houdaille, which the Court of Chancery has held cover claims against both Viking and Warren (the "Joint Excess Policies") (JA932; JA939; JA945-46); and (2) policies which cover only Viking

for the periods from 1964 to 1972 (the "Viking-only Excess Policies"). JA1896-97 ¶¶ 19, 22-23.

The Joint Excess Policies were part of Houdaille's program of primary, umbrella and excess comprehensive general liability insurance, described by both the Superior Court and Court of Chancery as "a seamless, layered plan" and "a comprehensive, multi-year insurance program." Ex. 1, 10/31/13 Op. at 5; JA0906; JA0921; JA0979 n.165. As the Superior Court summarized, "[e]ach year from 1972 through 1985, Houdaille purchased occurrence-based primary, or 'first layer' insurance and umbrella, or 'second layer' insurance, from Liberty Mutual," that "cover asbestos claims for any year that exposure is alleged." Ex. 1, 10/31/13 Op. at 5-6. Above the Liberty policies, "Houdaille purchased layers of excess insurance. In total, Houdaille purchased 35 excess policies through 20 different carriers." *Id.* at 5.

In addition to the 14-year block of Joint Excess Policies, Viking and Warren each have their own coverage in other time periods. For Viking, Liberty provided four 1968-1971 primary policies, each with $250,000 in limits, and primary and umbrella coverage for 1986. Ex. 1, 10/31/13 Op. at 6; JA1970. Two other pre-1968 insurers also provided limited amounts of primary-layer coverage to Viking. VA152-53. Viking's pre-1968 and 1986 primary-layer coverage is not yet fully

exhausted. VA156-57.[9] Viking also has eight umbrella or excess policies from 1964 to 1972. Ex. 1, 10/31/13 Op. at 6; *see also* JA1897 ¶¶ 22-23.

For Warren, Liberty issued pre-1969 primary policies and Travelers issued a 1971 umbrella policy. Ex. 1, 10/31/13 Op. at 6. Some of these policies are lost. VA178-94. Warren presented evidence at trial that this Warren-only primary and umbrella insurance was exhausted. VA198-203; JA1902-03 ¶¶ 53-57. The Joint Excess Insurers have disputed this contention, even while paying certain Warren asbestos claims. VA238-47; VA275-77; VA269-74; *see also* VA132 ("Neither New Warren nor New Viking have demonstrated that it has incurred liabilities that exceed the attachment point of the Liberty policies . . .").

Liberty has paid the bulk of Viking's asbestos defense and settlement costs for more than twenty years. VA151-52. Liberty has defended and indemnified Viking against all asbestos claims that have "triggered" at least one Liberty policy period, *i.e.*, all claims involving asbestos-related injuries that occurred during a Liberty policy period. VA205-06; *see also* Ex. 1, 10/31/13 Op. at 23-24. By contrast, the Joint Excess Insurers have refused to defend or indemnify Viking for any asbestos claims that trigger their policy periods.

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[9] As of trial, Viking's 1968 to 1971 Liberty coverage was not fully exhausted. As of June 30, 2014, these four policies were fully exhausted.

III. VIKING INSTITUTED THE COURT OF CHANCERY PROCEEDINGS IN LIGHT OF WARREN'S INCREASING CONSUMPTION OF THE SHARED INSURANCE POLICIES

Viking initiated this lawsuit in the Court of Chancery in 2005 because the asbestos claims against Warren had swelled and Warren's increasing payments were "draining" an ever-larger amount of the shared insurance coverage. Ex. 1, 10/31/13 Op. at 7; *see also* JA0914-15. Viking sued Liberty, seeking equitable apportionment and injunctive relief with respect to the 1972-1985 Liberty primary and umbrella policies. Ex. 1, 10/31/13 Op. at 7. Warren intervened. *Id.* Viking and Warren consummated separate settlements with Liberty in 2008, after rulings that both Viking and Warren were entitled to exercise the rights of insureds under the Liberty policies. *See* Ex. 1, 10/31/13 Op. at 7; *see also* VA207-09.

Warren continued to consume the lion's share of the shared 1972-1985 Liberty primary and umbrella policies, which were completely exhausted by August 2010. JA1905 ¶¶ 66, 67; VA204; VA210. As of the start of trial, because Liberty had paid only about REDACTED in settlements for Viking claims,[10] its payments for Warren asbestos claims had exhausted the vast majority of REDACTED limits of the 1972-1985 Liberty policies. VA158; VA221; VA204; JA1907 ¶ 76.

[10] Liberty has continued to pay additional Viking settlements since the trial.

After the shared 1972-1985 primary and umbrella policies were exhausted, Liberty continued to pay Viking's asbestos defense and settlement costs under 1968-1971 and 1986 Viking-only policies, pursuant to the terms of the Viking-Liberty Settlement Agreement, because the Joint Excess Insurers refused to do so. VA204-05; VA209-10; VA154-55. The Viking-only Liberty policies combined had a face value of $3 million in primary coverage and $3 million in umbrella coverage (VA322-23), of which REDACTED has been exhausted. Viking's entitlement to payments from Liberty under the settlement is subject to various conditions, including Viking exercising reasonable efforts to secure payment from the Joint Excess Insurers for asbestos claims and the Joint Excess Insurers denying such requests. VA299 ¶ IV.E.4.

In late 2009, with the shared 1972-1985 Liberty policies approaching full exhaustion, Viking and Warren each tendered asbestos claims to Granite State. VA255-57; VA258-59; JA1913 ¶¶ 96-100; VA334 at 29:6-30:17. Granite State accepted Warren's tender subject to a reservation of rights that specifically included exhaustion of all primary and umbrella coverage, (VA261-62; VA339 at 100:8-100:18) and paid Warren's asbestos settlements until its policy was exhausted. JA1913-14 ¶¶ 101-104. Granite State denied Viking's tender and paid nothing for its asbestos claims. VA339-40 at 106:21-107:13; VA341 at 127:22-

128:17. In December 2009, Warren tendered asbestos claims to International. VA237-38. Like Granite State had the year before, International paid Warren's asbestos settlements and defense costs subject to a reservation of rights regarding exhaustion. VA275-77; VA238-41; JA1916-17 ¶¶ 115-116, 123. Viking also tendered asbestos claims to International (VA248; JA1916 ¶¶ 118-119; VA278-82), but International exhausted the limits of its 1982 policy paying Warren's asbestos losses while paying nothing to Viking and taking no steps to preserve any limits for Viking, despite the competing claims for coverage. VA249-50; JA1917 ¶ 120. After International's 1982 policy was exhausted, Century likewise paid Warren's asbestos claims subject to a similar reservation of rights regarding exhaustion, but refused to pay any of Viking's claims. JA1918 ¶¶ 127-129, JA1920 ¶ 134; VA269-74; VA243-44; VA251. As of the trial, the Joint Excess Insurers had paid a total of REDACTED for Warren asbestos claims. VA260; VA263-67; VA268; VA326-31; VA254. They had paid Viking nothing.

Following trial, the jury returned a verdict for Viking that the Joint Excess Insurers' duties of good faith and fair dealing prevented them from treating Viking and Warren differently: "Granite State, International and Century were not permitted under their policies to pay Warren subject to a reservation of rights while at the same time refusing to pay Viking." JA1485 ¶ 16. The Joint Excess Insurers

did not challenge this verdict in post-trial briefing. The Superior Court's Final Judgment incorporates the jury verdict on this issue. JA1877; Ex. 2, 6/9/14 Final Judgment ¶ 24.

IV. THE SUPERIOR COURT'S HORIZONTAL EXHAUSTION RULING

The parties agreed, and the Superior Court held, that the issue of horizontal versus vertical exhaustion was to be decided by the court, not the jury. Ex. 1, 10/31/13 Op. at 58 ("The parties further agree that vertical or horizontal exhaustion presents a purely legal question").

Viking and Warren urged below that the plain language of the policies permitted vertical exhaustion and precluded requiring the policyholders to horizontally exhaust all years of primary and umbrella insurance, even in years not underlying the Joint Excess Policies. Each of these policies expressly provides that it is applicable upon exhaustion of the *directly* underlying insurance coverage (*i.e.* the policies in the same insurance tower). For example, Viking and Warren pointed out that the Granite State policy attaches pursuant to its express terms "after the *Underlying Umbrella Insurers* have paid or have been held liable to pay the full amount of their respective ultimate net loss liability . . ." JA3580 § II. (emphasis added) The policy makes clear that the term "Underlying Umbrella Insurers" refers *only* to the underlying Liberty umbrella insurance in the same vertical tower as the Granite State policy itself—listing only Liberty's directly

underlying $3 million umbrella policy in the accompanying Schedule, and not any primary or lower-level excess policies from other time periods. *Id.* The other Joint Excess Policies contain substantively identical "underlying limits" language. (*See* footnote 10, *infra*)

Viking and Warren also argued in post-trial briefs that the Court of Chancery's earlier "all sums" ruling precluded application of horizontal exhaustion. When it adopted the all sums allocation method, the Court of Chancery found it to be compelled by the policies' contract language and described how the policies must respond to claims using a hypothetical plaintiff whose claim triggered multiple policy periods "from January 1, 1972 to December 31, 1979." JA0960. The court ruled that the policyholders could select and proceed up a single policy year's "tower" of insurance, so long as the directly underlying policies in that year were exhausted:

> Under an all sums approach, New Viking could choose a policy year under which to make its claim. For instance, it could submit the $1 million dollar liability to Granite State Insurance Company, which issued the first layer Excess Policy for 1979 (assuming of course that the Primary and Umbrella Policies for 1979 have been exhausted). As long as there was $1 million in coverage left in Granite State's coverage, Granite State would then have to pay out the full $1 million.

JA0960. Before the Superior Court, Viking and Warren contended that the Court of Chancery's statement that Viking could access Granite State's 1979 excess policy under an all sums methodology once the primary and umbrella policies in

that year were exhausted precluded application of horizontal exhaustion, which would require exhaustion of all primary and umbrella coverage *from 1972 to 1979* under the court's hypothetical. JA1535-37.

In response, the Excess Insurers contended that the law of New York trumped the plain terms of their policies. JA1569. The Superior Court ultimately sided with the Excess Insurers, ruling, despite the policies' language, that "'New York courts have consistently found that an umbrella policy is not required to contribute to the payment of a settlement until all other applicable policies have been exhausted [despite policy language].'" Ex. 1, 10/31/13 Op. at 59-60 (bracketed text supplied by Superior Court; citations omitted). Notably, the court agreed that the policies' language in fact supported vertical exhaustion. *Id.* at 60 ("there is policy language supporting Plaintiffs' argument for vertical exhaustion" and "[b]ut for New York's law, the court could reject horizontal exhaustion"). But the court made no effort to compare the policy language at issue in the New York opinions on which it relied to the language in the Joint Excess Policies. Instead, based on its interpretation of what New York law required, untethered to any contractual language, the court concluded that Viking "must exhaust its primary and umbrella insurance layers before tapping the excess. With the underlying layers gone and the excess triggered, the insured then may choose which excess

tower will cover a claim's 'all sums.'" Ex. 1, 10/31/13 Op. at 61. The Superior Court's Final Judgment also reflects this "horizontal exhaustion" ruling. Ex. 2, 6/9/14 Final Judgment ¶ 5.[11]

The effect of the Superior Court's ruling is that Warren is now able to access the Joint Excess Policies while Viking cannot, irrevocably harming Viking. This is despite the jury's verdict that the Joint Excess Insurers are not entitled to treat their policyholders differently, paying Warren while refusing to pay Viking. JA1485 ¶ 16; Ex. 2, 6/9/14 Final Judgment ¶ 24. Viking therefore appeals from the Superior Court's horizontal exhaustion ruling.

[11] In a later opinion, the Superior Court predicted that "the New York high court would hold horizontal exhaustion governs only the primary and umbrella policies here, not the excess coverage." JA1798. The Superior Court recognized that "New York emphasizes the policies' purposes as evidenced by their language, premium amounts, and other indicators." *Id.* Viking does not appeal this ruling; but as discussed below, it cannot be reconciled with the Superior Court's disregard of controlling contract language in its earlier ruling regarding the primary and umbrella policies.

ARGUMENT

I. THE SUPERIOR COURT COMMITTED REVERSIBLE ERROR IN FINDING, AS A MATTER OF NEW YORK LAW, THAT ALL PRIMARY AND UMBRELLA INSURANCE TRIGGERED BY A LOSS MUST BE EXHAUSTED HORIZONTALLY

A. Question Presented

Did the Superior Court commit reversible error when it disregarded the contract language and held, under a mistaken belief concerning New York law, that none of the Excess Policies must respond to a Viking loss if there is any triggered primary or umbrella insurance available to Viking, even in other policy years? Viking preserved this issue in post-trial briefing. JA1534-40.

B. Scope Of Review

This Court reviews issues of insurance policy interpretation and other legal issues *de novo*. *Phillips Home Builders, Inc. v. Travelers Ins. Co.*, 700 A.2d 127, 129 (Del. 1997).

C. Merits Of Argument

1. The Plain Language Of The Joint Excess Policies Compels Vertical Exhaustion

The Joint Excess Policies are contracts governed by New York law's general principals of contract interpretation, which are the same as those employed by Delaware courts. *See* JA0923 ("Fortunately, all three jurisdictions [New York, Delaware, and Florida] apply the same general principles of contract

interpretation."). Like the law in Delaware, New York law commands that the interpretation of an insurance policy begins with the language itself. *See* JA0954 ("New York precedent requires that the court apply traditional principles of insurance contract interpretation to the policies at issue and then apply the approach that results from that interpretive exercise."); *Fieldston Property Owners Ass'n, Inc. v. Hermitage Ins. Co.*, 945 N.E.2d 1013, 1017 (N.Y. 2011); *see also E.I. du Pont de Nemours & Co. v. Allstate Ins. Co.*, 686 A.2d 152, 156 (Del. 1996) ("Where the parties differ concerning the meaning of an insurance contract, the court will be guided by 'a reasonable reading of the plain language of the policy.'") (citations omitted); *Raymond Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 833 N.E.2d 232, 234 (N.Y. 2005) (*quoting Consolidated Edison Co. of N.Y. v. Allstate Ins. Co.*, 774 N.E.2d 687, 693 (N.Y. 2002)) ("In determining a dispute over insurance coverage, we first look to the language of the policy.").

New York's highest court has defined the principles applicable to insurance policies as follows:

> As with any contract, unambiguous provisions of an insurance contract must be given their plain and ordinary meaning, and the interpretation of such provisions is a question of law for the court. It is well settled that "[a] contract is unambiguous if the language it uses has 'a definite and precise meaning, unattended by danger of misconception in the purport of the [agreement] itself, and concerning which there is no reasonable basis for a difference of opinion.'" "Thus, if the agreement on its face is reasonably susceptible of only

> one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity." If the terms of a policy are ambiguous, however, any ambiguity must be construed in favor of the insured and against the insurer.

White v. Cont'l Cas. Co., 878 N.E.2d 1019, 1021 (N.Y. 2007) (alterations in original; citations omitted).[12]

The Superior Court failed to follow these hornbook principles of contract interpretation in its horizontal exhaustion ruling. Despite agreeing that "there is policy language supporting Plaintiffs' argument for vertical exhaustion" (Ex. 1, 10/31/13 Op. at 60), the court apparently believed that there was some overriding general principle in New York law that required imposing a horizontal exhaustion rule without regard to the insurance contracts' plain language. Indeed, the court did not cite any contrary contract language to support horizontal exhaustion. Instead, the court believed that it was required by New York law to look past the policies' plain language: "[b]ut for New York's law, the court could reject horizontal exhaustion." *Id.*

In its February 28, 2014 opinion, however, the Superior Court had the opportunity to evaluate the Joint Excess Policies' language without that perceived

[12] Although the Joint Excess Policies unambiguously compel application of vertical exhaustion, New York courts, like the courts of Delaware, "commonly employ the *contra proferentum* rule and resolve ambiguities against the insurer." JA0967. That rule "requires that a 'construction favorable to the insurer will only be sustained where it is the sole construction which can fairly be placed upon the words employed.'" *Id.*

requirement because it apparently believed its construction of New York law applied only to primary and umbrella, but not excess, exhaustion issues. Here, where the Superior Court did not feel that it was constrained by New York law—*i.e.*, *within* the layers of the Joint Excess Policies—it applied vertical exhaustion. JA1798; JA1801.

The Superior Court's reading of the Joint Excess Policies in its second opinion was correct. The plain language of the Joint Excess Policies only requires exhaustion of the *directly underlying* insurance policies before the policy attaches. INA's first-layer excess policy in 1985, for example, provides coverage in excess of the insurance policies specified in items 4 and 5 of the policy's declarations. JA4421 §A. The declarations then make clear that those underlying policies are limited to the Liberty Mutual primary and umbrella policies for the policy period "1-1-85 to 1-1-86," and not primary or lower-level excess policies from other time periods. JA4420, Declarations Items 4 and 5. The other Joint Excess Policies contain substantively identical "underlying limits" language.[13]

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[13] The underlying insurance provisions of the Joint Excess Policies fall into four general categories: (1) excess policies providing that they are excess of certain underlying insurance identified in the policy expressly by insurer name, policy period, or policy number (or some combination of those) that is consistent with the directly underlying policies in the same policy period (JA2395; JA2595; JA2930; JA3071; JA3372-3374; JA3389; JA3433; JA3591, 3589, 3600; JA3614, 3616; JA3747-3748; JA3875-3876; JA4000, 3998; JA4025-4026; JA4117, 4113; JA4137-4138; JA4165, 4170-4171; JA4297, 4294; JA4302; JA4425, 4420; JA4464); (2) excess policies providing that they are excess of a specific aggregate amount of underlying insurance limits that coincides with the aggregate limits of the directly underlying

This interpretation was also endorsed by International's own underwriter, who testified that the 1982 International policy would be "up to bat" once the *directly underlying* primary and umbrella policies had been exhausted:

> Q. And so once that underlying insurance was exhausted *in the '82 year*, this International policy would be up to bat?
> A. Yes.
>
> * * *
>
> Q. Mr. Foradas just asked you -- I believe he was speaking about the '82-83 policy?
> A. Yes.
> Q. And he said would it follow to the -- would it pay after the Liberty Mutual policy below it the umbrella exhausted?
> A. Yes.
> Q. And that Liberty Mutual policy would start paying when, the umbrella policy?
> A. After the primary had exhausted.
>
> * * *
>
> Q. Mr. Quigley, the underlying primary policy you were just asked about, would that be the '82-83 policy as well?
> A. Yes.

VA228-30. (emphasis added)

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insurance policies in the same policy period (JA2581-2582; JA3621-3622; JA3751, 3753; JA3885, 3887; JA3911; JA4006; JA4158; JA4277; JA4433, 4427; JA4484); (3) a first-layer excess policy providing that it is excess of primary insurance issued by "Liberty Mutual, Policy Number To Be Agreed," which supports vertical exhaustion because Viking has lower-level insurance by carriers other than Liberty (JA2905-2907); and (4) first-layer excess policies providing that they are excess of umbrella insurance issues by Liberty Mutual and stating the aggregate limits of the directly underlying policy issued by Liberty Mutual, in the same policy year (JA2395; JA2867; JA3330; JA3591, 3589, 3600).

At least one court in another jurisdiction has held that policy language substantively identical to that used in the Joint Excess Policies' underlying insurance provisions requires vertical exhaustion. Interpreting a Granite State policy with identical underlying insurance language to the Granite State policy at issue in this case, the U.S. District Court for the Western District of Washington held that "each of the Granite State policies requires that [the insured] exhaust only the 'underlying insurances' before its coverage is triggered," and the term "underlying insurances" *did not include policies from other years. Cadet Mfg. Co. v. Am. Ins. Co.*, 391 F. Supp. 2d 884, 892 (W.D. Wash. 2005). The plain language of the policies here requires the same result.

2. Horizontal Exhaustion Is Inconsistent With The Court of Chancery's "All Sums" Ruling, With This Court's Own Explanation Concerning the Interplay of Allocation and Exhaustion Principles, and With the Treatment of These Issues By Other Courts

The error in the Superior Court's horizontal exhaustion ruling is underscored by the conflict it creates with the Court of Chancery's all sums ruling. In its October 14, 2009 opinion, the Court of Chancery found that the plain language of the policies required the "all sums" allocation method, which "means that a policy is responsible for all liability that flowed from a covered occurrence." JA0960. "In other words," the Court of Chancery continued, "any policy that covered part

of a Multi-Period Exposure is responsible—up to its policy limits—for all of the liability that resulted from the exposure as a whole." *Id.*

The Superior Court's later adoption of the horizontal exhaustion rule is inconsistent with the Court of Chancery's all sums ruling. This is apparent from the Court of Chancery's own description of all sums allocation. Describing a hypothetical claim against Viking alleging a multi-year asbestos exposure from 1972 to 1979, the Court of Chancery observed that Viking would be entitled to exhaust its excess coverage vertically once the underlying primary and umbrella coverage in a single applicable policy year was exhausted:

> Under an all sums approach, New Viking could choose a policy year under which to make its claim. For instance, it could submit the $1 million dollar liability to Granite State Insurance Company, which issued the first layer Excess Policy for 1979 (assuming of course that the Primary and Umbrella Policies *for 1979* have been exhausted).

Id. (emphasis added). The Court of Chancery thus made it clear that Viking need not horizontally exhaust the primary and umbrella policies in each of the policy periods triggered by the hypothetical exposure, which would have included all of the policies *for 1972 to 1979.* Viking now finds itself in exactly the situation described hypothetically by the Court of Chancery—the primary and umbrella policies for specific years have been exhausted. But the first-layer excess insurers for those years nonetheless have refused to cover Viking.

The Superior Court's horizontal exhaustion rule effectively eliminates Viking's right to obtain coverage on the "all sums" basis, which the Court of Chancery found to be compelled by the plain language of the policies. JA0973 ("Following New York's contact-focused analytical framework, I conclude that an all sums approach is the one embraced in the Houdaille Policies.") The horizontal exhaustion rule precludes Viking from acting on the basic premise of the all sums allocation rule: selecting any tower of coverage among the triggered policy years and then proceeding up that tower to obtain coverage for the full amount of its losses. By imposing a horizontal exhaustion rule, the Superior Court has thus taken away the very contractual right that the Court of Chancery found to be expressly granted by the Joint Excess Policies.

This Court has confirmed the Court of Chancery's understanding of the interplay between all sums allocation and vertical exhaustion. In *Stonewall Ins. Co. v. E.I. du Pont de Nemours & Co.*, 996 A.2d 1254, 1259 (Del. 2010), this Court addressed a dispute over application of a non-cumulation clause. In doing so, the Court noted that the issue implicated the motion judge's adoption of the all sums allocation method, which no party had challenged on appeal. The Court's description of the mechanics of all sums allocation contemplates that a

policyholder is entitled to access its excess coverage on a vertical basis once the underlying coverage in the applicable policy year is exhausted:

> Under the all sums approach, [the insured] may choose a single *tower* of coverage, applicable to a single year, from which to seek indemnity and defense costs. After selecting a tower, *coverage then proceeds up the tower from the first layer of coverage* until full indemnity or complete exhaustion of the policy limits occurs. In turn, the selected insurers may then seek contribution against other carriers from other towers whose policies were also triggered by the product liability claims.

Id. at 1259-60 (emphasis added). The Court's statements that an insured may select a "tower" of insurance to cover its losses and that "coverage then proceeds up the tower from the first layer of coverage" are the opposite of horizontal exhaustion.

The Superior Court attempted to distinguish *Stonewall* based on its erroneous view that New York law requires horizontal exhaustion: "[i]mportantly, unlike *Stonewall*, *Home Insurance* is a New York case applying New York law, which governs the excess policies. That is important here, as New York requires each underlying layer to be depleted before an insured can access *any* excess layer." Ex. 1, 10/31/13 Op. at 60 (emphasis in original). That attempt falls flat, because it relies on the unsupported premise that the same policies are interpreted differently in New York and Delaware. As explained in Section I.3, *infra*, the Superior Court's attempt to harmonize its ruling with *Stonewall* is based on its

erroneous views that New York law compelled a horizontal exhaustion rule without regard to the controlling language of the policies.

The Superior Court recognized that, but for its erroneous perception of what New York's law required, this Court's opinion in *Stonewall* supports the conclusion that vertical exhaustion is the appropriate rule where, as here, the policies pay on an all sums basis. It thus believed that New York and Delaware law are in conflict on this issue. *See* Ex. 1, 10/31/13 Op. at 60 ("But for New York's law, the Court could reject horizontal exhaustion. But, New York law controls here, and as to horizontal versus vertical exhaustion, there is a true conflict. Thus, this court must apply New York law."). There is no conflict. No New York court has even addressed horizontal exhaustion in the successive policy context. The Superior Court should therefore have applied *Stonewall.* This Court should give primacy to the contract language and rule, as in *Stonewall*, that vertical exhaustion principles apply, particularly given (a) the policy language at issue and (b) the Court of Chancery's prior adoption of an all sums rule.[14]

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[14] Under Delaware law, when there is no conflict between potentially applicable state laws, it is unnecessary to choose between them. *See, e.g., Deuley v. DynCorp Int'l, Inc.*, 8 A.3d 1156, 1161 (Del. 2010) ("As we explain below, the result would be the same under both Delaware and Dubai law. Therefore '[a]ccording to conflicts of law principles ... there is a "false conflict," and the Court should avoid the choice-of-law analysis altogether.'") (citations omitted); *Masonic Home of Delaware, Inc. v. Certain Underwriters at Lloyd's London*, No. 361, 2013 WL 5872283, at *1 (Del. Oct. 30, 2013) ("We do not have to decide these choice of law issues because the substantive rule under either New York or Delaware law is the same.").

This Court and the Court of Chancery are not alone in recognizing that an all sums allocation contemplates vertical exhaustion. Courts in other jurisdictions have likewise described the all sums policy language and resulting allocation method in terms that clearly contemplate vertical, not horizontal, exhaustion. In *Westport Insurance Corp. v. Appleton Papers Inc.*, 787 N.W.2d 894 (Wis. Ct. App. 2010), the Court of Appeals of Wisconsin described all sums allocation as allowing an insured to exhaust an entire *tower* of insurance coverage before turning to another triggered tower:

> The trial court, in a prescient ruling, held that the policy language requires the Insurers to pay "all sums" that API is "obligated to pay" under CERCLA, subject to each policy's "attachment point and limit of liability." . . . The trial court held that [the insured] *could select a policy year during the coverage period, and work its way up the coverage "tower" for that year before moving to another year.* Starting with the lowest level of insurance in the selected year, [the insured] could require indemnity by that policy until the limits were exhausted, then, as the attachment point for the next layer of insurance in that year was reached, move to the next policy until its liability limits were exhausted.

Id. at 917 (emphasis added).

Courts have recognized that insurers who argue for a horizontal exhaustion rule are, in effect, trying to evade the intent and plain language of policies that afford all sums coverage as described by the Court of Chancery below: permitting the insurer to choose a "single tower of coverage" and "proceed[] up the tower." In *Koppers Co. v. Aetna Casualty & Surety Co.*, for example, the United States Court

of Appeals for the Third Circuit adopted the all sums allocation method, rejecting the insurers' proposal of *pro rata* allocation. 98 F.3d 1440, 1453 (3d Cir. 1996) ("each non-settling insurer whose policy was triggered to cover an indivisible loss is jointly and severally liable, up to the limits of its policy, for the full amount of the judgment . . ."). The excess insurers argued that, despite the all sums ruling, horizontal exhaustion should be required: "*all* applicable primary coverage must be exhausted before *any* excess insurer will be obligated to pay." *Id.* at 1454 (emphasis original). The Third Circuit rejected the excess insurers' argument based on the same authority it cited for its all sums ruling, finding that "[o]nce the *directly underlying coverage* has been exhausted, then, each excess policy must indemnify the insured for the full excess loss up to policy limits." *Id.* (emphasis added). The court noted that this conclusion was compelled in part by the excess policies' language, which, like here, "provided layers of excess liability coverage over certain *specified, underlying* policy limits . . ." *Id.* (emphasis added).

These cases are not outliers. Rather, they represent a consistent line of authority applying vertical exhaustion where the all sums allocation method is adopted. *See Dayton Indep. Sch. Dist. v. Nat'l Gypsum Co.*, 682 F. Supp. 1403, 1411 n.23 (E.D. Tex. 1988), *rev'd on other grounds sub nom. W.R. Grace & Co. v. Cont'l Cas. Co.*, 896 F.2d 865 (5th Cir. 1990) ("once the limits immediately

underlying a given excess policy are exhausted, Grace may call upon that excess policy to provide coverage. Grace, however, is not obligated to first exhaust all underlying insurance in every policy period before it can proceed to obtain indemnification from its excess carriers."); *Cadet*, 391 F. Supp. 2d at 892 ("[horizontal exhaustion] flies in the face of the terms of Granite State's own policies and Washington's law of joint and several liability."). Application of vertical exhaustion was plainly the intent of the Court of Chancery's all sums ruling, which stated that Viking and Warren are entitled to access excess coverage once the *directly underlying* policies are "used up." JA0913-14. And it is how this Court described all sums and vertical exhaustion in *Stonewall.*

Against this weight of authority, the Superior Court wrongly concluded that the Court of Chancery's all sums ruling and its own horizontal exhaustion ruling can be applied harmoniously. Ex. 1, 10/31/13 Op. at 60-61. In straining to harmonize the two concepts, the Superior Court contorted the meaning of all sums allocation so that it bears little resemblance to the Court of Chancery's and this Court's descriptions of it. The Superior Court effectively re-defined all sums allocation so that the rule applies *by layer*. *Id.* at 61 ("[w]ith, the underlying layers gone and the excess triggered, the insured then may choose which excess tower will cover a claim's 'all sums.'"). This was the only way the Superior Court could

reconcile all sums allocation with horizontal exhaustion's requirement that all underlying policies triggered by a loss must be exhausted before an insured can tap any excess coverage. But this is not all sums allocation at all. As both this Court and the Court of Chancery made clear, the insured's rights under all sums allocation include the choice to tap a "tower" of insurance—not a layer—and then proceed "up the tower." *Stonewall*, 996 A.2d at 1259-60; JA0959-61.

The authority cited by the Superior Court to demonstrate this purported harmony does not support its ruling. The Superior Court cited the *Home Insurance* decision in New York as an example of a case that "involved all sums allocation and horizontal exhaustion." Ex. 1, 10/31/13 Op. at 60. However, *Home Insurance* involved injury within a single policy period and the effect of "other insurance" provisions on payments due from multiple insurers covering that same injury and time period. As the Superior Court itself recognized, New York's highest court has expressly held that the effect or application of "other insurance" provisions has nothing to do with the issue of how loss should be allocated where multiple policy periods are triggered by the loss. *See* JA1790 (*citing Consolidated Edison*, 774 N.E.2d at 694) ("'other insurance' clauses [apply] . . . 'when two or more policies provide coverage during the same period'")). By contrast, issues of exhaustion methodology are implicated only in the multi-policy-year context. *See* 2 BARRY R.

OSTRAGER & THOMAS R. NEWMAN, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* § 13.14 (16TH ed., 2013) ("When coverage for more than one policy period is triggered . . . there is a split of authority as to whether an excess insurer is required to respond to the loss before all the available primary coverage has been exhausted (horizontal exhaustion), or whether exhaustion of the underlying primary coverage triggers the excess insurer's policy obligations (vertical exhaustion).")[15]

In its February 28, 2014 clarifying opinion, the Superior Court cited additional authority from California and Illinois in favor of its horizontal exhaustion ruling, but those cases involved materially different contract language and likewise fail to support the court's ruling. The Superior Court cited *Kaiser Cement & Gypsum Corp. v. Insurance Co. of Pa.*, for instance, as an example of a case applying horizontal exhaustion in the context of all sums allocation. JA1786. However, unlike the Joint Excess Policies here, the excess policy at issue in *Kaiser*

[15] The Superior Court's reliance on the Couch insurance treatise is also misplaced. Although the treatise suggests that, after imposing "joint and several liability," some courts have held that "the insured must exhaust all available coverage at the same level before turning to coverage which is secondary to that level," neither of the cases Couch cites for this proposition actually supports it. The first case, *Chemical Leaman Tank Lines, Inc. v. Aetna Casualty & Surety Co.*, applied the *pro rata* allocation method, not all sums. 978 F. Supp. 589, 603-04 (D.N.J. 1997), *rev'd*, 177 F.3d 210 (3d Cir. 1999) (allocating environmental losses "related both to time on the risk and the risk assumed, *i.e.*, proration on the basis of policy limits, multiplied by years of coverage") (citation omitted). The second case, *SwedishAmerican Hospital Association of Rockford v. Illinois State Medical Inter-Insurance Exchange*, involved a loss falling within a single policy period, and the court there made no rulings concerning an allocation methodology. 916 N.E.2d 80 (Ill. App. Ct. 2009).

Cement expressly provided that its coverage obligations were not triggered until exhaustion of the directly underlying policies "'plus the applicable limit(s) of any other underlying insurance collectible by the Insureds." *Kaiser Cement & Gypsum Corp. v. Ins. Co. of Pa.*, 126 Cal. Rptr. 3d 602, 614 (Cal. Ct. App. 2011). And, like courts in Delaware and New York, California gives primacy to the contract language at issue. *Kaiser Alum. & Chem. Corp. v. Certain Underwriters at Lloyd's, London*, Case No. 312415, 2003 Extra LEXIS 174, at *6-7 (Cal. Super. Ct. June 13, 2003) ("The articulated basis in the cases upholding this [horizontal exhaustion] rule is one of contract interpretation. The policies interpreted therein all contained language to the effect that the excess policy was in excess of all other valid underlying insurance, whether or not scheduled."). The Superior Court also cited Illinois law as confirming that "'other insurance' clauses dictate horizontal exhaustion" (JA1787, *citing Kajima Constr. Servs., Inc. v. St. Paul Fire & Marine Ins. Co.*, 879 N.E.2d 305, 308 (Ill. 2007)), despite later recognizing in the same opinion that this is *not* the law of New York: "New York's highest court clarified that 'other insurance' clauses only prevent multiple recoveries 'when two or more policies provide coverage during the same period,' as opposed to successive policies." JA1790, *citing Consolidated Edison*, 774 N.E.2d 687, 694 (N.Y. 2002).

In sum, the Superior Court's horizontal exhaustion ruling not only is inconsistent with the plain language of the policies at issue, it is inconsistent with the Court of Chancery's construction of the policies in its all sums ruling and with the manner in which multiple courts, including this Court, have understood how principles of allocation and exhaustion must work together.

3. New York Law Does Not Require Horizontal Exhaustion

New York law did not compel the Superior Court's horizontal exhaustion ruling. The Superior Court failed to address the plain policy language because of a misplaced notion that New York law somehow requires horizontal exhaustion, without regard to what the contract language actually says:

> While there is policy language supporting Plaintiffs' argument for vertical exhaustion, as a matter of law, New York clearly requires each layer's exhaustion before reaching the next.

Ex. 1, 10/31/13 Op. at 60.[16]

But, as explained above, New York gives primacy to the parties' contract, not to any prescriptive rule of law that ignores their contract. The Court of Chancery understood this in its all sums ruling:

> "[t]his would be a simple case had the New York Court of Appeals adopted a firm position . . . declaring that regardless of what the relevant insurance policies said, New York common law mandated

[16] The Superior Court subsequently clarified its holding only applies to primary and umbrella policy layers. (JA1798; JA1801)

> that one of the particular [allocation] approaches be followed. But the New York Court of Appeals has done no such thing. Instead, that court and other New York state court cases make clear that, in a case governed by New York law, the question of which of the basic methods applies depends on which is the most faithful to the bargain struck by the parties to the insurance contracts at issue."

JA0964-65. "Put bluntly," the court continued, "what is important is which method best honors the parties' agreement." JA0965. The same is true when it comes to exhaustion methodology: New York courts similarly have not adopted horizontal exhaustion as a general rule of law, as the Superior Court suggested. To the contrary, the state's courts have not adopted any rule of common law that imposes an exhaustion scheme on all insurance contracts, let alone in the circumstances involved here—where losses spanning multiple policy periods are allocated under an all sums rule. The Superior Court itself conceded that no New York cases have applied horizontal exhaustion to the situation at issue here:

> Within the concurrent policy context, New York's horizontal exhaustion rule is well-developed. But, *while Illinois and California have expressly applied horizontal exhaustion to continuous injury cases, such as asbestos, New York has not.*

JA1790. (emphasis added) This acknowledgment is critical, because occurrences spanning multiple policy periods present the *only* situations in which a choice between vertical and horizontal exhaustion must be made. The Joint Excess Insurers have conceded as much. In briefing to the Superior Court, they admitted that "horizontal exhaustion applies *only* '[w]hen coverage for *more than one policy*

period is triggered.'" JA1654 (citation omitted) (emphasis added). Commentators agree. *See* BARRY R. OSTRAGER, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* § 13.14 (issue of horizontal versus vertical exhaustion arises "[w]hen coverage for more than one policy period is triggered . . ."); 1 PRACTICAL TOOLS FOR HANDLING INSURANCE CASES § 4:3 (Updated June 2014) ("RULE: Horizontal exhaustion requires each primary insurer to indemnify the insured *in each triggered year of a multi-year time period* to the full extent of its policy limits before requiring contribution of any of the excess policies.") (emphasis added); 4-39 NEW APPLEMAN INSURANCE LAW PRACTICE GUIDE § 39.13[5] (2014) (describing horizontal exhaustion in multiple-policy period context).

While acknowledging that horizontal exhaustion has never been applied in New York to situations involving multiple policy years, the Superior Court nonetheless based its horizontal exhaustion ruling entirely on New York cases involving losses falling within a single policy period. The Superior Court's error lies in the fact that it conflated two distinct concepts: (1) policy priority in contribution disputes among concurrent insurers involving losses suffered by multiple policyholders within a single policy period and (2) exhaustion rules governing losses of a single policyholder spanning multiple policy periods. All of the cases cited by the Superior Court in favor of horizontal exhaustion are in the

former context, and their general statements concerning policy priority have no bearing on exhaustion methodology, particularly under an "all sums" methodology.

American Home Assurance Co. v. International Insurance Co., 684 N.E.2d 14 (N.Y. 1997), for example, involved a first-layer excess insurer's claim for contribution against two higher-level excess insurers *in the same policy year*. The sole issue addressed in *American Home* was whether the higher-level excess insurers could use late notice as a basis for denying coverage where they suffered no prejudice. *Id.* at 15-16. The court's general statements concerning attachment points for excess coverage, which the Superior Court quoted out of context to craft a horizontal exhaustion "rule," were only to distinguish excess policies from policies of reinsurance in the context of the notice-prejudice rule. *Id.* at 17-18.

Home Insurance Co. v. Liberty Mutual Insurance Co., 678 F. Supp. 1066 (S.D.N.Y. 1988), likewise provides no support for the Superior Court's horizontal exhaustion ruling. There, two policyholders who were found jointly liable in a personal injury lawsuit were insured, under different policies, by the same primary insurer. As part of the settlement in the underlying litigation, the primary insurer paid under one of its policyholder's policies, but not the other. The next-layer umbrella insurer also contributed to the settlement and then sued the primary insurer for contribution under its other insured's primary policy. *Id.* at 1068. As

with *American Home*, the loss at issue in *Home Insurance* did not trigger successive policy years, and therefore did not implicate the issue of vertical versus horizontal exhaustion or allocation of loss among multiple triggered policy years.

At bottom, neither of the two New York cases cited by the Superior Court applied horizontal exhaustion in a multi-year context or even endorsed the theory. Neither case addressed the issue of exhaustion methodology for multi-year losses, because neither case involved losses triggering more than one policy period. Accordingly, neither case supports the Superior Court's ruling that New York has adopted horizontal exhaustion as a rule of law.

But even if the contribution cases cited by the Superior Court had any bearing on the issue of horizontal versus vertical exhaustion, they do not support the Superior Court's pronouncement of a rule of law, because—contrary to the Superior Court's ruling—those cases simply are examples of courts interpreting the policy language actually before them as required by New York law, not announcing an abstract legal principle unconnected to the contract language.

The Superior Court's conclusion that horizontal exhaustion is required as a matter of New York law rested principally on the *Home Insurance* decision. The Superior Court quoted *Home Insurance* for the proposition that "'New York courts have consistently found that an umbrella policy is not required to contribute to the

payment of a settlement until all other applicable policies have been exhausted [despite policy language].'" Ex. 1, 10/31/13 Op. at 59-60 (quoting *Home Insurance* with bracketed text supplied by Superior Court, not the *Home Insurance* court) (citation omitted). Setting aside whether *Home Insurance* actually applied horizontal exhaustion (which it did not), the Superior Court's suggestion that the *Home Insurance* opinion created or applied a per se horizontal exhaustion rule "despite policy language"—a phrase coined by the Superior Court, not the *Home Insurance* court—is shown to be error when the original language from the opinion is reinserted to replace the Superior Court's bracketed text. *Id.* The sentence as it appears in the *Home Insurance* opinion reads: "New York courts have consistently found that an umbrella policy is not required to contribute to the payment of a settlement until all other applicable policies have been exhausted *regardless of the wording of those policies 'other insurance' clauses.*" *Home Insurance*, 678 F. Supp. at 1069 (emphasis added).

In its original form, the quotation simply establishes that, as a matter of law, a primary policy's "other insurance" clause cannot transform it into an excess policy—*i.e.*, one that does not apply until primary insurance covering the same time period is exhausted. *See Seneca Ins. Co. v. Ill. Nat'l Ins. Co.*, 2009 WL 2001565, at *5 (S.D.N.Y. July 9, 2009) (describing the holding of *Home*

Insurance: "Under New York law, 'an excess "other insurance" clause will not render a policy sold as primary insurance . . . excess to a true excess or umbrella policy sold to provide a higher tier of coverage . . .'"). This is a much narrower proposition than the one implied in the Superior Court's opinion: in the context of *contribution* disputes between or among insurers, where "other insurance" is at issue—*i.e.*, insurance covering the same risk and time period—an "other insurance" provision in a primary insurance policy may only be applied to other primary policies. [17] Here, Viking is not an insurer seeking contribution from any of the Joint Excess Insurers. It is a policyholder seeking to allocate loss among the Joint Excess Policies' multiple triggered policy years using the "all sums" allocation methodology that the Court of Chancery held applies here. The Court of Chancery expressly recognized that this methodology allows a policyholder to allocate loss vertically, and, as explained in Section IV, above, the "underlying insurance" provisions of the Joint Excess Policies themselves expressly provide that the Joint Excess Policies' coverage is triggered once the *directly underlying* insurance policies are exhausted.

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[17] The "other insurance" clause at issue in *Home Insurance* provided, in relevant part, that "[t]he insurance afforded by this policy is excess insurance, and does not apply to the extent that any other valid and collectible insurance is available to the Insured, whether on a primary, contributory or excess basis . . ." 678 F. Supp. at 1067-68.

The cases cited in the *Home Insurance* opinion likewise highlight the difference between that case's limited ruling and the broad legal pronouncement that the Superior Court made of it. *Home Insurance* cites three cases in support of its ruling that "other insurance" provisions cannot be used to make a primary insurance policy sit above a higher umbrella or excess policy in the same policy period. *Home Insurance*, 678 F. Supp. at 1069. In each case, the court held that an umbrella policy is not required to contribute until underlying policies *in the same policy period* are exhausted. *See State Farm Fire & Cas. Co. v. LiMauro*, 482 N.E.2d 13, 16 (N.Y. Ct. App. 1985) (umbrella policy provides top layer of coverage and is not triggered until exhaustion of directly underlying policies, despite the presence of "Other Insurance" clauses in underlying policy); *Lumbermens Mut. Cas. Co. v. Allstate Ins. Co.*, 417 N.E.2d 66 (N.Y. Ct. App. 1980) (driver's automobile and executive policies must be exhausted before the umbrella policy in the same year is required to contribute to the judgment); *Northbrook Excess & Surplus Ins. Co. v. Chubb Group of Ins. Cos.*, 496 N.Y.S.2d 430 (N.Y. App. Div. 1985) (umbrella policy not required to contribute to personal injury settlement until exhaustion of other policies in same policy period).

Importantly, as New York law requires, the courts in all of these cases based their rulings on the specific language of the applicable policies. *See LiMauro*, 482

N.E.2d at 17 (noting that priority between the policies "turns on consideration of the purpose each policy was intended to serve as evidenced by both its stated coverage and the premium paid for it, as well as upon the wording of its provision concerning excess insurance."); *Lumbermens*, 51 N.Y.2d at 655 (despite "general rule" that "where there are multiple policies covering the same risk, and each generally purports to be excess to the other, the excess coverage clauses are held to cancel out each other . . . ," "this rule is inapplicable to the case before us because its use would effectively deny and clearly distort the plain meaning of the terms of the policies of insurance here involved."); *Northbrook*, 496 N.Y.S.2d at 432 (focusing on policy language that "provides that it 'shall be in excess of, and shall not contribute with' other collectible insurance covering a loss available to the insured, except such as in excess of the limits of the umbrella policy"). Thus, the holdings of the cases underlying the *Home Insurance* decision confirm that the specific wording of a policy is determinative and show that the Superior Court's perception of a general rule of New York law was error.[18]

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[18] Courts outside New York that have actually addressed the issue of whether to apply vertical or horizontal exhaustion to occurrences spanning multiple policy periods have generally done so (a) as a matter of contract interpretation and (b) with specific focus on excess policy provisions addressing exhaustion of underlying insurance. *See, e.g., Kaiser Cement & Gypsum Corp. v. Ins. Co. of Pa.*, 155 Cal. Rptr. 3d 283, 295 (Cal. Ct. App. 2013) (provision requiring exhaustion of "any other underlying insurance collectible by the Insured" referred to "all available primary insurance," which required horizontal exhaustion); *Cmty. Redevelopment Agency v. Aetna Cas. & Sur. Co.*, 57 Cal. Rptr. 2d 755, 761 n.6 (Cal. Ct. App. 1996) ("If an excess policy states that it is excess over a specifically described policy

4. The Superior Court's Horizontal Exhaustion Ruling Deprives Viking of a Shared Insurance Asset

In announcing an exhaustion rule that is at odds with the contract language and nowhere compelled by New York law, the Superior Court endorsed disparate and inequitable treatment of two policyholders that share equally in a limited asset. As a consequence of the Superior Court's horizontal exhaustion ruling, Viking will receive less insurance coverage under the Joint Excess Policies for *ongoing* losses simply because its own *prior* losses are smaller. And, Viking will be forced to continue to consume its limited insurance from the Viking-only primary and umbrella policies in other time periods, while Warren, after principally exhausting the shared Liberty policies and its own independent coverage, exhausts the Joint Excess Policies solely for its own benefit. Warren will thus obtain an ever-larger share of the Joint Excess Policies by virtue of having paid more for prior settlements and thereby exhausting its Warren-only coverage in other policy years. But the claims for which both policyholders seek coverage are and always have

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and will cover a claim when that specific primary policy is exhausted, such language is sufficiently clear to overcome the usual presumption that all primary coverage must be exhausted."); *Kaiser Aluminum & Chem. Corp. v. Certain Underwriters at Lloyds, London*, Case No. 312415, 2003 Extra LEXIS 174, at *6-*7 (Cal. Super. Ct. June 12, 2003) ("The articulated basis in the cases upholding this rule [of horizontal exhaustion] is one of contract interpretation. The policies interpreted therein all contained language to the effect that the excess policy was in excess of all other valid underlying insurance, whether or not scheduled.").

been identical: asbestos claims involving bodily injury during the applicable policy periods.

The inequitable and illogical nature of the court's ruling can be illustrated by a simple example: Assume that both Warren and Viking are sued by the same plaintiff in the same case involving injuries from their products in every year between 1971 and 1985. Each settles the claim for $500,000. Under the Superior Court's rulings, Warren may obtain payment from *any* tower of insurance in *any* policy year between 1972 and 1985, but *none* of those insurers must pay Viking because it has remaining primary insurance in a single applicable year—1971. This disparate and unequal access to the Joint Excess Policies is a direct consequence of the Superior Court's unwarranted application of the horizontal exhaustion rule. Under a vertical exhaustion scheme, Viking and Warren would be equally and currently entitled to access the limits of the Joint Excess Policies. Under the Superior Court's horizontal exhaustion ruling, however, Viking cannot access these policies because its more limited prior losses mean that it still has insurance in other years, while Warren—which has exhausted its other insurance because of larger prior losses—can unilaterally deplete this shared, finite asset. And because Warren has historically sustained much higher losses in asbestos-related litigation than has Viking, the risk grows with each passing day that Viking

will never obtain any benefit from this shared insurance asset. VA150-51; VA221; VA325; VA166-67; VA169; VA172-74.

Because the Superior Court ruling that created this inequitable result was reversible error, this Court should restore these policyholders to their status of equal holders of the Joint Excess Policies by ruling that they are entitled to exhaust their shared insurance on a vertical basis.

CONCLUSION

The Superior Court's horizontal exhaustion ruling should be reversed. The plain language of the Joint Excess Policies clearly supports application of vertical exhaustion—a point the Superior Court conceded. Moreover, the Superior Court's horizontal exhaustion ruling is not compelled by New York law, and it is inconsistent with the Court of Chancery's prior all sums allocation ruling and this Court's own explanation of the interplay between exhaustion and allocation principles in situations involving multiple policy periods.

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Dated: November 6, 2014

CERTIFICATE OF SERVICE

I, Travis S. Hunter, hereby certify that on November 6, 2014, I caused a copy of the foregoing document to be served via File & Serve Xpress upon all counsel of record.

/s/ Travis S. Hunter
Travis S. Hunter (#5350)

CERTIFICATE OF SERVICE

I, Travis S. Hunter, hereby certify that on November 21, 2014, I caused a copy of the foregoing document to be served via File & Serve Xpress upon all counsel of record.

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