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NEW YORK COURT OF APPEALS ROUNDUP

COURT ISSUES TWO INSURANCE DECISIONS

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The Court of Appeals handed down two significant insurance decisions last month. One interpreted a "follow-the-form" clause in an excess insurance policy. The other involved an "other insurance" clause. We discuss these decisions, as well as a decision concerning whether options to renew leases violate the rule against perpetuities.

'Follow-the-Form' Clause

As is common when an insured procures both primary and excess insurance coverage, the excess insurance policy at issue in *Union Carbide Corp. v. Affiliated FM Insurance Co.* contained what is known as a "follow-the-form" clause that incorporates by reference the terms and conditions of the primary policy. Certain insurers on a three-year excess policy asserted that the phrase "subject to the declarations set forth below" limited the policy to providing $30 million in coverage over the course of the policy, despite the fact that the primary policy provided $30 million in coverage for each of the three years. The Court disagreed.

Union Carbide obtained $5 million in primary insurance and numerous layers of excess insurance for the period December 1973 to December 1976. The primary policy referred to an "annual aggregate" of coverage and stated that it limited the insurer's liability for net loss "during each consecutive 12 months of the policy period." The parties agreed that this policy provided $5 million in coverage for each of the three years of the policy period.

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Due to its sale of asbestos, Union Carbide incurred very substantial defense costs and paid out large sums in settlements and judgments. It therefore reached the $30 million fifth layer of excess insurance covering losses between $70 million and $100 million. The fifth excess layer was provided by a subscription policy in which six companies each bore $5 million of potential liability.

Two of the participants in the subscription policy asserted that their liability was capped at $5 million each for the entire three-year period. The policy provided that, "subject to the declarations set forth below…this agreement shall follow all the terms, insuring agreements, definitions, conditions and exclusions of [the] underlying [primary] Policy…." One of the declarations stated that the limit of liability was "$30 million each occurrence and in the aggregate…." According to the insurers, the absence of the word "annual" before "aggregate" meant that the policy did not extend $30 million in coverage each year.

The Court unanimously sided with Union Carbide. Judge Robert S. Smith's opinion for the Court first analyzed the text of the excess policy. The Court observed that there would be no reason for the policy to impose a $30 million limit per occurrence, in addition to in the aggregate, if $30 million was the most the excess insurers would ever have to pay.

The Court held that the follow-the-form clause should prevail, noting that such clauses serve the "important purpose" of allowing an insured to obtain uniform coverage without having to analyze the exact wording of each policy in an insurance tower. "It is implausible that an insured with as large and complicated an insurance program as [Union Carbide] would have bargained for policies that differed, as between primary and excess layers, in the time over which the policy limits were spread."

The opinion also discussed extrinsic evidence without determining whether the policy language was ambiguous, finding such a determination was unnecessary because its textual analysis and the extrinsic evidence led to the same result. Union Carbide submitted both expert testimony that it was industry custom at the time to provide annual limits, and evidence that at least some participants in the subscription policy assumed the limit was an annual one.[1]

'Other Insurance' Clause

In another unanimous decision, the Court determined that the issuer of a commercial general liability (CGL) policy was required to cover the entire defense costs of an action that asserted claims covered both by that policy and by a directors' and officers' liability (D&O) policy, due to the latter's "other insurance" clause.

In *Fieldston Property Owners Ass'n Inc. v. Hermitage Insurance Co.*, Fieldston procured a one-year CGL policy from Hermitage Insurance Company and a three-year D&O policy from Federal Insurance Company. The CGL policy provided primary coverage, except when the insurance was excess over certain types of insurance not relevant to the dispute.

Plaintiff in the underlying action filed against Fieldston and its officers alleged that some wrongful acts were committed during the period covered by both policies and that other acts were committed only within the longer period of the D&O policy. In addition, although several causes of action were solely covered under the D&O policy, one cause of action was clearly covered by the CGL policy and possibly covered by the D&O policy. Hermitage agreed to defend Fieldston, but under a full reservation of rights.

After Fieldston succeeded on its motion to dismiss certain claims, including the one covered by the CGL policy, Hermitage demanded that Federal assume defense of the action going forward, which it did.

Thereafter, two declaratory judgment actions were filed. One was brought by Fieldston in order to establish the insurers' respective responsibilities. The other was brought by Hermitage seeking reimbursement of the defense costs already paid, either in full or in part.

Judge Carmen Beauchamp Ciparick's opinion for the Court noted the distinction between an insurer's duty to indemnify and its much broader duty to defend. It is well established that if any claim against an insured is arguably covered by a policy, the insurer must defend the entire action. As a result, Hermitage was obligated to provide a defense against all claims, including those covered by the Federal policy. The Federal policy provided that its coverage was excess where "any Loss" (defined to include defense costs) from a claim "is insured under any other valid policy(ies)," and Federal therefore had no obligation to reimburse Heritage for any portion of the defense costs at issue.

The Court expressed the view that the result that had been reached by the Appellate Division, namely that Federal reimburse Hermitage for its equitable share of the defense costs, had "much equitable appeal." However, the Court could not re-write the language of the contracts that made Federal's policy excess in these circumstances. In dicta, the Court stated that "Federal would appear to have an obligation to indemnify Fieldston for a greater proportion of the causes of action, if successfully prosecuted."

Option to Renew Lease

The case of *Bleecker Street Tenants Corp. v. Bleeker Jones LLC* was decided under a provision of common law that many practitioners have not had occasion to think about since the bar examination: the rule against perpetuities. The Court's holding that the rule "does not apply to options to renew leases" was criticized both in Judges Susan Phillips Read's concurring opinion and Judge Victoria A. Graffeo's dissenting opinion as an overbroad interpretation of the "American common law rule" codified in New York.

In 1983, the tenant corporation that owned a cooperative apartment building leased the first floor commercial space. The initial lease term was 14 years, with nine consecutive options to renew for 10 years. The agreement called for the landlord to provide the tenant with seven months' notice of the expiration date of a term and the tenant to give six months' notice that it was exercising the option to renew. If the landlord failed to give seven months' notice, at the expiration of the then-current term, the agreement converted into a month-to-month lease. The option to renew did not expire automatically, however. Instead, the landlord was required to give the tenant notice that the option was expiring unless exercised within 60 days. Thus, under the agreement, it was possible for the tenant to exercise an option to renew even after the initial 14-year term ended.

In December 2007, approximately three months after the initial lease term had expired, the landlord brought an action seeking to void the lease under subsections (a) and (b) of EPTL 9-1.1 and the common law. The Supreme Court granted summary judgment for the tenant, but the First Department of the Appellate Division unanimously reversed. The First Department, relying on the fact that the option had not been exercised prior to the expiration of the lease term, concluded that the month-to-month holdover tenancy was not an extension of a pre-existing lease, but created a new lease. Accordingly, the First Department reasoned, the option was not "appurtenant" to the lease and therefore violated the "remote vesting rule" of EPTL 9-1.1(b), otherwise known as the rule against perpetuities. It rejected the landlord's argument that the provision violated the "rule against unreasonable restraints of alienation" of EPTL 9-1.1(a), however. The Court of Appeals addressed only subsection (b) of the statute, and reversed.

The various opinions that were written canvassed treatises, the English and American versions of the common law rule, including cases dating back to the 18th and 19th centuries, New York's very narrow statutory version of the rule adopted in the early 1800s, and the legislative history of the current statute that made clear that, in enacting EPTL 9-1.1(b) in 1966, the Legislature sought to codify the broader American version of the rule. Section 9.1-1(b) provides that no estate in property shall be valid unless it must vest not later than 21 years after any life in being at the time of its creation, plus the period of gestation.

Judge Theodore T. Jones' opinion for the Court noted that options to renew leases in perpetuity have always been considered valid. They encourage tenants to maintain and develop property without interfering with an owner's right to sell it. In contrast, if an owner were permitted to control the ownership of property indefinitely through "dead hand" provisions that allow title to vest an unreasonable amount of time into the future—the evil that the rule against perpetuities was intended to avoid—an owner would have little incentive to maintain and develop property of which it might lose control. The majority stated that an option that can be exercised by a former tenant is not an option to renew because the original lease has already expired. It reasoned that options to renew can only be exercised by current tenants and therefore are inherently appurtenant to the lease, which renders the rule against perpetuities inapplicable.

Both the concurring and dissenting opinions objected to the blanket nature of the majority opinion's pronouncement concerning all options to renew leases. They argued that an option to renew is not necessarily part of the same instrument as the lease itself, and can be drafted as exercisable after the lease term had expired, in which case the option would not be appurtenant to the lease and therefore should be invalid.

The two opinions differed on one point. Judge Read concurred in the result because she concluded that the initial term was still in effect during the month-to-month tenancy based upon the definition of "term" in the lease. Judge Graffeo, however, agreed with the Appellate Division that the lease's term was no longer in effect during the month-to-month tenancy and thus could not be exercised without violating the rule against perpetuities as codified in New York.

Footnotes:

1. The Court also addressed whether a two-month extension of a policy provided a year's worth of additional coverage or merely extended the period during which losses under one year's coverage could be incurred. Because the record on that point was unclear, the Court held that issue could not be decided on a summary judgment motion, and remanded the claim.