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New York's Highest Court Requires Policyholder-Specific Choice-of-Law Analysis by Insurers in Liquidation

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The New York Court of Appeals decision on April 5, in the Midland Insurance Company liquidation (*In re Liquidation of Midland Insurance Company*[1]) is an important affirmation of policyholder rights. In this decision, New York's highest court held that a policyholder is entitled to a claim and policy-specific choice of law analysis in the liquidation process, rejecting the Midland liquidator's effort to make a blanket application of New York law to Midland's 38,000 policyholders. The essential holding of the New York Court of Appeals, i.e., that insolvency does not alter an insurer's obligations to its policyholders, is not itself remarkable. However, this holding by New York's highest court will have broad implications because of New York's status of the domicile of hundreds of insurance companies. And, because this decision is also consistent with the decision of the only other state supreme court to address this question, policyholders may more confidently assert an individualized choice-of-law position when prosecuting claims in insurance company liquidation proceedings.

In liquidation proceedings, policyholders typically are required to submit claims to the liquidator of the insurance company in liquidation, appointed by the state regulatory body of the state in which the insolvent insurer is chartered. An "allowed claim" or "recommended amount" in the liquidation process must typically be approved by a trial court in the state in which the insurance company in liquidation is chartered. This court also hears disputes when a policyholder disagrees with a determination by the liquidator. Frequently, liquidators seek to make a blanket application of the law of the state in which the liquidation is proceeding, not only for administrative reasons but also because the law of such jurisdiction is typically friendly to insurers. New York is a particularly apt example of such a jurisdiction.

Background

Midland Insurance Company is a New York–chartered multiline insurer.[2] When the New York State Insurance Department determined that Midland's liabilities exceeded its assets in 1985, Midland was placed into liquidation pursuant to Article 74 of the New York Insurance Law (Article 74).[3] Pursuant to

1. — N.E.2d. —, 2011 WL 1233571 (N.Y. Apr. 5, 2011).
2. *Id*. at *2.
3. *Id*.

the liquidation order, the Superintendent of the Insurance Department (the Liquidator) took possession of Midland's property and sold or otherwise disposed of it.[4] The Liquidator provided notice to persons with potential claims against Midland, including more than 38,000 known Midland insurance policyholders.[5]

Claimants in *Midland* were policyholders based in various states who submitted proofs of claim to the Liquidator seeking an allowed claim in the liquidation for various environmental and toxic tort liabilities.[6] The Liquidator determined that some of the policyholders' claims should be disallowed, prompting the policyholders to file an objection with the New York Supreme Court.[7] A key aspect of the policyholders' objections was the Liquidator's unilateral decision to make a blanket application of New York law in making its disallowance decisions.[8] The New York Supreme Court disagreed with the Liquidator, concluding that the applicable substantive state law should be decided based on the "grouping of contacts" approach of the Restatement (Second) of Conflict of Laws, and that a choice-of-law determination must be made on a case-by-case basis.[9] Under the "grouping of contacts" analysis, "[i]n the context of liability insurance contracts, the jurisdiction with the most 'significant relationship to the transaction and the parties' will generally be the jurisdiction 'which the parties understood was to be the principal location of the insured risk . . . unless with respect to the particular issue, some other [jurisdiction] has a more significant relationship.'"[10]

The New York Appellate Division reversed. It distinguished the policyholders' insurance claims from claims against solvent insurers, reasoning that New York law must apply to the claims in a liquidation proceeding because of New York's "paramount" interest in ensuring equitable distributions from an insolvent insurer's estate.[11] The Appellate Division voiced concern that to do otherwise would create "subclasses" among the policyholders in violation of New York Insurance Law Section 7434(a).[12]

The Final Decision

On further appeal, the New York Court of Appeals found the Appellate Division's decision to be in error, concluding that each policy in dispute should receive an individual choice-of-law analysis to determine which jurisdiction's law should govern. The Court of Appeals reaffirmed that under New York law, the "center of gravity" or "grouping of contacts" approach applies to choice-of-law when an insolvent insurer is involved.

The Liquidator did not dispute the applicability of the rule to claims against solvent insurers, but argued that Article 74 creates an exception to the rule where the insurer has been adjudged insolvent and is in liquidation.[13] The Court of Appeals performed a thorough analysis of Article 74 and flatly rejected the

4. *Id*. at *3.

5. *Id*.

6. *Id*. at *4.

7. *Id*. at *5.

8. *See id.*

9. *Id*. at *6.

10. *Id*. at *8 (citing *Zurich Ins. Co. v. Shearson Lehman Hutton*, 84 N.Y. 2d 309, 318 (1994) (quoting Restatement (Second) of Conflicts of Laws § 193)).

11. *Id*. at *7.

12. *Id*.

13. *Id*. at *9.

Liquidator's arguments. The court concluded that post-insolvency laws do not address choice-of-law issues or dictate any variation in common law choice-of-law principles when handling claims.[14] The court acknowledged that the policyholders' claims against Midland derived from insurance policies that were issued prior to insolvency and reasoned that, because the "grouping of contacts" analysis would apply to claims submitted to an insurer, there was no reason that claims submitted to a liquidator after the insurer's insolvency should be treated differently.[15] To the contrary, the court recognized that blanket application of New York law to all of the policies would conflict with the statutory mandate that the Liquidator determine the amount "justly owed" to the policyholders because the calculation of what is "justly owed" varies based on different jurisdictions' methodologies of calculating the insured's loss.[16] The Court of Appeals further dispensed with the Appellate Division's concern that to allow individual law choice-of-law analyses would create prohibited "subclasses" of persons entitled to distributions from the liquidations.[17] The court held that the proscription against subclasses applies only to the treatment of claimants at the asset distribution phase, not at the claim allowance or valuation stage.[18]

Thus, through its analysis of the plain language of Article 74, the court concluded that the policyholders are "entitled to an evaluation of their claims by the Liquidator under the same common law choice-of-law principles that clearly applied to their claims prior to Midland's insolvency."[19]

Implications

The holding of *Midland* is consistent with the language of general liability policies and with existing law. [20]

The New York Court of Appeals approvingly cited a 2004 Missouri Supreme Court case that held that "the insurer's insolvency did not change its coverage obligations" and that "insurer insolvency laws did not address choice-of-law and therefore Missouri's pre-insolvency choice-of-law principles continued to govern the insurance policies at issue."[21] With these two state supreme court decisions reaching the same result, policyholders prosecuting claims in insurer liquidation proceedings may confidently assert individualized choice-of-law positions, either on a policyholder-specific, claim-specific, or policy-specific basis, just as they would if they were litigating over coverage in a court of law.

If you have any questions or would like more information on any of the issues discussed in this LawFlash, please contact either of the following Morgan Lewis attorneys:

Washington, D.C.
Paul A. Zevnik 202.739.5755 pzevnik@morganlewis.com

14. *See id.* at *10–*13.
15. *Id*. at *10.
16. *Id*. at *10–*11.
17. *Id*. at *11–*13.
18. *Id*. at *13.
19. *Id*. at *13–*14.
20. *Id*. at *14 (*citing Viacom, Inc. v. Transit Cas. Co*., 138 S.W.3d 723 (Mo. 2004)).
21. *Id*.

Los Angeles
Michel Yves Horton 213.612.7300 mhorton@morganlewis.com

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