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New York's Choice Of Law Doctrine In Coverage Cases Is Moving Inexorably Toward The Site-Specific Approach

By

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COMMENTARY

Insurance practitioners involved in major toxic tort coverage cases know the opening gambit well. Policy holders and insurers race to the respective courts and forums whose choice of law rules and substantive law favor them the most. Both partes then batten down the hatches for the inevitable fight over the appropriateness of the forum, arguing motions under the doctrine of *forum non conveniens*, the existence of jurisdiction, and the panoply of choice-of-law issues.

Though strategies, theories and approaches may vary, one thing remains fairly consistent: Policyholders seek to avoid the application of New York law to their claims, and insurers seek the opposite. New York law does offer its share of (or at least some) pro-policyholder doctrines. Its approach to the owned-property exclusion, the definition of "expected and intended," and what costs are recoverable "as damages" are favorable to policyholders. But by and large, insurers prefer New York for one simple reason: None of these doctrines will ever come into play if the insurer can secure a summary judgement on the basis of late notice. In New York, it often can.

New York has historically refused to consider prejudice when considering whether coverage is barred by the primary insured's late notice. The strict rule under New York law is that if a policyholder fails to give notice of claim "as soon as practicable," it has failed to meet a condition precedent to coverage, and no showing that the insurer has not been prejudiced can remedy this deficiency. *See, e.g., AXA Marine & Aviation Ins. Co. v. Seajet Indus., Inc.*, 84 F.3d 622 (2d Cir. 1996). *But see*, "Should No Prejudice Rule Be Abolished?" *N.Y.L.J.*, January 13, 1997, p. 7.

In the environmental coverage arena, late notice sounds the death-knell for many claims, since the law (i.e., regulatory and coverage) of environmental liability has lagged chronologically behind the acts causing the liability, as well as efforts to remediate the damage.

There are other reasons insurers seek application of New York law. New York is also strongly pro-insurer in interpretation of the standard Commercial General Liability policy language referring to "sudden and accidental" discharges, taking the position that the term has a strictly "temporal" meaning. Thus coverage is available under New York law only where an abrupt, sudden event has caused the environmental damage. *See*, e.g., *State of New York v. Amro Realty Corp.*, 936 F.2d 1420 (2d Cir. 1991); *Avondale Indus. v. Travelers Indem. Co.*, 887 F.2d 1200 (2d Cir. 1989). *But see*, "Today's News Update," *N.Y.L.J.*, September 10, 1996, p. 1 (New York Court of Appeals grants leave to appeal scope of pollution exclusion clause in *Northville Indus. Corp. v. Nat. Union Fire Ins. Co. of Pittsburgh*, 218 A.D. 2d 19, 636 N.Y.S.2d 359 (App. Div., 2d Dept., 1995)). Between the late notice bar and the "sudden and accidental" clause, coverage litigation in New York, under New York law, is usually a worst-case outcome for policyholders.

The substantive law applied to a coverage dispute, of course, should not depend on where it is ultimately tried. Under the well-known rule of *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 61 S. Ct. 1020, 85 L. Ed. 1477 (1941), a federal court sitting in diversity looks to the choice-of-law rules of the forum state. But because New York's choice of law doctrine has consistently resulted in application of New York law in coverage cases, getting into a court located in New York has been a virtual guarantee that substantive New York law would govern. The reason for this is that New York's choice-of-law approach has historically favored the rule of *lex loci contractus*, i.e., that the interpretation of a contract is fundamentally governed by the law of the state where the contract was formed. For more than a century, of course, the headquarters of innumerable far-flung commercial entities have been located in New York. As a result, for decades New York substantive law has been applied routinely to insurance contracts covering non-New York risks.

But New York now seems to be joining the trend toward applying the "law of the site" — the locus of the environmental liability, as opposed to the place of contracting or of the insured's headquarters — to multi-site, multi-state insurance coverage disputes. This doctrine is represented in its purest and most powerful form in New Jersey's *Gilbert Spruance v. Pennsylvania Manufacturer's Ass'n Ins. Co.*, 134 N.J. 96. Policyholders favor it because it often allows them to escape some of New York's more oppressive insurance-law holdings, and argue that it more accurately reflects the expectations of the parties entering into the contract of insurance.[1] Insurers, clinging to *lex loci*, insist that the contracting parties could never have envisioned one insurance contract as being interpreted under the law of dozens or scores of localities.[2]

The Development Of New York's Conflicts Doctrine

New York's conflicts law has been in flux in the decades since *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d99 (1954). One leading scholar has written, "I cannot think of any field of law that has in modern times become as hopelessly jumbled as the present New York law of conflicts." H. Korn, "The Choice-of-Law Revolution: A Critique," 83 Colum. L. Rev. 772,956 (1983).

Through the early part of this decade, a policyholder seeking to avoid the ominous prosect of New York substantive law could urge only the Appellate Division decision *Avnet Inc. v. Aetna Cas. & Sur. Co.*, 160 A.D.2d 463, 554 N.Y.S.2d 134 (App. Div.,1st Dept. 1990) as authority for its view of New York conflicts law. *Avnet*, it could be argued, stood for the proposition that New York was continuing its evolution away from the old rule of *lex loci* and toward a modern "grouping of interests" standard. This is the approach of the Restatement (Second) of Conflict of

Laws (the "Restatement"). *Avnet's* holding was that the mere fact that an insurance contract was issued in New York did not mean that New York was the most appropriate forum for a coverage action. But the decision, made in response to a *forum non conveniens* motion, went no further than that.

Two years later, *Borg-Warner Corp. v. Insurance Co. of North America,* 174 A.D.2d 24, 577 N.Y.S.2d (App. Div., 3d Dept. 1992), explicitly recognized the authority of the Restatement in New York. *Id.* at 30, 577 N.Y.S.2d at 956. Other cases have cited, as settled New York law, the general proposition that the locus of an insured risk is the appropriate determinant of the choice of law to apply to the insurance contract. *See, e.g., Mount Vernon Fire Ins. Co. v. Creative Housing Ltd.,* 797 F. Supp. 176 (E.D.N.Y. 1992); *General Star Indemnity Co. v. Custom Editions Upholstery Corp.,* ___ F. Supp. ___, 1996 WL 578238 (S.D.N.Y., 1996). But the citation to the Restatement in *Borg-Warner* only supported the view that the plaintiff's choice of forum deserves deference, per Restatement § 188(1). And insurers could argue that there was not a single New York decision in a which court applied the law of more than one jurisdiction to a single insurance policy. Nor, until New Jersey's (arguably radical) *Gilbert Spruance* decision, could policyholders point to opinions in other jurisdictions that applied more than two different states' laws to the same contract.

In the last two years, however, the state of the law has changed. The modern approach to conflicts of laws in insurance contracts has now been adopted in two New York cases, one decided in 1994 and one at the end of 1995. These cases have swung New York's choice-of-law doctrine towards the modern approach of the Restatement.

The Restatement Approach To Choice Of Law

Restatement § 188 sets out four factors that, in addition to the plaintiff's choice of forum and the place of contracting, determine which state has the most significant relationship to a contract. These criteria determine which state's laws should apply to interpretation of a contract. The factors are (i) the place of negotiation; (ii) the place of performance; (iii) the location of the subject matter (e.g., the location of the insured risk); and (iv) the domicile or place of business of the contracting parties.[3]

Significantly, there is one more provision of § 188, which reads as follows:

> (3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203. (Emphasis added.)

In late 1994 the Court of Appeals issued its opinion in *Zurich Ins. v. Shearson Lehman Hutton,* 84 N.Y.2d 312, 642 N.E.2d 1065, 618 N.Y.S.2d 609 (1994). In that case, a liability insurer sought a declaratory judgment that its comprehensive general liability ("CGL") policy did not provide damages for punitive damages awarded in other states. In deciding the claim, the court analyzed New York choice-of-law principles as applied to insurance disputes. For the first time, the Court of Appeals recognized the application of § 193 of the Restatement, which the court described as addressing "that special subset of contracts that involves insurance," *Id.* at 318, 642 N.E.2d at 1069, 618 N.Y.S.2d at 613.

In *Zurich,* the court found that the place of negotiation and performance of the contract were the same. Thus the court had to take recourse to the other Restatement sections referred to in § 188(3). The relevant provision there was § 193, which reads as follows:

> **Contracts of Fire, Surety or Cas. Insurance**
>
> The validity of a contract of fire, surety or Cas. insurance and the rights created thereby are determined by the local law of the state which the parties understood was to be the principal location of the insured risk during the term of the policy, unless with respect to the particular issue, some other state has a more significant relationship under the principles stated in § 6[4] to the transaction and the parties, in which case the local law of the other state will be applied.

(Emphasis added.) Official Comment (f) to § 193 adds as follows:

> *Multiple risk policies.* A special problem is presented by multiple risk policies which provide insurance against risks located in several states. . . . Presumably, the courts would be inclined to treat such a case, at least with respect to most issues, as if it involved [multiple] policies, each insuring an individual risk.

Before *Zurich,* no New York case had referred to § 193. But in the *Zurich* decision, the Court of Appeals quoted the passage quoted above and discussed how § 193 would affect the case. *Id.* at 318, 642 N.E.2d at 1069, 618 N.Y.S.2d at 613. The court then contrasted the parties' opposing views of the location of the risk. It ultimately concluded that New York's extant public policy as to the insurability of punitive damages was paramount, and that — for that reason, and not because of the place of contracting — New York law applied.

In *Zurich,* therefore, the New York Court of Appeals explicitly recognized the applicability of Restatement § 193 to New York's choice of law doctrine. Clearly the court was prepared to determine the appropriate choice of law by identifying the location of the risk. It declined to do so only because of New York's current, unambiguous policy forbidding indemnification for punitive damages.

The Witco Case

Since the *Zurich* decision, another New York court has applied the reasoning of § 193 and held that the local law of the sites govern the terms of a CGL policy in a coverage case such as this one. That decision, issued late in 1995, is the first in New York to apply more than two different states' laws to the same insurance contract.

The case is *Aetna Cas. & Surety Co. v. Witco Corp.* (Sup. Ct. N.Y. Co., Index. No. 118985/93-037), a multi-state, multi-site environmental insurance case in New York State Supreme Court in Manhattan. In 1994, Aetna filed for a declaratory judgment that would allow it to avoid paying out on the insurance policies it sold to Witco. The underlying occurrences were claims for environmental damage at 83 sites in 22 states. *Id.,* 8 No. 27 MLRINS 9.

Like any rational policyholder, Witco sought to escape from the New York forum. It moved to dismiss on forum non conveniens grounds. In May of 1994 the court denied Witco's motion. But the rationale of decision was hardly what the carriers expected. The court explained that, essentially, Witco had nothing to fear from a New York forum. Under *Avnet*, wrote Justice Shainswit, New York choice-of-law principles dictated a site-by-site approach:

> It is well settled that claims in environmental insurance coverage litigation such as this are site-specific, and the law of the situs states that necessarily will be relied upon to resolve the parties' contentions. See *Avnet v. Aetna Cas. and Surety Co.* . . . The outcome of each case will vary according to the forum's law, and the result achieved will most significantly affect that particular state's environment.

Witco, Memorandum and Order dated May 9, 1994, at 3; Mealey's Doc. #03-940517-107 (citation omitted).

The *Witco* court distinguished the case before it from *Avnet,* however. It explained that in *Avnet* New Jersey was an obvious alternative forum. In Witco, however, the case could be litigated in any number of possible jurisdictions — none more appropriate than any other. In the interests of judicial economy, and in deference to Aetna's choice of forum, the court held therefore that it would retain jurisdiction and appoint a special master to sort out the state-by-state issues. *Id.* at 4-5. In a subsequent September 15, 1995 order, the court affirmed its earlier choice-of-law decision was not dictum but a controlling ruling.

The choice-of-law ruling in *Witco* is consistent with *Zurich* and Restatement § 193. Applying "the local law of the state[s] which the parties understood was to be the principle location of the insured risk" means applying the law of the sites where the complained-of environmental damage took place.

States' Interests

As the Court of Appeals noted in *Zurich*, important conflicts of policy often underlay conflicts of law. New York retains the right to set aside the grouping-of-contacts analysis of § 188 in order to insure the enforcement of its, or another state's, compelling public policy.[5] *Id.* at 318, 642 N.E.2d at 1069, 618 N.Y.S.2d at 613. Policyholders increasingly argue, however, that New York public policy actually supports the application of the laws of the respective states to environmental sites in their own borders. This effectuates the states' respective policies as to environmental cleanup issues that affect them most. The *Witco* decision put it straightforwardly:

> It is well settled that claims in environmental insurance coverage litigation such as this are site-specific, and the laws of the situs states necessarily will be relied upon to resolve the parties' contentions. See *Avnet v. Aetna Cas. and Surety Co., supra.* In our case, California has more sites involving claims against Witco than any other state, but still less than 20 percent of the claims; New Jersey has approximately 14 percent of the sites; New York has less than three percent. Based solely on the situs criterion, no

> forum has an overriding paramount interest in resolution of all of plaintiff's claims. The outcome of each case will vary according to the forum's law, and the result achieved obviously will most significantly affect that particular state's environment.

(Emphasis added.) The *Witco* court's approach recognizes that jurisdictions are entitled to have their own law applied to environmental cleanup litigation affecting their state. Such a rule is logical, equitable and good public policy.

Enforcing Expectations

Carrying out the parties' intentions, of course, is the prime directive of contract interpretation. It is also the touchstone of the Restatement's conflicts analysis, lately approved in New York.

The traditional, "nationwide standard" thesis is that the parties would expect the law of the state where the contract is negotiated to apply regardless of where a conflict regarding the claim arose. That analysis was rejected by § 193 and, later, by *Gilbert Spruance*. Comment (b) to § 193 explicitly states that the location or locations of the risk are intrinsic to the development of the insurance bargain:

> *Rationale.* The rule of this Section calls for application of the local law of the state which the parties understood was to be the principal location of the insured risk during the term of the policy . . .
>
> A number of reasons serve to explain why such importance is attached to the principal location of the insured risk. This location has an intimate bearing on the risk's nature and extent and is a factor upon which the terms and conditions of the policy will frequently depend. . . . [T]he location of the risk is a matter of intense concern to the parties to the insurance contract. And it can often be assumed that the parties, to the extent that they thought about the matter at all, would expect that the local law of the state where the risk is to be principally located would be applied to determine many of the issues arising under the contract. Likewise, the state where the insured risk will be principally located during the term of the policy has a natural interest in the determination of issues arising under the insurance contract.

(Emphasis added.)

The reasoning of the Restatement rings especially true where the application of the law of a state foreign to the risk, and to the interests of the state where it is located, would eviscerate the bargained-for coverage. Commentary (a) § 188(2) reads as follows:

> Parties entertaining a contract will expect at the very least, subject perhaps to rare exceptions, that the provisions of the contract will be binding on them. Their expectations should not be frustrated by application of the local rule of a state which would strike down

> the contract or a provision thereof unless the expectations of the parties is substantially outweighed by [the public policy exception].

This last paragraph is particularly relevant in the context of the typical New York coverage action, since the insurers' goal is the same one the Commentary abjures. Carriers seek application of New York law precisely because New York's strict legal rules potentially bars coverage in virtually all large-scale toxic tort cases. If indeed the language of this Commentary has been adopted by the New York courts as part of the overall approval of the Restatement, such a development is potentially devastating to this typical insurer stratagem.

Conclusion

The *Witco* and *Zurich* decisions demonstrate that, as New Jersey has done, New York will now apply site-specific local law to insurance claims. This development does more than bring New York into line with a growing number of jurisdictions following the modern Restatement approach. It bodes well for the development of logical policy interpretation that accounts for the parties' expectations. And, ideally, it will reduce significantly the collateral forum litigation that diverts time, resources, and, no less important, attention better spent on resolving the substantive insurance issues in coverage litigation.

ENDNOTES

1. This latter is often proved by producing correspondence denying coverage for an isolated claim based on an interpretation of the insurance policy under the law of the state where the risk is located.

2. There are exceptions to this rule. In *CPC Int'l, Inc. v. Northbrook Excess & Surplus Ins. Co.*, 46 F.3d 1211 (1st Cir. 1995), the plaintiff was a New Jersey-based manufacturer seeking indemnification for environmental cleanup costs. The district court followed New Jersey choice-of-law principles gleaned from then-current case law. The court held that because of the supposed interest in "nationwide" policy interpretation (*see infra*), the place of risk, Rhode Island, did not affect the choice of law. The law of New Jersey, location of the insured's headquarters, was held to govern interpretation of the policy. *CPC Int'l*, 46F.3d at 1213. Shortly thereafter, the New Jersey Supreme Court issued its decision in *Gilbert Spruance*. One of the carriers then petitioned the Rhode Island district court to reconsider its choice-of-law ruling in the wake of *Gilbert Spruance*. The district court held that the change in the law overcame the "law of the case" presumption, and ruled in favor of the carrier that the law of the site (Rhode Island) should apply. 46 F.3d at 1215.

3. These are only slight variations of the factors used by the Southern District in *Olin Corp. v. Insurance Co. of North America*, 743 F.Supp. 1044 (S.D.N.Y. 1990).

4. Section 6 sets out the basic choice-of-law principles of the Restatement.

5. This principle is also recognized by Restatement itself, which throughout § 188 makes repeated reference to the basic Restatement choice-of-law principles found in § 6. Section 6(2)(b) includes consideration of "the relevant policies of the forum" and § 6(2)(c) addresses "the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue." Put otherwise, as the *Zurich* court recognized, the "grouping of contacts" result, including as it does aspects of public policy, can be identical to the "compelling public policy" result. 46 F.3d at 1217. ■