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Expert Analysis

Court of Appeals Clarifies Anti-Subrogation Rule

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Under the terms of many insurance policies, the insurer has a right of subrogation which permits the insurer to seek recovery from a third party who is responsible for the insured loss. "Subrogation: Primer and Recent Environmental Cleanup Cases," New York Law Journal, Volume 253, No. 95 (May 19, 2015). The Court of Appeals has recognized this right on a number of occasions, acknowledging that the insurer can "'stand in the shoes' of its insured to seek repayment from a third party whose wrongdoing caused the loss to the insured which the insurer was obligated to cover." *Jefferson Insurance Co. of New York v. Travelers Indemnity Company*, 92 N.Y.2d 363 (1998). The purpose of subrogation, according to the Court of Appeals, is to "allocate responsibility for the loss to the person who in equity and good conscience ought to pay for it … ." *Millennium Holdings v. The Glidden Company*, 27 N.Y.3d 406 (2016).

The anti-subrogation rule, as one might expect from the title, imposes a limitation on the insurer's right to subrogate. Under that rule, promulgated by the Court of Appeals in 1986, an insurer may not bring a subrogation claim against its own insured for a claim arising from the risk for which the insured was covered under the insurance policy. *Pennsylvania Gen'l Ins. Co. v. Austin Powder*, 510 N.Y.S.2d 67 (1986).

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The anti-subrogation rule has two primary purposes. First, to avoid a conflict of interest that would jeopardize the insurer's incentive to provide a vigorous defense to the insured with respect to the insured claim. Second, to prohibit the insurer from passing on to its insured loss incurred in connection with a risk that the insurer agreed to cover. *Millennium Holdings*, 27 N.Y.3d at 415; *Jefferson Insurance*, 92 N.Y.2d at 374.

In *Millennium Holdings*, a decision issued last May, the Court of Appeals clarified that, except for rare public-policy driven exceptions, in order for the anti-subrogation rule to apply, the party seeking the protection of the rule must be insured under the insurance policy. In so ruling, the Court of Appeals reversed the rulings of the lower courts which, according to the Court of Appeals, would have improperly expanded application of

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the rule to non-insured parties. 27 N.Y.3d at 406.

'Millennium Holdings': Facts

The dispute at issue in *Millennium Holdings* arose out of the complex corporate history of the Glidden Company, which marketed and sold lead paint beginning around 1917. In the late 1960s, Glidden was purchased by SCM Corporation and then, in 1986, SCM Corporation was acquired in a hostile takeover. The takeover and subsequent corporate transactions, which included separation of the business into multiple entities, resulted in a situation where the insurance policies issued to Glidden and SCM during the period from 1962 to 1970 were separated from the Glidden paint business. The paint business was ultimately sold to an entity that became Akzo Nobel Paints (ANP), while the insurance rights were sold to an entity that ultimately became Millennium. In connection with these transactions, the predecessors of Millennium and ANP entered into an indemnification agreement pursuant to which Millennium's predecessor agreed to indemnify ANP's predecessor for certain business-related product liability claims that arose during the period from 1986 to 1994, and ANP's predecessor agreed to indemnify Millennium's predecessor for such claims made after 1994.

Beginning in 1987, numerous lawsuits were filed against the predecessors of both Millennium and ANP alleging personal injury or property damage arising from exposure to lead paint. These lead paint claims implicated the insurance policies issued during the period from 1962 to 1970. Until 1994, Millennium indemnified ANP for these claims under the indemnification agreement, but a dispute arose when ANP refused to indemnify Millennium when the indemnification obligation switched over in 1994. Litigation between Millennium and ANP ensued.

> The takeaway from 'Millennium Holdings' appears to be that the anti-subrogation rule will generally only apply where (1) the defendant is insured under the policy—either as a named insured, an additional insured or in some other manner; and (2) the insurer seeks to enforce a right to subrogation in connection with a risk insured by the policy.

For a period of five years, the insurers of the relevant policies funded the defense of Millennium and ANP with respect to the lead paint claims under an interim funding agreement. In 2000, the insurers terminated the interim funding agreement and filed an action seeking a declaration that ANP was not entitled to coverage under the policies. The Ohio Supreme Court agreed with the insurers, holding that ANP was not insured under the policies, and the insurers stopped paying ANP's defense costs and entered into a new defense funding agreement with Millennium alone.

Millennium then filed an action against ANP seeking to enforce its right to indemnification in the Supreme Court, New York County. The insurers sought to intervene in the action to recover from ANP amounts paid in settlement of certain lead paint cases. Millennium and ANP entered into a settlement resolving their litigation, but the settlement did not address the rights of the insurers.

The insurers asserted a claim for subrogation against ANP, alleging that they were entitled to stand in the shoes of Millennium under the terms of the indemnification agreement entered into by Millennium and ANP's predecessors, and that therefore ANP was required to indemnify the insurers for the amounts paid on behalf of Millennium in connection with the defense and settlement of the lead paint cases from 1994 forward. Id.

Trial Court Decision

Both the insurers and ANP moved for summary judgment before the trial court. The trial court held that it was bound by the Ohio ruling that

ANP was not entitled to coverage under the policies. ANP argued, however, that the insurers' claim for indemnification was nonetheless barred by the anti-subrogation rule. According to ANP, its technical lack of coverage was not fatal to its position, because the insurers were barred from bringing a subrogation claim to recover amounts paid in connection with the very risk insured by the insurers—the risk of liability arising from the marketing and sale of lead paint by the predecessors of Millennium and ANP.

The trial court agreed with ANP, finding that the anti-subrogation rule barred the insurers' claim even though ANP was not insured under the policies. The trial court explained that "ANP's liability arose between 1962 and 1970, when the lead in SCM's products caused property damage. That liability was expressly covered by the subject policies and is the exact liability that the [insurers] do not want to pay for." The court concluded that "[u]nder the principles of subrogation, the [insurers] cannot evade their coverage obligation and 'should not be surprised to pay the claims that [they] covered.'" *Millennium Holdings v. The Glidden Company*, 41 Misc.3d 1231(A) (Supreme Court, New York County, Nov. 25, 2013).

In support of its holding, the trial court relied on the Court of Appeals' ruling in *Jefferson Insurance*, which, according to the trial court, held that an insurance company was barred by the anti-subrogation rule from bringing a claim against the permissive user of an automobile, who the trial court stated was not covered by the policy. *Jefferson Insurance*, 92 N.Y.2d at 373-74. In reliance on *Jefferson*, the trial court determined that the fundamental purpose of the anti-subrogation rule is to prevent the insurer from recovering for "the very claim for which the insured was covered." The First Department affirmed. *Millennium Holdings v. The Glidden Company*, 121 A.D.3d 444 (1st Dep't 2014).

Court of Appeals Reverses

The Court of Appeals disagreed and reversed, holding that the "principal element for application of the anti-subrogation rule" is that the insurer is seeking to enforce its right to subrogation against an insured. Therefore, because ANP was not insured under the policies, the anti-subrogation rule did not apply.

The Court of Appeals explained that the defendant need not be a named insured for the rule to apply, but must be an "insured, an additional insured or a party who is intended to be covered by the insurance policy in some other way." *Millennium Holdings*, 27 N.Y.3d at 406. With respect to *Jefferson*, the court elaborated, "we held that the anti-subrogation rule applied even though the permissive user was not specifically named as an insured or an additional insured … We reasoned that, although the operator was not named on the policy, the operator qualified as an insured because the policy covered permissive users of the vehicle, and that the distinction between a named insured and a permissive user was 'immaterial for purposes of application of the anti-subrogation rule." Id.

The court was careful to explain that *Jefferson* had not extended the application of the anti-subrogation rule to non-insureds, because the vehicle operator was insured as a permissive user. However, the court acknowledged that there have been a few instances where the anti-subrogation rule has been extended to bar claims against third parties who were not covered by the insurance policy based on the public policy of avoiding a conflict of interest between the insurer and the insured.

For example, in *Fireman's Insurance Co. of Newark v. Wheeler*, the Third Department applied the anti-subrogation rule to dismiss a subrogation claim brought by the insurer against the president and principal shareholder of an insured closely held corporation in connection with a claim for loss from a fire at a family-operated brass foundry. 165 A.D.2d 141 (3d Dep't 1991). Although the president

was not specifically named as an insured under the relevant section of the policy, the court extended the anti-subrogation rule to bar claims against him, reasoning that the insurer was presumed to have known the nature of the defendant's relationship to the insured entity and to have understood that the risk of liability extends to the negligence of corporate officers of a closely held corporation.

The court explained that to allow subrogation in such circumstances would pose an inherent conflict of interest. The insured entity has a duty to provide the insurer with full disclosure of information regarding the loss and to cooperate with the insurer with respect to any subrogation rights. Failure to do so could result in the forfeiture of coverage. In *Wheeler*, the president was the individual responsible for providing the insurer with information regarding the fire and was the one who actually signed the agreement, on behalf of the insured entity, providing the insurer with subrogation rights and agreeing to cooperate in the prosecution of any such claims. This placed the president in the "dilemma" of having to "furnish the necessary information" and to "fully cooperate" in the insurer's efforts "to recover the loss from him personally" or to forfeit his corporation's right to coverage. The court found that this would "compromise the integrity of the insurer's relationship with its insured" and refused to allow subrogation. Id. at 145-46.

Likewise, the Court of Appeals referred to *Medical Liability Mutual Insurance v. Schurig,* a case in which the First Department held that public policy considerations prohibited an insurer from subrogating against the insured's own nurse-employee in the context of a medical malpractice action. 211 A.D.2d 518 (1st Dep't 1995).

Finally, the court referenced *Kerr v. Louisville Housing*, a case in which the Third Department affirmed a ruling prohibiting an insurer from asserting a subrogation claim against the insured property owner's property manager. As in *Jefferson*, the anti-subrogation rule applied in *Kerr* because the property manager, although not expressly identified as a named insured, was nevertheless insured under the policy. 2 A.D.3d 924 (3d Dep't 2003).

The Court of Appeals further explained that if it were to "extend application of the anti-subrogation rule to all non-covered third parties, an insurer who fulfills its obligation to pay on the risks insured by the relevant policy would essentially be foreclosed from the ability to subrogate." *Millennium Holdings*, 27 N.Y.3d at 416. Such a broad application of the anti-subrogation rule would swallow the right to subrogation.

Looking Forward

The takeaway from the Court of Appeals' ruling in *Millennium Holdings* appears to be that the anti-subrogation rule will generally only apply where (1) the defendant is insured under the policy—either as a named insured, an additional insured or in some other manner; and (2) the insurer seeks to enforce a right to subrogation in connection with a risk insured by the policy.

In limited circumstances, the anti-subrogation rule might be extended to non-insureds, where allowing the insurer to bring a subrogation claim would create a conflict of interest which would undermine the defense of the insured or its right to coverage. Based on the precedent discussed by the Court of Appeals, however, any such extension to claims against non-insureds is likely to be very narrowly construed.

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