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NEWSLETTER

Insurer Entitled to Allocate Loss Based on "Relative Exposure" Standard

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The New York Supreme Court has held that the terms of a management liability policy allow an insurer to allocate loss between insured and non-insured parties through the application of the relative exposure standard. *Clifford Chance Ltd. Liab. P'ship v. Indian Harbor Ins. Co.*, 2006 WL 3821841 (N.Y. Sup. Ct. Dec. 27, 2006).

The insurer issued a management liability policy to a law firm. The policy contained an allocation provision requiring the parties to "use their best efforts" to allocate loss where a claim is made against both parties insured under the policy and parties who are not insureds. The policy provided that "in determining a fair and appropriate allocation of Loss, the parties will take into account the relative legal and financial exposures of, and relative benefits obtained in connection with the defense and/or settlement of the Claim by the Insured and others."

After 17 partners of another firm, including the second firm's former managing partner, left the second firm to join the policyholder firm, both the policyholder firm and the defecting partners became embroiled in litigation concerning the defection of the partners and the collapse of the second firm. The underlying litigation settled, and the law firm sought coverage for the entire amount of the settlement. The insurer maintained that an allocation of loss was necessary since the 17 defecting partners were not being sued for wrongful acts taken while they were at the policyholder firm.

After the policyholder firm and the insurer could not reach agreement on an allocation, the insurer forwarded a check for 40 percent of the settlement amount. The insurer maintained that this was the proper allocation of the settlement between covered and uncovered loss. The insurer also denied payment for legal fees and expenses over the retention, asserting that any fee in excess of the $2 million retention was allocable to the former managing partner of the second firm, and he was not being sued in his capacity as an insured under the policy issued to the policyholder firm, but rather for actions taken while at the first firm.

The policyholder firm did not dispute the insurer's position that the defecting parties were not insureds. Rather, the policyholder firm argued that the insurer could not require an allocation because of the "larger settlement rule." This rule, applied in cases from the Seventh and Ninth circuits, prohibits insurers from allocating a portion of a settlement to an uninsured party unless the settlement was made larger by the activities of

uninsured parties.

The court denied the policyholder firm's motion for summary judgment, holding that "[i]nsurers are entitled to allocate loss, or settlement costs, between covered and non-covered claims, or parties, where there is a factual basis for the allocation." Although the court noted that there was limited New York law on the subject, it reasoned that the language of the policy at issue "specifically charts a course for application of what some courts and commentators have denominated the 'relative exposure rule'" as articulated by *PepsiCo, Inc. v. Continental Casualty Co.*, 640 F. Supp. 656 (S.D.N.Y. 1986).

The court distinguished cases in which courts from other jurisdictions had applied the larger settlement rule, explaining that the policies at issue in those cases either did not contain allocation clauses or "required the parties to negotiate an allocation, without reference to the method to be employed." "By contrast," the court held, "the Policy in this case contains bargained for language that 'the parties will take into account the relative legal and financial exposures of, and relative benefits obtained in connection with the defense and/or settlement of the Claim by the Insured and others.'" Therefore, the court held that the larger settlement rule was "inapplicable to this case on either the facts or the law."

The court further held that whether the insurance company properly allocated the settlement and costs between insured and non-insured parties was an issue of fact that could not be decided on the basis of the papers submitted in connection with the summary judgment motion.