

## Second Circuit Addresses Coverage Limits Under Stub Policies And Application Of Non-Cumulation Clauses (Insurance Law Alert)

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The Second Circuit addressed the coverage limits available under stub policies, the effect of non-cumulation provisions, and the duty of an excess insurer to “drop down” upon a primary insurer’s insolvency. *Ferguson Enterprises, Inc. v. American Home Assurance Co.*, 2022 WL 2165921 (2d Cir. June 16, 2022).

In this declaratory judgment action, various insurers sought rulings as to their rights and obligations in connection with underlying asbestos litigation. Applying California law, a New York district court granted the insurers’ summary judgment motion as to three issues. The Second Circuit affirmed in part and reversed in part.

### *Stub Policies*

Reversing the district court, the Second Circuit ruled that with respect to three policies, the full aggregate limits were available during stub policy periods.

One policy covered a three-year period and provided a limit of liability of \$10 million “in the aggregate of each annual period.” By endorsement, and in consideration of an additional premium, the policy period was extended by ten days. The endorsement documenting the extension stated that “[a]ll other terms and conditions remain the same.” The court concluded that this language was ambiguous as to whether the ten-day stub period carried with it a full endorsement limit, separate and apart from preceding annual period, or whether it simply extended the annual period. Resolving this ambiguity in favor of the insured’s “objectively reasonable expectations,” the court concluded that the policy had four annual aggregate limits of \$10 million each. Applying the same reasoning, the court deemed a similar extension endorsement in a second policy ambiguous.

A third policy in effect from December 18, 1984 to April 1, 1986, included an aggregate limit of \$5 million “during each policy year.” The court held that the undefined term “policy year” was ambiguous in the context of this 15.5-month policy period. In particular, the court explained that it could be reasonably interpreted to mean no less than 365 days, in which case the policy had only one policy year and one aggregate limit, or conversely, to mean that a new “policy year” begins on each anniversary of the policy’s effective date, such that there were two policy

years (each beginning on December 18) and two aggregate limits. In accordance with the policyholder’s reasonable expectations, the court adopted the latter interpretation.

*Non-Cumulation Provision*

The district court granted an insurer’s summary judgment motion with respect to a non-cumulation provision in its umbrella and excess policies, holding that the policy “clearly and unambiguously limit[ed] the potential liability under both . . . policies and this per-occurrence limit applie[d] across policy periods,” thereby making “[a]ny potential reduction . . . depend[ent] on the limits reached in previous policies.” The Second Circuit vacated the ruling, deeming it unclear in its scope. More specifically, the Second Circuit noted that the ruling was ambiguous as to whether it held, as a general matter, that non-cumulation clauses may be enforced as anti-stacking provisions or that in this particular case, the provision was actually triggered such that aggregate limits under specific policies were reduced by virtue of payments under earlier policies. Finding a lack of factual support for the latter conclusion, the court remanded the matter for further proceedings.

*Drop Down Obligation*

The Second Circuit affirmed the district court’s ruling that an excess insurer need not “drop down” to provide coverage following the primary insurer’s insolvency. The court explained that exhaustion of primary policies, for purposes of triggering an excess insurer’s coverage obligations, occurs by virtue of payment, not insolvency.

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