A COLLISION BETWEEN EXCESS, MARINE, AND LAND-BASED PROPERTY INSURANCE POLICIES AND A DRY DOCK

By: Timothy Semenoro[1]

When applying for insurance, being upfront can matter. The United States Court of Appeals for the Second Circuit recently considered a loss covered by multiple insurance policies issued by several insurers. The insured's failure to be straightforward about the condition of a poorly maintained dry dock proved fatal to coverage.

In *Fireman's Fund Ins. Co. v. Great American Ins. Co.*,[2] the Second Circuit reviewed a dispute between multiple insurers over which of them were obligated to cover the damage to a dry dock and the resulting pollution and clean-up costs. At the District Court level,[3] the primary and excess marine general liability insurer brought an action seeking a declaration that the owner and its excess property policy and pollution policy insurers were responsible for losses associated with the sinking of a dry dock. The parties alleged various cross-claims and counterclaims and, eventually, several motions for summary judgment were filed. The District Court entered summary judgment in favor of the excess commercial property and pollution liability insurers by holding that they were not required to provide coverage. The marine general liability insurer appealed.

The underlying incident involved the sinking of a dry dock in Texas in 2009. The dry dock was built in 1944 for the U.S. Navy to be used to repair military vessels. The owner had leased the dry dock and then acquired it in 2005. Over the course of the lease and ownership, the owner had received several reports on the deteriorated condition of the dry dock. These reports indicated the expected remaining usable life of the dry dock, identified structural issues, noted leaks, and provided recommendations on necessary repairs. In an attempt to implement one of the recommendations regarding the configuration of the pontoons, the dry dock sank. Removal and cleanup efforts were completed in 2012.

At the time of the loss, there were five policies of insurance against risks related to the dry dock: (1) a marine general liability policy issued by Fireman's Fund (as the lead) providing $1 million in coverage per occurrence less a $100,000 deductible; (2) a marine excess liability policy issued by Fireman's Fund (as the lead) providing $25 million in coverage per occurrence; (3) a pollution policy issued by Great American providing $5 million in coverage; (4) a primary property insurance policy issued by Westchester Surplus Lines Insurance Company providing $10 million in coverage; and (5) an excess property insurance policy issued by MSI providing $15 million in coverage. Back in 2009, the dry dock itself was valued at about $13.6 million.

After the loss, the full amount of the primary property insurance policy (from Westchester), i.e., $10 million, and a portion of the excess property insurance policy (from MSI), i.e., $3.6 million less the deductible, were paid to the owner, based on the value of the dry dock because it was a total loss. The excess property insurer (MSI) and the pollution policy insurer (Great American) took the position that they were not obligated to cover the costs of removing the dry dock and cleaning up the site. The general marine insurance underwriter (Fireman's Fund) paid about $12.4 million for the cost of removal and cleanup, but reserved the right to seek reimbursement from the excess property insurer (MSI) and the pollution policy insurer (Great American). Hence, the subject legal actions resulted.

Whether a contract is a maritime contract, and subject to U.S. federal admiralty jurisdiction, depends upon the nature and character of the contract. In the context of an insurance policy, the focus is on whether the insurer assumes risks that are marine risks – risks related to maritime commerce. Coverage under the policy ultimately determines whether the risk is truly maritime in nature. If there is a marine risk, then U.S. federal maritime law controls the interpretation of the insurance contract.

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2 *Fireman's Fund Ins. Co. v. Great American Ins. Co.*, 822 F.3d 620 (2d Cir. 2016).

3 *Fireman's Fund Ins. Co. v. Great American Ins. Co.*, 10 F.Supp.3d 460 (S.D.N.Y. 2014).

Federal maritime law recognizes the doctrine of *uberrimae fidei*, or utmost good faith, which burdens the insured with informing the insurer about any known circumstances that could materially affect the risk being underwritten. This obligation is a continuing one. So, if the circumstance is discovered after having applied for insurance, then the insured must inform the insurer. That said, the standard for disclosure is based on whether a reasonable person in the insured's position would know that the particular fact is material. If known materials facts are not disclosed, intentionally or not, then the marine insurance contract is voidable at the election of the insurer.

As a threshold issue, the Second Circuit confirmed that the dispute was maritime in nature because the sinking of a dry dock impacted the public health, environment, and maritime commerce in the surrounding waters. In addition, the actual dispute concerned information provided to an insurer for coverage of a structure used in the repair and maintenance of vessels.

Regarding the pollution liability policy (from Great American) itself, the Second Circuit determined that it was a maritime contract. The terms of the policy indicated that the insurer meant to underwrite accidental discharge (or substantial threat of discharge) of pollution from a dry dock into navigable waters. The policy also contemplated coverage in light of the Oil Pollution Act (OPA) and Federal Water Pollution Control Act (FWPCA), both statutes are applicable to the pollution of navigable waters. In addition, the policy covered any emissions from vessels being repaired within a 100 mile radius of the dry dock.

Accordingly, the pollution liability policy (from Great American) was subject to admiralty jurisdiction and U.S. federal maritime law, including the doctrine of *uberrimae fidei*. The Second Circuit then went on to find that the owner of the dry dock had breached its duty under *uberrimae fidei* by failing to disclose the poor condition of the dry dock, as revealed by various reports in the possession of the owner, to the pollution liability insurer (Great American). Since this information about the deterioration and unrepaired portions of the dry dock would have influenced a reasonable and prudent underwriter, the Second Circuit confirmed that the unreported information was material and would have been relied upon by the insurer to determine whether accept the risk at all. Hence, the pollution liability insurer could void the policy.

Previously, the District Court had held that the excess property insurance policy (from MSI) was a non-maritime contract and subject to Mississippi State law. On appeal to the Second Circuit, the challenge was whether Texas State law should apply instead and, alternatively, that Mississippi State law was not properly applied. Following a choice of law analysis and determination that Mississippi state law applied to the excess property policy (from MSI), the Second Circuit recognized that, under Mississippi State law, a misrepresentation in an insurance application is material, and can render the policy voidable, if knowledge of the true facts would have influenced a prudent insurer as to whether to accept the risk. Similar to the application of the federal maritime law doctrine of *uberrimae fidei*, the misrepresentation could be intentional or unintentional.

In the end, the Second Circuit found that the owner's application submission included a statement of values (versus the report indicating the dry dock had a negative value); and a report describing the possibility of the dry dock sinking as an extremely low probability. Moreover, the owner had failed to disclose the dry dock's dilapidated state or that repairs were not being made. As such, the Second Circuit held that the owner's failure to disclose these details of the dry dock in its application was a misrepresentation rendering the excess property policy (from MSI) voidable as the insurer was, in fact, induced to underwrite a policy without the benefit of undisclosed material information.

Accordingly, the Second Circuit affirmed the District Court judgments that both the pollution liability policy (from Great American) and excess property policy (from MSI) could be voided by their respective insurers, albeit for different legal reasons, because of the material misrepresentations made by the owner about the dry dock. As a result, Fireman's Fund is out about $12.4 million without the ability to get contribution from the other insurers because they were able to void their policies.

The moral of the story is that the insured needs to be upfront about the condition of the property being underwritten. If US maritime law applies to the policy, then there is a heightened standard to disclose, i.e., *uberrimae fidei*. Some states apply similar doctrines. Assuming the insured was straightforward about the risks and reasonably maintained the property, the policies of insurance should provide coverage as per their contractual terms. Of course, care must always be given to understanding the terms and exclusions of each policy to appreciate where coverage overlaps and gaps exist. ⚖