CHANCES ARE . . . A FORTUITY CASE STUDY

THE INSURER’S PERSPECTIVE

PRESENTED BY:

MYLES A. PARKER, ESQ.
CARROLL WARREN & PARKER PLLC
188 EAST CAPITOL STREET, SUITE 1200
JACKSON, MISSISSIPPI 39201
Introduction

This paper is written in the format utilized for written submissions in London arbitration. The consecutively numbered paragraphs provide a quick and efficient point of reference for the issues addressed.

At the outset, it should be noted that this paper is written with a view towards the fortuity discussion that will take place based upon the involved case study. The analysis is from the perspective of insurer’s counsel, who is tasked with evaluating and defending a large commercial first-party property insurance claim based upon non-fortuity. The thoughts and analysis provided are intended to be thought provoking on the issue of fortuity, and to provide some advocacy insight to the insurance practitioner.

Fortuity – Case Study Concepts

1. In recent years, property insurers have often been reluctant to base a denial of coverage upon lack of fortuity. Courts, brokers, and insurance professionals all seem to frown to varying degrees upon the fortuity defense, as if it is a relic of the past that no longer has application to modern claims. But there are certain scenarios where the defense has merit and should be considered – and perhaps asserted. The case study that we will be discussing provides such a scenario. Without getting into specific factual detail, the general foundation for the potential application of the fortuity doctrine to decline coverage involves an old piece of plant equipment that is being operated by the insured in contravention of industry standards, as well as its own internal operating procedures. Operational deficiencies were known, yet use of the equipment continued. This “reckless optimism” culminates in a fire and explosion, thus leading to a 100 plus million dollar claim for time element losses.

2. Against this backdrop, one should understand that the doctrine of fortuity is a basic concept of property insurance. Historically, issues of fortuity were familiar in cases where the insured intended to harm his own property. Some classic examples are arson of warehouses by impecunious owners and scuttling of ships on behalf of fraudulent ship owners. However, many instances where the doctrine could arguably come into play from the insurer’s perspective are not extreme cases of that kind. In general, it can be assumed with some confidence that an insured does not maliciously cause, for example, its plant to explode intending to cause harm. But when an insured continually fails to take precautions against known risks and a loss results, an insurer is faced with the pivotal question of determining the dividing line between cover and no cover under the fortuity doctrine.

3. In evaluating this question for an insurer, it should be recognized that the intent of first-party property insurance is to insure against accidental risks – not risks which are substantially within the control of the insured. It is one thing for the insured to make a mistake, even if it involves some degree of negligence, resulting in a fortuitous occurrence
of damage. But it is quite another thing to follow a course of conduct which falls well below applicable internal and industry standards, which ultimately results in the property’s failure and loss. Damages resulting from such conduct should arguably fall outside the risk assumed by an insurer, particularly when the course of conduct followed is a course the insured knows is not the ordinary prudent way to proceed and substantially increases the likelihood of loss.

4. In the “reckless optimism” scenario offered by the case study, an insurer may take the position that the insured engaged in the deliberate courting of a known risk by, among other things, operating equipment in a manner that was knowingly contrary to acceptable safe operating procedures, which directly caused the loss. Thus, denial of the claim based upon the fortuity doctrine may be warranted.

Fortuity – The Law

5. All common-law jurisdictions recognize the proposition that insurance policies provide cover only for fortuities. However, common-law courts do not all draw the dividing line between what is and what is not a fortuitous loss in precisely the same place. Rather, different jurisdictions rely on at least four justifications to varying extents to support the fortuity proposition, namely:

   A. As a matter of contractual interpretation, cover is not intended to be provided for losses resulting from misconduct of the insured, which may include deliberate conduct attended by elevated risk;

   B. It is in the very nature of insurance that it covers risks, not certainties;

   C. There is a public policy against allowing an insured to recover under an insurance policy for the consequences of misconduct; and

   D. Conventional insurance practice is that certain matters are not regarded as fortuitous (for example, inherent vice is not conventionally covered by an “all risks” policy).

6. One result of the varying justifications given by courts to support the fortuity proposition is that a range of phrases and terminology is used to express the rule in different contexts. To that end, while courts will naturally tend to choose language apt to the decision of the case being decided, it is important not to mistake a particular expression of the rule for an exhaustive definition of fortuity.

7. In National Union Fire Insurance Co. of Pittsburgh, Pa. v. Stroh Cos., Inc., 265 F. 3d 97, 106 (2d Cir. 2001), the United States Court of Appeals for the Second Circuit described fortuity as a doctrine that holds “insurance is not available for losses that the policyholder knows of, planned, intended, or is aware are substantially certain to occur.” Id. This generic

---

statement sets out the foundational analysis employed by many courts when considering fortuity.

8. The policy involved in the case study requires the application of New York law. Therefore, the fortuity doctrine and its application must be analyzed primarily under New York law as it has been established by the New York Court of Appeals and/or applicable federal courts.

9. New York’s fortuity rule is based primarily on the grounds that insurance is not intended to cover misconduct of the insured, nor is it intended to cover certainties. The three most authoritative guides to New York law on fortuity are:

   A. *Newtown Creek Towing Co. v. Aetna Insurance Co.*, 57 N.E. 302 (N.Y. 1900), where the Court of Appeals determined the limit on the type of causative conduct by the insured that the parties intended to cover;

   B. The provisions of New York Insurance Law § 1101 (McKinney 2011); and

   C. *Consolidated Edison Co. of N.Y. v. Allstate Insurance Co.*, 98 N.Y.2d 208 (N.Y. 2002), where the Court of Appeals determined that the insured had the initial burden of proving a loss was fortuitous.

10. In *Newtown Creek*, the question was whether the loss was within liability cover for accidents caused by collision. The cause of loss was reckless optimism on the part of the insured. The court approached the issue of coverage for such a loss as a question of the proper interpretation of the policy, and decided that coverage was not intended:

    A tug was towing a boat (the McMahon), lashed beside it, at night on a river where there were ice cakes all around. A collision with the ice caused the McMahon to sink. The critical evidence was testimony of the master of the tug:

    A. If we find the ice too heavy or dangerous then we stop.

    Q. Was the ice so dangerous on this occasion that you should stop?

    A. Well, I couldn’t see.

    *Newtown Creek*, 57 N.E. at 303.

11. The court in *Newtown Creek* stated:

    [T]he testimony showed that the master of the tugboat, heedless of the risk incident to an attempt to take a tow through the ice when it was ‘too heavy or dangerous,’ took the chances of forcing the McMahon through in the nighttime, when he could not see, with full knowledge that the ice was all around the boat, ahead of it and behind it, and as the injury came
while the boat was being thus rammed through the ice, it was not caused by a collision within the meaning of the contract in suit.

***

[W]hen the master of the vessel insured designedly takes the chance of running into a perfectly apparent obstruction, although with the hope and expectation that the vessel will successfully meet the encounter, the contact is not a collision within the meaning of the term as employed in this contract.

***

Emerigon . . . states the rule as follows: ‘(1) When a vessel on which I have effected insurance has been damaged by collision with another vessel, or by an anchor, or by a stake, or net, or such like, the insurers are bound to indemnify me for the damage suffered if the action has happened through mere chance (cas fortuit). . . . This rule we conceive to be correct, and, applying it to the facts of this case, we find that the accident did not happen by mere chance . . . .

Id. at 302-03 (emphasis added).

12. The provisions of New York Insurance Law § 1101 provide a codified definition of insurance contracts, for the purpose of the State licensing of insurance companies. Section 1101 provides:

(a) In this article: (1) “Insurance contract” means any agreement or other transaction whereby one party, the “insurer”, is obligated to confer a benefit of pecuniary value upon another party, the “insured” or “beneficiary”, dependent upon the happening of a fortuitous event in which the insured or beneficiary has, or is expected to have at the time of such happening, a material interest which will be adversely affected by the happening of such event.

(2) “Fortuitous event” means any occurrence or failure to occur which is, or is assumed by the parties to be, to a substantial extent beyond the control of either party.

N.Y. INS. LAW § 1101(a) (McKinney 2011) (emphasis added).

13. While the definition under Section 1101 is provided for a particular statutory and regulatory purpose, it is clearly consistent with the Newtown Creek decision. A loss resulting from (for example) a recklessly optimistic course of conduct by the insured is not a fortuitous event within the statutory definition, because such a loss is properly judged not to be substantially beyond the control of the insured.
14. In Consolidated Edison Company, the question that arose in relation to the wording of a number of public liability policies was:

whether the insured (or the insurers) should have the burden of proving that the damage was (or was not) the result of an “accident” or “occurrence” within the meaning of the policies . . . .

98 N.Y.2d at 215 (N.Y. 2002).

15. In deciding that the burden of proof was on the insured, the court stated:

Insurance policies generally require “fortuity” and thus implicitly exclude coverage for intended or expected harms.

Id. at 220.

16. The court then recited the provisions of New York Insurance Law § 1101(a)(1) and (2), and continued:

Thus, the requirement of a fortuitous loss is a necessary element of insurance policies based on either an “accident” or “occurrence.” The insured has the initial burden of proving that the damage was the result of an “accident” or “occurrence” to establish coverage where it would not otherwise exist . . . . Once coverage is established, the insurer bears the burden of proving that an exclusion applies.

Id.

17. The significance of Consolidated Edison Company in relation to the fortuity issue is threefold:

A. The court regarded the provisions of New York Insurance Law § 1101 as a guide to understanding the scope of the policies’ coverage;

B. The court stated that the requirement of a fortuitous loss is a necessary element of insurance policies that are based on accident (as in Newtown Creek) or occurrence (as in the case study); and

---

2 The policies used the express terms “accident” or “occurrence.”
3 The court stated that none of the policies contained an exclusion for intended or expected harm. Consol. Edison Co., 98 N.Y.2d at 218.
4 See also Catalano v. State Farm Ins. Cas. Co., No. 04-CV-452A, 2007 WL 295321, at *4-5 (W.D.N.Y. 2007) (where insured sought coverage for mold damage under property policy covering “accidental” loss, insured had burden of proof to “demonstrate that the loss was fortuitous, or beyond its control,” and insured could not establish coverage because evidence was “uncontroversial that the mold contamination was not caused by a fortuitous event, but was the result of ‘long term moisture problems;’ ‘long-standing moisture migration;’ and a ‘long-standing ventilation problem’ caused by inadequate maintenance”).
C. The court decided that the burden of proof of fortuity was on the insured.

18. It should be noted that the phrase “intended or expected harms” was not stated by the court to be an exhaustive exposition of the boundaries of fortuity, but rather deployed by way of introduction to the definition in the New York Insurance Law. The meaning of that phrase needs to be understood in the light of the Newtown Creek decision and the express language of Section 1101. The insured’s intent is only one aspect of the concept of fortuity.

19. The concept of “control” appears in the wider jurisprudence on the fortuity doctrine. This is conveniently illustrated by reference to Cincinnati Insurance Co. v. Motorists Mutual Insurance Co., 306 S.W.3d 69 (Ky. 2010), where the Supreme Court of Kentucky, in a review of the fortuity doctrine, stated:

   In short, fortuity consists of two central aspects: intent, which we have discussed in earlier opinions, and control, which we have not previously discussed.

   Id. at 74.

20. Because of the centrality of “control,” the Motorists Mutual court decided that faulty workmanship by the insured, although unintended, was under the insured’s control and was not an insured occurrence under a commercial general liability policy. With respect to this concept, it is important to note that in New York, the concept of control has been expressly incorporated into the fortuity doctrine, qualified by the phrase “to a substantial extent.”

   This concept is readily understood by comparison with the expression “mere chance” adopted in Newtown Creek. An event, which is to a substantial extent within the control of the insured, is not an occurrence that happens by mere chance.

21. In Northwestern Mutual Life Insurance Co. v. Linard, 498 F.2d 556 (2nd Cir. 1974), the United States Court of Appeals for the Second Circuit properly stated:

   In all contracts of insurance, there is an implied understanding or agreement that the risks insured against are such as the thing insured, whether it is property, or health, or life, is usually subject to, and the assured cannot voluntarily and intentionally vary them.

   Id. at 564 (emphasis added).

22. This rationale, as explained in Northwestern Mutual, provides additional reasoning for interpreting the intent of the parties to a contract of insurance in the manner indicated in Newtown Creek and New York Insurance Law § 1101. Where the assured knowingly adopts a course of conduct which increases the risk of loss beyond the risks which the insured property is usually subject to, that constitutes a voluntary and intentional varying of the risk. A loss resulting from such conduct is substantially within the control of the insured, and is therefore outside the intended cover of the policy.

   ———

   See Petro, Inc. v. Serio, 804 N.Y.S.2d 598 (N.Y. Sup. Ct. 2005) for a case applying the “substantial control test.” Under the test, “an event is deemed fortuitous if its occurrence is beyond the substantial control of either party.” Id. at 608.
23. In most instances, an insured’s contention as to fortuity under New York law will differ considerably from the above concepts. For example, an insured will likely assert that a loss – such as the equipment failure in the case study – is fortuitous unless the insured: (a) knew, before the policy went into effect, the loss event was inevitable;\(^6\) or (b) intended the loss event to occur;\(^7\) or (c) knew the loss event would occur as a direct and immediate result of the insured’s intentional acts.\(^8\) While these expressions of what is required to prove non-fortuity may be valid examples, they do not exhaustively define the situations where a loss is regarded as non-fortuitous under New York law. Indeed, these expressions have a narrow focus upon the state of mind of the insured without considering the broader question whether the loss is, to a substantial extent, beyond the control of the insured.

24. Further, insureds often contend that New York law imposes a “fairly light” burden on the insured of showing that losses were fortuitous, and that, in the event of such a showing, the burden shifts to the insurer to overcome that showing by producing sufficient evidence the losses were not fortuitous. The United States Court of Appeals for the Second Circuit used the expression “relatively light” in *International Multifoods Corp. v. Commercial Union Insurance Co.*, 309 F.3d 76, 83 (2nd Cir. 2002).\(^9\) The point being made by the use of the expression “relatively light” was that under an “all-risks” policy the insured “needs only to show a fortuitous loss; it need not explain the precise cause of the loss.” Id. at 84.

25. It is correct that an insured, in order to obtain cover under an all risks policy, need not explain the precise cause of the loss. However, the insured does have to show that the loss is fortuitous.\(^10\) There is no burden on an insurer to disprove fortuity. Nevertheless, in practice, as well as in the case study, the insurer should be prepared to present substantial evidence of non-fortuity.\(^11\)

---

\(^6\) See 40 Gardenville, LLC v. Travelers Prop. Cas. of Am., 387 F. Supp. 2d 205 (W.D.N.Y. 2005) (rejecting insurer’s fortuity defense because evidence did not show insureds “knew when they procured the policy that mold contamination existed or was substantially certain to occur.”)

\(^7\) See Highland Capital Mgmt., L.P. v. Global Aerospace Managers Ltd., 488 Fed. App’x 473, 475-76 (2d Cir. 2012) (finding all risks policy covering “direct and accidental physical loss” to aircraft did not cover co-insureds’ claims because “airframe and engine losses . . . were caused by the intentional misconduct of plaintiffs’ coinsured” and thus “the damage was not fortuitous”).

\(^8\) See *In re Margulies*, No. 16 Civ. 2643 (KPF), 2017 WL 1049548 (S.D.N.Y. Mar. 20, 2017) (“[T]he incident was not ‘to a substantial extent beyond the control of either party.’ [Insured] was in control of his car, had the capacity to use his brakes, and chose not to do so. The situation was well within his capacity to avoid.”).


\(^10\) *National Union Fire Ins. Co. of Pittsburgh, PA v. Turner Construction Co.*, 986 N.Y.S.2d 74 (N.Y. App. Div. 2014) (“[T]he addition of ‘event’ or ‘happening’ to the definition of ‘occurrence’ [does] not alter the legal requirement that the ‘occurrence’ triggering the coverage must be fortuitous . . . [but] was developed by the insurance industry ‘to provide clearly for coverage of gradual, continuous, and prolonged events that might have been excluded by the instantaneous connotation of ‘accident.’ Thus the addition . . . does not change the fact that fortuity is still an essential consideration.”).

Fortuity – Conclusion

26. An insurer receives premiums for insuring the insured’s property against fortuitous “occurrences,” not from deliberately reckless acts or operations performed at the behest of the insured. If the insured cannot credibly demonstrate that the loss happened through “mere chance” or that the loss was “to a substantial extent beyond the control” of the insured, an insurer may reasonably deny the claim under the fortuity doctrine.

27. In the case study, the loss in question was arguably not fortuitous. Rather, it was an incident that could and should have been foreseen by the insured as likely to occur due to the reckless manner in which the plant operations were being carried out. The event leading to the loss was to a substantial extent within the control of the insured – and did not result by mere chance.

28. We are hopeful that the issues and discussion presented provide some practical insight into establishing a meaningful and compelling fortuity defense. Ultimately, each case will turn upon the unique facts and circumstances involved, and how they are developed – and more importantly – presented by counsel.