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Continental Insurance: Insureds Strike Gold In California

Stephen A. Klein

HOLLINGSWORTH LLP

For two decades, courts have struggled with how to allocate long-tail environmental liabilities, asbestos claims and similar mass torts across the multiple years of insurance coverage triggered by such claims. The language of the standard commercial general liability ("CGL") policy does not neatly answer the question. Some jurisdictions, seeking a seemingly "equitable" result, have adopted a "pro rata" allocation, in which the loss is spread evenly over all triggered years – including years in which the policyholder has no coverage. Not surprisingly, this result generally is favored by insurers. A slightly smaller number of states, focused on staying true to the standard policy language, have adopted an "all sums" approach, under which the entire loss may be allocated to a single policy year for payment up to full policy limits, with no allocation to uninsured years. But few jurisdictions have adopted what can be called, with only slight hyperbole, the holy grail of allocation outcomes for policyholders – an all sums approach with "stacking," which permits a policyholder to access the full limits available in as many triggered policy years as needed to cover the entire loss.

Add one more jurisdiction to those ranks. In an important decision handed down in August, the California Supreme Court reaffirmed the state's all sums allocation rule and for the first time permitted a policyholder to stack available policy limits, providing much-needed clarity on a question over which the lower courts in the state long had been divided. *State v. Continental Insurance Co*., 55 Cal. 4th 186 (2012). This decision could significantly benefit corporate policyholders with environmental liabilities or significant asbestos exposure in California – and elsewhere. Without stacking, an insured under an all sums allocation scheme at most could recover the maximum policy limits purchased in any single triggered year. With the ability to stack limits over 10, 20 or 30 years of triggered policies, the total available insurance may have increased overnight by one or more orders of magnitude. So dig out and dust off those liability policies purchased in the '50s, '60s and '70s – they just became substantially more valuable.

Stephen A. Klein

Stephen A. Klein is a Partner at Hollingsworth LLP in Washington, DC. Mr. Klein has represented corporate policyholders for nearly 20 years in complex coverage matters involving a variety of coverages, including general liability, specialty pollution, D&O, E&O, fidelity, and surety bonds. Please visit http://www.metrocorpcounsel.com/articles/21090/continental-insurance-insureds-strike-gold-california for the footnotes to this article.

The Basis For "All Sums" And Pro Rata Allocation

From a textual perspective, the allocation debate turns on whether the concepts of "trigger" and "scope" are viewed as distinct. The term "trigger" does not actually appear in the standard CGL policy, but rather is "a term of 'convenience used to describe that which . . . must happen in the policy period in order for the *potential* of coverage to arise.'"[1] "Scope" refers to how much of a loss a policy, once triggered, will pay. Proponents of pro rata allocation see these questions as overlapping, whereas backers of "all sums" view them as distinct.

The standard CGL insuring agreement generally provides as follows:

> The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies, caused by an occurrence.[2]

An "occurrence," in turn, generally is defined, as in the policies before the California Supreme Court, as "an accident or repeated exposure to conditions which result in damage to property *during the policy period*."[3] Under this definition, there must be covered bodily injury or property damage (including environmental contamination) during the policy period, and any policy during which such injury or damage occurs is triggered. Thus, for example, the continual release of pollution from a waste facility over 20 years constitutes an occurrence that triggers the policies in place during each of those years.

But what share of the liability does each triggered policy pay? The language in the standard insuring agreement states that each policy will pay "all sums" for which the policyholder is legally liable. But the pro rata approach construes the insurer's promise to pay "all sums" as modified by the language in the definition of "occurrence" requiring property damage "during the policy period." That is, property damage during the policy period not only triggers the policy, it also defines the scope of what is covered – the insurer has not promised, under this interpretation, to pay "all sums" for property damage arising from a triggering occurrence, only "all sums" for that property damage during the policy period.

Recognizing the impossibility in most cases of tying contamination at a site many years later to specific releases during particular policy periods, some courts utilize a simple pro rata allocation as a (very) rough approximation of the property damage occurring during a particular policy period, which such courts believe is the most equitable method of ensuring that each policy pays no more than its proportionate share of the loss.[4]

The "all sums" approach, which has long been the rule in California,[5] rejects this analysis. As the *Continental Insurance* court explained, the CGL policy requirement for property damage "during the policy period" appears in the definition of "occurrence," not in the policy's insuring agreement (the

Please email the author at sklein@hollingsworthllp.com with questions about this article.

insurer's basic promise of coverage), and thus is "neither logically [n]or grammatically related to the 'all sums' language in the insuring agreement."[6] The pro rata construction, under which the policy does not cover property damage occurring before or after the policy period, "would unduly restrict [the insurers'] agreement to pay 'all sums' the insured is obligated to pay for damages."[7] In other words, the requirement for property damage during the policy period is a function of trigger alone; once triggered, the policy's "scope" is determined by the "all sums" language in the insuring agreement. As the California Supreme Court notes, a growing number of states have adopted this interpretation.[8]

Continental Insurance Adopts Stacking

Though California clearly was in the "all sums" camp, the appellate courts in the state had diverged on the related question of whether a policyholder could stack the limits to receive "all sums" up to policy limits of multiple triggered policies.[9] The rationale against stacking: permitting access to multiple per-occurrence limits under multiple policies for a single (albeit multi-year) occurrence supposedly would provide the policyholder with more coverage than it paid for.[10]

The California Supreme Court disagreed. It found that the standard policy language permits stacking and expressly disapproved *FMC*. 55 Cal. App. 4th at 201. The opinion does not provide an in-depth analysis, but the court's rationale flows naturally from the two policy interpretations it previously had adopted, i.e., the continuous injury trigger and the "all sums" scope. Applying these twin concepts, there is no basis *not* to require every triggered policy, in succession, to pay that which it had individually promised in its insuring agreement – "all sums" up to policy limits. Hence, stacking. *See id*. ("The all-sums-with-stacking indemnity principle properly incorporates the *Montrose* continuous injury trigger of coverage rule and the *Aerojet* all sums rule").

The court also found that the equities favor stacking. Otherwise, the policyholder would not receive the full limits for which it paid, and insurers would obtain an unwarranted benefit from the policyholder's purchase of multiple years of coverage. A policyholder should not be *disadvantaged* by acting responsibly and purchasing coverage in successive years. Stacking, the court found, thus comports with the parties' reasonable expectations. It is the appropriate result, both from a textual and equitable perspective.[11]

The Impact – Significantly More Coverage Under Past Policies

Continental Insurance should have a substantial and far-reaching effect on the extent to which historic long-tail liabilities are covered. Not only does stacking increase, perhaps dramatically, the available limits in covered years, it does so without requiring the policyholder to assume a share of the loss for "triggered" years in which it has no coverage (either because it did not purchase coverage or because its insurer for that year now is insolvent, a not-uncommon scenario facing many U.S. corporate policyholders).

A simple example illustrates the potential significance of the decision. Assume a long-tail environmental claim arising from contamination over a five-year period, which will cost $30 million to remediate. The policyholder's coverage program is as follows:

Year 1: $1 million per-occurrence
Year 2: $5 million per-occurrence
Year 3: $5 million per-occurrence
Year 4: $20 million per-occurrence
Year 5: No coverage/Insolvent coverage

Under a pro-rata allocation, the $30 million loss is evenly spread across the trigger period, including Year 5 in which the policyholder has no effective coverage, resulting in an allocation of $6 million of loss to each year. Thus, the policyholder recovers only $17 million of its $30 million loss ($1 million in Year 1, $5 million in Years 2 and 3, and $6 million in Year 4). The policyholder fares slightly better under an *FMC*-style all sums allocation without stacking – it would select the Year 4 policy to respond and would recover $20 million. But with stacking, the policyholder can recover its full loss – after the Year 4 policy pays its full limits of $20 million, the policyholder then can require the Years 2 and 3 policies to pay their full limits of $5 million each.[12] Thus, under *Continental Insurance*, the coverage available to this hypothetical policyholder increased by 50 percent or more.

Given the power of an all-sums-with-stacking result, insurers undoubtedly will seek to minimize the reach of the California Supreme Court's decision. Insurers can be expected to contest choice of law in coverage disputes with renewed vigor. But even for liabilities in other states, *Continental Insurance* may reverberate well beyond California's borders. The nation's most populous state always has outsized influence, and the decisions of its high court are no exception. The California Supreme Court has been identified as the most influential state supreme court in the nation – by a significant margin – based upon the rate by which its decisions are followed by courts in other states.[13] California jurisprudence has been particularly influential in the field of insurance coverage – the Supreme Court's *Montrose* decision, for example, which was one of the early groundbreaking decisions regarding the continuous injury trigger, has been cited in judicial opinions, according to a recent legal database search, nearly 400 times.

But Will Insurers Close The Door Going Forward?

Many observers have predicted that the insurance industry will attempt to undo the *Continental Insurance* decision for new policies by adding antistacking language to the standard CGL form. The California Supreme Court all but invited this outcome, noting that the one "caveat" to its ruling was that it expressly "contemplates" such a response by insurers.[14] Though courts have been split over the enforceability of past anti-stacking-type provisions,[15] the California Supreme Court strongly signaled it is likely to uphold the validity of new anti-stacking language: "Of course, in the future, contracting parties can write into their policies whatever language they agree upon, including limitations on indemnity, equitable pro rata coverage allocation rules, and prohibitions on stacking."[16]

But for most interested parties, the effect of *Continental Insurance* on the available coverage under past policies far outweighs the potential curtailing of stacking in future coverage. Some of the most consequential long-tail claims for U.S. industry, including pollution, asbestos and silicosis, generally have been excluded from CGL coverage for many years with the advent of policy exclusions addressing those specific hazards; the ability to stack limits in new policies thus will have a limited impact.

Without doubt, the real effect of the California Supreme Court's ruling will be on the value of past coverage that companies purchased years ago. Indeed, in the wake of the decision, one financial consulting firm is advising insurers and reinsurers to "conduct an inventory of pre-1986 [CGL] and excess policies . . . [and] quantify their exposure and review their reserves for pending long-tail asbestos and environmental claims," and correspondingly, advises that for policyholders, the ruling "will potentially reduce corporate self-insured reserve exposure" for such claims.[17]

That is sound advice. *Continental Insurance* has altered the landscape for the coverage of older long-tail claims, certainly in California and potentially beyond. Both policyholders and insurers are well advised to re-evaluate their exposure for such claims in light of the potential availability of stacked policy limits; policyholders may find that their pool of available coverage for such claims suddenly has grown.