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# Where Is The Pro Rata V. All Sums Debate Today?

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In its seminal Boston Gas decision five years ago, the Massachusetts Supreme Judicial Court adopted a pro rata approach to allocation of indemnity costs of long-tail insurance claims. Boston Gas Co. v. Century Indem. Co., 454 Mass. 337 (2009). However, the court made clear that it was not addressing the allocation of defense costs, and insurers and policyholders have continued to struggle with that issue.

Hugh Scott

A recently filed case in federal court in Boston, Continental Insurance Company v. Eckel Industries, No. 14-cv-13630 (D. Mass. filed Sept. 15, 2014), squarely presents the question of how defense costs should be allocated for long-tail claims and holds the promise of providing authoritative guidance on the issue.

Continental's complaint seeks a declaration that it is obligated to pay only its pro rata share of Eckel Industries' defense and indemnity costs associated with hundreds of asbestos bodily injury cases pending in multiple jurisdictions. In 1997, Eckel and its insurers, including Continental, entered into an interim defense agreement, under which the insurers agreed to a temporary allocation of defense costs. In November 2013, Continental informed Eckel that it was terminating its participation in the interim defense agreement and that, effective Jan. 6, 2014, Continental would pay only its pro rata time on the risk share of Eckel's defense and indemnity costs for the underlying bodily injury cases. Eckel disputes that Continental's obligations are limited to its pro rata share of the defense and indemnity costs, and Continental has filed suit seeking declaratory judgment to resolve that issue.

**All Sums vs. Pro Rata**

More than 30 years ago, two federal appeals courts articulated two polar opposite approaches to allocation of defense and indemnity costs arising from so-called long-tail claims under standard commercial general liability policy language. Long-tail claims typically allege damage or injury which occurs continuously or progressively over a number of years, such as environmental clean-up claims and asbestos bodily injury claims. When such claims trigger a number of insurance policies, the issue of how to allocate defense and indemnity costs among those policies arises.

In 1980, the Sixth Circuit in the Forty-Eight Insulations case adopted the pro rata allocation method. Ins. Co.

of N. Am. v. Forty-Eight Insulations Inc., 633 F.2d 1212 (6th Cir. 1980). This method allocates defense and indemnity costs among all years in which the damage or injury occurred, generally using one of two formulas: either percentage of "time on the risk" or percentage of "years plus limits." Under most applications of the pro rata method, the insured is on the hook for costs allocated to periods during which it was uninsured. This method is generally favored by insurers.

In 1981, the D.C. Circuit in the Keene case adopted the all sums allocation method, sometimes referred to as "joint and several liability." Keene Corp. v. Ins. Co. of N. Am., 667 F.2 1034 (D.C. Cir. 1981). This method allows a policyholder to select the tower of policies in a single triggered policy year to pay all defense and indemnity costs in full, up to their policy limits. If this is insufficient to pay all of the insured's costs, some applications of the all sums method allow the insured to "stack" coverage by selecting an additional policy year or years to pay the remaining costs. Usually, the insurers who have been selected can then bring suit against the other responsible insurers for contribution. This method is generally favored by insureds.

**The Case for Pro Rata Allocation**

Advocates for pro rata allocation and courts that have adopted that approach tend to focus on four general arguments.

***Policy Language***

The insuring clause of a standard CGL policy typically provides coverage for "all sums which the insured shall become legally obligated to pay as damages because of" either, in some policies, "an occurrence," or, in other policies, "property damage to which this policy applies." The policy language goes on either, in the first instance, to define an occurrence as being an event that results in "damage during the policy period" or, in the second instance, to state that the policy applies only to "damage which occurs during the policy period." In other words, the plain text of the coverage grant and its modifying clauses limits coverage to damage "during the policy period." No costs for damage outside the policy period are covered.

***Equity and Public Policy***

All sums allocation of costs reduces the incentive of property owners or manufacturers to purchase insurance, because it permits policyholders to recover all their costs incurred over a number of years from a one-year policy. By allocating the costs incurred in uninsured years to the insured, the pro rata method encourages the purchase of adequate insurance. As the Forty-Eight Insulations court noted, "[W]ere [it] to adopt [the insured's] position on defense costs [an insured] which had insurance coverage for only one year out of 20 would be entitled to a complete defense of all asbestos actions the same as [an insured] which had coverage for 20 years out of 20." The all sums method of allocation ignores and rewards the insured's decision not to purchase insurance and disregards the benefit of the bargain to which both insurers and policyholders agree when they enter into an insurance contract. The pro rata method is more equitable.

***Judicial Economy***

The Boston Gas court recognized that adopting the pro rata approach promotes judicial economy. The all sums approach is inefficient because it does not solve the problem of allocation among insurers, but merely postpones the decision to a contribution action. This bifurcation results in increased litigation costs, which are then passed onto policyholders via higher premiums. In contrast, the pro rata approach resolves all coverage and allocation issues in a single proceeding.

### *Reasonable Expectations*

Applying the pro rata method of allocation comports with the reasonable expectations of the insured. In adopting the pro rata method for allocating defense costs, the Connecticut Supreme Court found that "[n]either the insurers nor the insured could reasonably have expected that the insurers would be liable for losses occurring in periods outside of their respective policy coverage periods." Sec. Ins. Co. of Hartford v. Lumbermens Mut. Cas. Co., 826 A.2d 107, 121 (Conn. 2003). Similarly, the Boston Gas court stated that the pro rata allocation of indemnity costs conforms with the expectations of the insured.

## The Case for All Sums Allocation

Advocates for all sums allocation and courts that have adopted that approach tend to focus on three general arguments.

### *Policy Language of the Coverage Grant*

The Keene court focused on the policy language stating that the insurer will pay "all sums" which the insured becomes legally obligated to pay and concluded that "once coverage is triggered ... the insurer is liable in full" for an insured's liability because "[t]here is nothing in the policies that provides for a reduction of the insurer's liability if an injury occurs only in part during a policy period." In arriving at this conclusion, the court ignored the policy language that plainly limits coverage to damage occurring during the policy period. In rejecting the all sums approach, the Connecticut Supreme Court stated that it "cannot torture the insurance policy language in order to provide [the insured] with uninterrupted insurance coverage where there was none." Nonetheless, advocates of the all sums approach continue to rely on the two words "all sums" in the coverage grant.

### *Policy Language Regarding the Duty to Defend*

The Keene court adopted the all sums approach to defense costs based, in part, on policy language requiring the insurer to defend "any suit" against the insured seeking damages, even if the suit is groundless, false or fraudulent. The court read this language as making the duty to defend broader than the duty to indemnify.

### *Broad Duty to Defend Both Covered and Noncovered Claims*

All sums advocates point to a body of cases holding the duty to defend is sufficiently broad that, when one count of the complaint is within policy coverage and other counts are not, the defense obligation extends to both covered and noncovered counts. By analogy, in the context of long-tail claims, the broad duty to defend applies not only to claims of damage during the policy period, but also to claims of damage outside the policy period.

## Score Card

Three decades after Forty-Eight Insulations and Keene, the pro rata approach appears to be winning. For indemnity costs, pro rata allocation has been adopted by the supreme courts of at least 12 states and all sums allocation has been adopted by at least seven.

For defense costs, the Supreme Court of New York has concluded that either pro rata or all sums allocation may be appropriate depending on the circumstances. Pro rata allocation has been adopted by the supreme

courts of at least four states — Vermont, Connecticut, Utah and New Jersey — and all sums allocation has been adopted by the supreme courts of at least two states (Wisconsin and Pennsylvania).

**Will Eckel Resolve the Defense Costs Allocation Issue Under Massachusetts Law?**

Since the Massachusetts Supreme Judicial Court did not address allocation of defense costs in the Boston Gas case, it is unclear how it would resolve that issue. Consideration of how to allocate defense costs implicates policy language not relevant to the indemnity costs analysis — the obligation to defend "any suit" language. In distinguishing a First Circuit case applying the all sums approach to allocation of defense costs under Rhode Island law, the Massachusetts SJC quoted in Boston Gas the First Circuit's statement that "there is no connection between limiting coverage by the policy period and the amount of defense costs." This suggests that the SJC may not simply extend pro rata allocation to defense costs, but instead engage in an independent analysis of the issue. That said, the Massachusetts SJC's three primary reasons for applying the pro rata approach to indemnity costs in Boston Gas — equity and public policy, judicial economy and reasonable expectations of the insured — are equally applicable in the defense costs context.

In the absence of definitive authority from the Massachusetts SJC, the role of the federal court is to predict whether the SJC would adopt pro rata or all sums allocation for defense costs. Since the Boston Gas case came down, at least three federal district courts have waded into that thicket with diverse results. In Peabody Essex Museum Inc. v. U.S. Fire Ins. Co., No. 06-cv-11209, 2010 U.S. Dist. LEXIS 106275, at *47-48 (D. Mass. Sept. 30, 2010), the court declined to extend Boston Gas to the duty to defend. In Graphic Arts Mut. Ins. Co. v. D.N. Lukens, No. 11-cv-10460, 2013 U.S. Dist. LEXIS 75201, at *21 (D. Mass. May 29, 2013, the court appears to have applied Boston Gas to defense costs. In Narragansett Elec. Co. v. Am. Home Assur. Co., 999 F. Supp. 2d 511, 518-25 (S.D.N.Y. 2014), the court predicted that the Massachusetts SJC would not extend Boston Gas to defense costs, but rather would adopt all sums allocation for defense costs.

The Eckel court has two options: (1) it could wade into the thicket itself and attempt another prediction about what allocation method the Massachusetts SJC would adopt for defense costs; or (2) it could ask the Massachusetts SJC to resolve that issue definitively by certifying the question to that court — as the First Circuit did with the indemnity cost allocation issue in Boston Gas. In view of the importance to both policyholders and insurers of certainty regarding allocation of defense costs in long-tail claims, which often involve many millions of dollars in defense costs, and the uncertainty about how the Massachusetts SJC will ultimately resolve that issue, the Eckel court would do a great service to litigants and the courts alike if it certified the question to the Massachusetts SJC.

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