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Liability For Long-Tail Claims: Pro Rata Or All Sums?

Law360, New York (November 06, 2009) -- In the six years from 2003 through 2008, five state supreme courts joined the ranks of states that had adopted a "pro rata" approach to allocating liability among insurance policies for claims involving damage that spans multiple policy years. During that period, no state supreme court adopted an "all sums" approach to allocating such liability.

Nearly 30 years after the debate between pro rata and all sums allocation began, the debate appeared to be nearing its end. Then, in January of this year, the Wisconsin Supreme Court bucked the trend and adopted the all sums approach. See Plastics Engineering Co. v. Liberty Mutual Ins. Co., 315 Wis. 2d 556 (2009).

In stark contrast, Massachusetts' highest court this past summer adopted the pro rata approach. See Boston Gas Co. v. Century Indem. Co., 454 Mass. 337 (2009).

Although the pertinent policy language was similar in the two cases, the courts reached very different results, suggesting that the pro rata versus all sums debate is still alive and well.

The divergence between the two courts highlights the uncertainty about how the state supreme courts that have yet to address the allocation issue will resolve it.

Thirty-three states have not chosen definitively between pro rata and all sums. Trial and federal courts in those undecided states continue to struggle with the two different approaches.

Faced with conflicting lower court decisions, California's Supreme Court has granted review of a decision adopting all sums. See California v. Continental Insurance Co., 88 Cal. Rptr.3d 288 (Cal. App. 2009), review granted, 203 P.3d 425 (Cal. March 18, 2009).

With so much at stake, California's Supreme Court has been deluged with amicus briefs arguing for and against all sums and pro rata.

Until the dust settles in the undecided jurisdictions, policyholders and insurance companies caught litigating in the morass of unsettled law need to hedge their bets, think proactively about the evidence necessary to eventually allocate damages, and move the trial court for early resolution of the debate in their case.

What the Debate is About

The debate began with the advent in the late 1970s and early 1980s of so-called "long-tail" exposure claims — such as environmental pollution claims and asbestos claims — where the alleged damage occurs continuously or progressively over a number of years (or decades) and triggers a series of insurance policies.

In such cases, the question becomes what portion of the total damage will be allocated to any particular insurance policy.

The seminal pro rata case, decided by the Sixth Circuit in 1980, held that each policy was responsible only for the pro rata share of the total damage that occurred during the policy period. See Insurance Co. of N. Am. v. Forty-Eight Insulations Inc., 633 F.2d 1212 (6th Cir. 1980).

The seminal all sums case, decided by the D.C. Circuit the following year, held that each policy was responsible (up to its limits) for the total amount of the damage, and the policyholder could choose which policy to tap. See Keene Corp. v. Insurance Co. of North America, 667 F.2d 1034 (D.C. Cir. 1981).

The Current Score Card

By 2001, states were nearly evenly split between pro rata and all sums. Since then, the balance has tipped sharply in favor of the pro rata approach. Currently, the supreme courts of 11 states have adopted pro rata allocation and six have adopted all sums allocation.

The 11 pro rata jurisdictions are Colorado, Connecticut, Kansas, Kentucky, Massachusetts, Minnesota, New Hampshire, New Jersey, New York, Utah and Vermont.

See Public Serv. Co. of Colo. v. Wallis & Cos., 986 P.2d 924 (Colo. 1999); Security Ins. Co. v. Lumbermens Mut. Cas. Co., 264 Conn. 688 (2003); Atchison, Topeka & Santa Fe Ry. v. Stonewall Ins. Co., 275 Kan. 698 (2003); Aetna Cas. & Sur. Co. v. Commw., 179 S.W.3d 830 (Ky. 2005); Boston Gas Co. v. Century Indem. Co., supra; Domtar Inc. v. Niagara Fire Ins. Co., 563 N.W.2d 724 (Minn. 1997); EnergyNorth Natural Gas Inc. v. Certain Underwriters at Lloyd's, 156 N.H. 333 (2007); Owens-Illinois Inc. v. United Ins. Co., 138 N.J. 437 (1994); Consolidated Edison Co. of N.Y. v. Allstate Ins. Co., 98 N.Y.2d 208 (2002); Sharon Steel Corp. v. Aetna Cas. & Sur. Co., 931 P.2d 127 (Utah 1997); Towns v. Northern Sec. Ins. Co., 964 A.2d 1150 (Vt. 2008).

The six all sums jurisdictions are Delaware, Indiana, Ohio, Pennsylvania, Washington and Wisconsin.

See Hercules Inc. v. AIU Ins. Co., 784 A.2d 481 (Del. 2001); Allstate Ins. Co. v. Dana Corp., 759 N.E.2d 1049 (Ind. 2001); Goodyear Tire & Rubber Co. v. Aetna Cas. & Sur. Co., 95 Ohio St.3d 512 (2002); J.H. France Refractories Co. v. Allstate Ins. Co., 534 Pa. 29 (1993); American Nat'l Fire Ins. Co. v. B & L Trucking & Constr. Co., 134 Wash.2d 413 (1998); Plastics Eng'g Co. v. Liberty Mut. Ins. Co., supra.

The "All Sums" Approach

Policyholders typically favor all sums allocation. Under this approach, the policyholder can collect the full amount of its claim from any triggered policy it chooses, subject to the policy's limits.

Hence, all sums allocation is frequently referred to as "joint and several" or "pick and choose" allocation.

Under all sums, as long as the targeted insurer's policy is triggered by some damage occurring during the policy period, when the remainder of the policyholder's liability occurred is irrelevant.

Courts adopting all sums allocation typically focus upon the language in the grant of coverage in a usual comprehensive general liability policy obliging the insurer to "pay ... all sums which the insured shall become legally obligated to pay as damages ..." See, e.g., Plastics Engineering, 315 Wis.2d at 583.

Typically, once a policyholder has chosen a particular primary policy, the policyholder can "spike" upwards to collect from the excess policies sitting above that primary policy.

Also typically — and of great benefit to the policyholder — damages occurring during years with no insurance coverage or uncollectible insurance coverage (for example, an insolvent carrier) must be paid by the insurers who are chosen by the policyholder.

Eventually, after paying all of the damages, the targeted insurers are entitled to seek contribution from any other nontargeted insurers on the risk in a "phase two" contribution proceeding.

The "Pro Rata" Approach

Insurance companies typically favor pro rata allocation. Under this approach, each triggered policy is liable only for the proportional share of the total damage that occurred during the policy's period.

The method of calculating a policy's proportional share varies by jurisdiction ("time-on-the-risk" and "by policies and limits" are two of the most familiar), but the premise is the

same — an insurer contracts only to pay for losses that happen during its policy periods. Any damage that occurs outside a policy's period is not covered under that policy.

Courts adopting pro rata allocation typically focus on language in the definitions or the scope of coverage portions of a usual comprehensive general liability policy, which modify the "all sums" language and limit it to all sums for damage occurring "during the policy period." See, e.g., Boston Gas, 454 Mass. at 358-60.

Under pro rata allocation, the policyholder must sue each insurer who issued a policy under which the policyholder seeks recovery. Typically — and of great benefit to the insurers — damages occurring during years with no insurance coverage or uncollectible insurance coverage must be borne by the policyholder.

What Will the Future Bring?

In general, courts adopting the all sums approach tend to do so in ill-reasoned opinions, like the Ohio Supreme Court's 2002 decision in Goodyear, 95 Ohio St.3d 512, which lacked rigorous analysis of the policy language and simply adopted the result-driven approach of maximizing the policyholder's recovery without regard for broader implications.

The half dozen state supreme courts that have adopted the pro rata approach since then have, as typified by the recent Boston Gas decision in Massachusetts, engaged in disciplined interpretation of the policy language, with consideration of the public policy implications of their decisions.

Where the all sums courts have simply ignored, and read out of the insurance policies, the language limiting liability to damage "during the policy period," the pro rata courts, while acknowledging the "all sums" language, have followed the polestar of contract interpretation that the policy must be construed as a whole, and have given effect to all of its provisions, including the "during the policy period" limitation.

Where the all sums courts have ignored the economic irrationality of forcing insurers to provide coverage for uninsured periods for which the policyholder paid no premiums, the pro rata courts have recognized the perverse incentive created by allowing a policyholder to collect all of its damages incurred over many years from one policy, even if the policyholder never purchased any additional coverage.

As the Massachusetts court recently stated in Boston Gas, "[n]o reasonable policyholder could have expected that a single one-year policy would cover all losses caused by toxic industrial wastes released into the environment over the course of several decades.

"Any reasonable insured purchasing a series of occurrence-based policies would have understood that each policy covered it only for property damage occurring during the policy year." 454 Mass. at 363.

Hopefully, the California Supreme Court when it decides the allocation issue pending before it, and other state supreme courts in the years to come, will join the trend of well-reasoned pro rata decisions, exhibited most recently by Boston Gas.

How to Prevent Being Whipsawed by Unsettled Allocation Law

With allocation law still unsettled in more than 30 states, policyholders in these jurisdictions have the option of bringing an all sums case against one (or a very few) policies or a pro rata case against all insurers on all policies. Policyholders would do well to hedge their bets and name all insurers as defendants.

While the pro rata approach creates a more unwieldy case with many insurer defendants, doing so could save significant time and litigation costs later if an unsettled jurisdiction adopts pro rata allocation while an all sums case is pending, thus requiring the addition of many insurer defendants and a restart to the litigation. Boston Gas produced this result in Massachusetts.

Conversely, defendant insurers should seek to protect themselves by moving quickly for an allocation determination. Allocation arguments hinge on the language of the policies.

Once the policy language has been determined, the allocation issue is ripe for summary judgment. A successful pro rata summary judgment motion can substantially reduce an insurer's potential exposure and increase the chance of early settlement.

After 30 years, the debate between pro rata and all sums allocation is still vibrant. Pro rata is the majority rule because of its reliance on policy language and common sense, but all sums, because it maximizes insurer payouts, is not going away quietly.

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