ALLOCATION OF LOSS IN INSURANCE LITIGATION
EFFECTIVE SCOPE OF COVERAGE STRATEGIES

ALLOCATION BETWEEN INSURERS AND POLICYHOLDERS
ALLOCATION AMONG MULTIPLE INSURERS

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ALLOCATION BETWEEN INSURERS AND POLICYHOLDERS

Under what circumstances will the policyholder share in the coverage and defense?

RETENTIONS AND DEDUCTIBLES

- When a policyholder chooses to maintain a large self-insured retention (SIR) or deductible, that amount is often treated as a period self-insurance

- Issues that repeatedly arise include whether a separate SIR must be paid in full for each triggered policy and whether policyholder may prorate SIRs

DECISIONS ON RETENTIONS/DEDUCTIBLES

Question of whether policyholder will owe a yearly SIR accepted for review by Supreme Judicial Court of Massachusetts: Boston Gas Co. v. Century Indem. Co., 529 F.3d 8 (1st Cir. 2008)

Policyholder could not prorate deductible: Benjamin Moore & Co. v. Aetna Cas. & Sur. Co., 843 A2d 1094 (N.J. 2004)

Separate SIR must be paid in full by policyholder for each policy triggered: Liberty Mut. Ins. Co. v. Wheelwright Trucking Co., Inc., 851 So.2d 466 (Ala. 2002)

Single deductible could not be prorated and new deductible applied to each policy period: Olin Corp. v. Insurance Co. of North Am., 221 F.3d 307 (2d Cir. 2000)

Policyholder responsible for single SIR per triggered period: Public Service Co. of Colorado v. Wallis, 986 P.2d 924 (Colo. 1999)

MISSING POLICIES

- Policyholder can be held responsible for self-insured periods and periods where policies are lost or missing
- Questions also arise over the appropriate level of proof required to introduce evidence of a lost policy

UNINSURED PERIODS OR GAPS IN COVERAGE

- Disputes arise over responsibility for gaps in coverage, sometimes referred to as “orphan shares”
- How gaps in coverage are handled can depend on how they were created
  - Uninsured or underinsured periods
  - Insolvency of one or more insurers
  - Settlement of claims or exhaustion of limits
  - Coverage exclusions
  - Unavailability of coverage

UNINSURED OR UNDER-INSURED PERIODS

- When a policyholder forgoes coverage or chooses to purchase insufficient insurance, courts generally hold the policyholder responsible for liability in that period
- Policyholder is responsible for its decisions to limit or go without coverage

DECISIONS ON ALLOCATION FOR UNINSURED PERIODS

Allocation to policyholder for years it did not purchase coverage is appropriate: Stonewall Ins. Co. v. Asbestos Claims Management Corp., 73 F.3d 1178 (2d Cir. 1995)

When periods of no insurance reflect decision to assume or retain risk, policyholder should share in allocation: Owens-Illinois, Inc. v. United Ins. Co., 650 A.2d 974 (N.J. 1994)

Defense costs are prorated to policyholders during periods of self-insurance: Commercial Union Ins. Co. v. Sepco Corp., 918 F.2d 920, (11th Cir. 1990)

GAPS IN COVERAGE DUE TO ALLEGED UNAVAILABILITY OR EXCLUSIONS

- Policyholders have argued that coverage for some risks (e.g. asbestos) was unavailable in the marketplace and therefore, they should not be responsible for years in which they could not obtain coverage
- Several courts have rejected this theory, holding that policyholder will remain responsible for all uninsured periods: AAA Disposal Systems, Inc. v. Aetna Cas. Sur. Co., 821 N.E.2d 1278 (Ill. App. 2005)
- Courts have questioned what it means for coverage to be unavailable, finding that "prohibitively expensive" is not "unavailable": Sybron Transition Corp. v. Security Ins. Co. of Hartford, No. 92-C-779 (E.D. Wis. Jan. 14, 2000)
- Some courts have narrowly defined "available" coverage to mean coverage for the precise risk manifested: Champion Dyeing & Finishing Co., Inc. v. Centennial Ins. Co., 2002 WL 31552947 (N.J. Super. 2002)

GAPS IN COVERAGE DUE TO INSOLVENCIES

- Insurer insolvency is a common source of coverage gaps, given the dramatic increases in insurer insolvencies since 1980s
- However, the risk of insolvency is a factor evaluated by sophisticated policyholders and their brokers
- As a result, most courts agree that the policyholder must absorb the insolvent share
- To force other insurers to drop down or otherwise assume insolvent shares would be to extend coverage beyond agreed obligations

DECISIONS INVOLVING ALLOCATION OF INSOLVENT SHARES

- Risk of insurer insolvency placed on policyholder: AAA Disposal Systems, Inc. v. Aetna Cas. & Sur. Co., 821 N.E.2d 1278 (Ill. App. 2005)
- Policyholder assumes the risk of insurer insolvency: Benjamin Moore & Co. v. Aetna Cas & Sur. Co., 843 A.2d 1094 (N.J. 2004)

EXHAUSTION OF AVAILABLE COVERAGE: VARIOUS METHODS

- Excess insurance is not required to respond to claims until underlying insurance has been exhausted
- Exhaustion theory used in applicable jurisdiction will determine which policies respond first
- Horizontal exhaustion: All triggered underlying policies must be exhausted - - regardless of policy period - - before any excess policy responds to coverage
  - Exhaustion may be by limit or by layer
- Vertical exhaustion: Only policies directly underlying an excess policy in the same period need be exhausted before the excess insurance is obligated

WHAT CONSTITUTES EXHAUSTION

- Questions arise over what qualifies as exhaustion in the event of settlement
- When the settlement is for less than full policy limits, policyholder may bear responsibility for difference between policy limits and the settlement amount

POLICYHOLDER RESPONSIBILITIES IN REALLOCATION

- Courts adopting pro rata allocation generally require policyholder to participate in allocation
  - Policyholder bears the loss for periods of no insurance, insufficient insurance and self-insurance
  - Owens-Illinois, Inc. v. United Ins. Co., 650 A.2d 974 (N.J. 1994)
  - Stonewall Ins. Co. v. Asbestos Claims Management Corp., 73 F.3d 1178 (2d Cir. 1995)
  - Rationale: expecting the risk bearer to share in the allocation is reasonable

POLICYHOLDER ROLE IN REALLOCATION

- Decisions about allocation are not simply left to policyholder
- Excess insurers are not forced to accept policyholder's subjective allocation of underlying coverage
- Even in states that allow targeted tender to selected insurer, courts require policyholder to exhaust underlying insurance before selecting excess insurers to respond to coverage

ALLOCATION AMONG MULTIPLE INSURERS

When multiple insurers and/or multiple years of coverage are triggered, disputes inevitably arise over what amounts are allocated to each insurer's policy

"OTHER INSURANCE" CLAUSES

- Parties sometimes look to "other insurance" provisions to allocate loss
- Sample other insurance language:

  "This policy shall be excess over any other insurance whether prior or subsequent hereto, and by whomsoever affected, directly or indirectly covering loss or damage insured hereunder, and this Company shall be liable only for the excess of such loss or damage beyond the amount due from such other insurance, whether collectible or not, however, not exceeding the limits as set forth in the Declarations."

APPLICATION OF "OTHER INSURANCE" CLAUSES

- Issue of concern is the priority of coverage between multiple policies, and often different types of policies (i.e. claims made and occurrence policies)
- "Other insurance" clauses in concurrent insurers' policies generally have little bearing on defense costs
- There is no contractual obligation between insurers, but most courts allow contribution among insurers that both owe defense

MULTI-YEAR CONTRACTS

- Frequent dispute: whether a multi-year contract with per occurrence limits provides separate annual limits or a single per occurrence limit
- Under a single limit theory, if there is one occurrence, there is a single per occurrence limit available, regardless whether the injuries or damages take place at the same time or over several policy years

STUB CONTRACTS

- In an ideal coverage program, all primary and excess policies would be issued for full year periods with matching inception and expiration dates
- Reality does not always reflect that ideal and coverage often exists for fractional years, either by design or due to early termination, creating “stub” periods
- Stub periods may be issued intentionally to protect the policyholder while it seeks other insurance
- Frequently, the policyholder pays a prorated premium for stub policy; as a result, the insurer will argue that it owes a prorated limit

DECISIONS APPLYING LESS THAN FULL LIMITS FOR STUB PERIODS

- Certain courts have held that stub policies do not invoke a full set of aggregate limits:
  - Flintkote Co. v. American Mut. Liability Ins. Co., No. 808-594 (Cal. Super. Ct., Aug. 17, 1993): no separate limit allowed for one-month extension
  - Diamond Shamrock Chem. Co. v. Aetna Cas. & Sur. Co., 258 N.J. Super. 167 (1992): one-month extension did not equate to the issuance of new contract and did not create additional limit of liability

PRORATION OF LIMITS

- Argument for proration of limits for stub periods is strongest when:
  - Supported by policy language:

    "…each consecutive period of one year commencing from the inception date of this policy"
  - Premium is prorated or no additional premium is paid
  - Contract is issued in order to enable policyholder to obtain coverage with another insurer
  - There are no gaps in aggregate or per occurrence coverage and policyholder obtains same or greater limits for remaining policy period

DEFINING AN OCCURRENCE

- What qualifies as an "occurrence" when the alleged injuries are sustained by numerous individuals at varying geographic locations over several years?
- To determine the number of occurrences, some courts use a cause test
  - If a single, uninterrupted cause results in a number of injuries or damages, it is one occurrence
  - If cause is interrupted and replaced by another cause, there is more than one occurrence
- Courts have also used an "unfortunate event" test
- More recently, courts have attempted to craft tests that reflect the nature of complex, long-tail claims

IMPACT OF NUMBER OF OCCURRENCES ON LIMITS

- Number of occurrences can have a significant impact on the bottom line of both parties
- Number of occurrences influences:
  - Limits available under multi-year contracts
  - Per occurrence limits
  - Aggregate limits
  - Premises/operations limits
  - Number of deductibles or SIRs

APPORTIONMENT OF DEFENSE COSTS

- Certain states have held that beyond allocating indemnity, an insurer is also responsible for its allocated share of defense costs
- This is a significant issue because defense costs can be extremely high and recovering defense expenses once they are paid can be difficult

NATURE OF UNDERLYING CLAIMS

- The nature of the underlying claims may help the court resolve issues related to allocation, including the number of occurrences
- Special consideration will be given to claims involving long-tail, continuous losses, such as:
  - Asbestos bodily injury/property damage
  - Environmental claims and other mass torts
- The unique and difficult nature of these long-tail claims has driven many of the allocation issues discussed today