



1999

An Introduction to Insurance Allocation Issues in Multiple-Trigger Cases

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Thomas M. Jones & Jon D. Hurwitz, *An Introduction to Insurance Allocation Issues in Multiple-Trigger Cases*, 10 Vill. Envtl. L.J. 25 (1999).

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AN INTRODUCTION TO INSURANCE ALLOCATION
ISSUES IN MULTIPLE-TRIGGER CASES

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I. INTRODUCTION

With the advent of complex multi-claim litigation, cumulative exposure cases, long-term environmental damage claims and toxic tort litigation, courts have faced the question of how to allocate indemnity payments among multiple insurers and their insureds on an increasingly frequent basis.¹ The stakes of “environmental litigation” are staggering.² For example, cleanup costs under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) are projected to reach between eighty billion and one trillion dollars.³ Although complex environmental coverage

1. See C. MacNeil Mitchell, *Pollution Insurance Coverage: Practical Suggestions for Resolving Allocation Issues*, 12 No. 8 CORP. COUNS. 4, Jan. 1998, at *4 (explaining that these cases arise as result of so-called long-tail insured losses). One commentator describes these cases as “those in which the ‘accident’ . . . or ‘occurrence’ . . . causing the loss took place over more than one — and usually five or more — years.” *Id.* Such losses are also commonly known as “progressive injuries.” Michael G. Doherty, Comment, *Allocating Progressive Injury Liability Among Successive Insurance Policies*, 64 U. CHI. L. REV. 257, 257 & n.1 (1997). Courts typically consider complex allocation and exhaustion issues in the context of long-tail injury cases involving environmental contamination and toxic torts. See, e.g., *Koppers Co. v. Aetna Cas. and Sur. Co.*, 98 F.3d 1440, 1444 (3d Cir. 1996) (involving liability for property damage to soil, sub-soil and groundwater); *Uniroyal, Inc. v. Home Ins. Co.*, 707 F. Supp. 1368, 1369 (E.D.N.Y. 1988) (considering indemnification for illnesses “Agent Orange” herbicide allegedly caused); *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974, 976 (N.J. 1994) (addressing coverage for asbestos-related personal injury and property damage claims).

2. See Debra Winthrop Pollack, *Environmental Damages Analysis: The Key to Litigation Strategy*, in RISK ASSESSMENT FOR INSURANCE COUNSEL, at 85, 87 (PLI Litig. & Admin. Practice Course Handbook Series No. 550, 1996) (explaining that “environmental litigation” encompasses actions originating from both environmental law enforcement as well as private toxic tort actions). For a discussion of courts’ potential to reach different allocation conclusions in toxic tort cases and in “traditional” environmental damages cases, see Garrett G. Gillespie, Note, *The Allocation of Coverage Responsibility Among Multiple Triggered Commercial General Liability Policies in Environmental Cases: Life After Owens-Illinois*, 15 VA. ENVTL. L.J. 525, 559-60 (1996).

3. See David L. Markell, *The Federal Superfund Program: Proposals for Strengthening the Federal/State Relationship*, 18 WM. & MARY J. ENVTL. L. 1, 15 (1993) (discussing costs of Superfund cleanups). In 1993, the average cost of remedying the hazardous condition at a Superfund National Priority List site exceeded \$30 million. See Kenneth S. Abraham, *Cleaning Up the Environmental Liability Insurance Mess*, 27 VAL. U. L. REV. 601, 603 (1993). Although insurance companies may have anticipated claims for pollution-related damages, it appears unlikely that they prepared for the tremendous liability arising from Superfund and similar state statutes. See *Northern States Power Co. v. Fidelity & Cas. Co.*, 523 N.W.2d 657, 660-61 (Minn. 1994). Because CERCLA defines “response” costs as “remedial action,” unbounded even by property value, environmental damages are “theoretically limitless” under the federal statute. *Id.* at 661 (citing Comprehensive Environmental Response, Compensation and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C. §§ 9601-75 (1994))). Consequently, it is extremely difficult to calculate potential liability for environmental damage. See *id.* This difficulty does not, however, make the potential for liability any less realistic. See Chris

litigation has received a great deal of attention over the last decade, the judiciary has only recently begun to address the problematic allocation and exhaustion issues created largely by multiple-trigger rulings in favor of policyholders.⁴ While it is impossible to reconcile substantively the myriad of allocation and exhaustion decisions, one recurring theme is many courts' desire to maximize the coverage available to policyholders.⁵ In light of this, as well as the great financial stakes of environmental litigation, it is imperative that

Roush, *Insurance: Fields of Green — and Disaster Areas*, Bus. Wk., Jan. 9, 1995, at 94 (quoting Dean R. O'Hare).

4. See C. MacNeil Mitchell, *Allocating Liability for "Long Tail" Pollution Damages*, 12 No. 7 CORP. COUNS. 11, Dec. 1997, at *11 (noting that "[u]nlike the more settled rules of law governing 'scope of coverage' issues, the rules governing 'allocation of coverage' have not yet achieved the same degree of appellate clarification"). To the contrary, some higher courts have moved away from earlier bright line rules to permit more flexible allocation at the trial court level. See *id.*; see also David O. Larson et al., *Review of Recent Developments in Excess, Surplus Lines, and Reinsurance Law*, 32 TORT & INS. L.J. 359, 360 (1997) (highlighting that California's appellate courts have granted trial courts discretion to choose most equitable allocation method).

A court's choice regarding the applicable trigger of coverage bears directly on the issue of allocation. See *Northern States Power*, 523 N.W.2d at 662 (explaining that "choice of trigger theory is related to the method a court will choose to allocate damages between insurers"). Although the allocation and "trigger of coverage" issues are related, it is important to note their conceptual and analytical differences. While "trigger analysis" determines which policies are potentially liable, "allocation analysis" determines the amount of liability any one policy will bear. Additionally, although allocation is not usually an issue where damages are confined to a single policy period, when it is an issue, trigger analysis is considerably important. One commentator states that "pinning down the trigger period to where it is no longer in real dispute is probably the single most important ingredient in resolving the overall insurance allocation question." Mitchell, *supra* note 1, at *5.

5. See, e.g., *Lac d'Amiante du Quebec, Ltee. v. American Home Assurance Co.*, 613 F. Supp. 1549, 1551 (D.N.J. 1985) (observing that "the courts have offered conflicting interpretations of the manner in which virtually identical policies allocate liability"). In *Lac d'Amiante*, a case in which property damage led to an asbestos coverage dispute, the court attributed the inconsistent judicial outcomes in this type of case to the difficulties inherent in both defining the concept of "injury" as well as determining specific coverage periods in which injury might have occurred. See *id.* The *Lac d'Amiante* court also highlighted some courts' "desire . . . to maximize coverage even when to do so requires judicial sleight of hand." *Id.* Similarly, in one of the most well-known decisions in this area, *Owens-Illinois, Inc. v. United Insurance Co.*, the New Jersey Supreme Court acknowledged that "the differing interpretations of which occurrence constitutes the injury contemplated by the language of insurance policies" sometimes result from a "leap of logic" that all the damages can be thought to be imposed in any one of the years of exposure or release." *Owens-Illinois, Inc., v. United Ins. Co.*, 650 A.2d 974, 989 (N.J. 1994) (quoting *Lac D'Amiante*, 613 F. Supp. at 1551). Many commentators assert that courts should reject this "coverage maximization" rationale because the long-term results it produces are "both inefficient and unfair." Doherty, *supra* note 1, at 266-67.

both carriers and insureds understand the issues involved in multiple-policy coverage litigation.

This Comment provides a broad survey of insurance allocation issues. Part II reviews the insurance concepts that underlie the multiple-policy coverage issues.⁶ Part III provides an overview of the judicial application of “horizontal” versus “vertical” policy exhaustion.⁷ Part IV outlines the four principal methods by which courts allocate indemnification obligations among multiple carriers.⁸ Part V addresses allocation of defense costs.⁹ Part VI summarizes allocation of shares to the policyholder, also known as “orphan shares.”¹⁰

II. BACKGROUND OF THE GENERAL STRUCTURE OF INSURANCE POLICIES

A. Underlying Policy Language

From the late 1960s through the mid-1980s, comprehensive general liability (CGL) policies contained insuring agreements under which the insurer would pay “all sums which the insured shall become legally obligated to pay as damages because of property damage or bodily injury to which this insurance applies, caused by an occurrence.”¹¹ The CGL’s policy’s definitions of “bodily in-

6. For a review of the insurance concepts that underlie the multiple-policy coverage issues that subsequent Parts of this Comment discuss, see *infra* notes 11-20 and accompanying text.

7. For an overview of the judicial application of “horizontal” versus “vertical” policy exhaustion, see *infra* notes 21-51 and accompanying text.

8. For an outline of the four principal methods by which courts allocate indemnification obligations among multiple carriers, see *infra* notes 52-105 and accompanying text.

9. For a discussion of allocation of defense costs, see *infra* notes 106-14 and accompanying text.

10. For a summary of allocation of shares to the policyholder, also known as “orphan shares,” see *infra* notes 115-35 and accompanying text.

11. Jeffrey Silberfield, *Duty to Defend Under CGL Policies*, in HAZARDOUS WASTE, TOXIC TORT, AND PRODUCTS LIABILITY INSURANCE PROBLEMS 1987, at 9, 11 (PLI Com. L. & Practice Course Handbook Series No. 419, 1987). The insuring agreements in standard CGL policies of the late 1960s through the mid-1980s stated the following, or similarly:

The Company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of

Coverage A. bodily injury or

Coverage B. property damage

to which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such property damage or bodily injury, even if any of the allegations of the suit are groundless, false or fraudulent, and may make such investigation and settlement of any claim or suit as it deems expedient, but the Company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the

jury” and “property damage” made it clear that the insured would be indemnified only for losses occurring during the policy period.¹² A preliminary question in any coverage analysis is, therefore, whether damage or injury during the policy period triggered a policy’s coverage. This is known as the “trigger of coverage” issue.

Many CGL policies also contain an “other insurance” clause, which limits the carrier’s obligations when the insured has “other valid and collectible insurance” available.¹³ When other insurance is available, if the CGL policy is primary, the carrier’s obligations are unaffected unless the other collectible insurance is also primary, in which case the insurers will share the loss.¹⁴ The “other insurance” clause further provides that if the CGL policy is excess insurance, the insurer will pay its share of the loss that exceeds the sum of “(1) [t]he total amount that all [collectible] other insurance would pay for the loss in the absence of [that] insurance; and (2) [t]he total of all deductible and self-insured amounts under all that other insurance.”¹⁵ Additionally, the excess insurer’s duty to de-

Company’s liability has been exhausted by payment of judgment or settlements.

Id.

12. *See id.* CGL policies commonly defined “occurrence,” “bodily injury” and “property damage” as follows:

“Occurrence” means an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.

“Bodily injury” means bodily injury, sickness or disease sustained by any person *which occurs during the policy period*, including death at any time resulting therefrom.

“Property damage” means (1) physical injury to or destruction of tangible property *which occurs during the policy period*, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed, provided such loss of use is caused by an occurrence *during the policy period*.

Id. (emphasis added).

13. *Id.* The New Jersey Supreme Court noted in *Owens-Illinois v. United Insurance Co.* that “[h]istorically, ‘other insurance’ clauses were designed to prevent multiple recoveries when more than one policy provided coverage for a given loss.” *Owens-Illinois v. United Ins. Co.*, 650 A.2d 974, 995 (N.J. 1994).

14. *See* H. James Wulfsberg & Timothy A. Colvig, *The 1986 Commercial General Liability Insurance Program*, in *CONSTRUCTION CONTRACTS AND LITIGATION* 1988, at 446 (PLI Real Est. L. & Practice Course Handbook Series No. 308, 1988) (stating that “[i]f this insurance is primary, our obligations are not affected unless any of the other insurance is also primary and . . . [t]hen, we will share with all that other insurance by the method described . . . below”). For an explanation of the method by which insurers share the loss, see *infra* note 17 and accompanying text.

15. Wulfsberg & Colvig, *supra* note 14, at 446. A typical “other insurance” states: “Excess Insurance. This insurance is excess over any of the other insurance, whether primary, excess, contingent or on any other basis.” *Id.* The clause contin-

fend under the “other insurance” clause is limited.¹⁶ When multiple insurers are to share a loss, the clause calls for “contribution by equal shares” if permissible and “contribution by limits” in all other cases.¹⁷

B. Excess Liability Insurance Policies

1. Primary Policies Versus Excess Policies

Policyholders exposed to large amounts of liability frequently purchase several layers of insurance coverage. Primary insurance typically comprises the first layer of coverage. Most primary-level policies impose on the insurer a duty to defend, subject to appropriate notice and tender. A carrier’s obligations under a primary policy attach immediately upon the happening of a covered event or “occurrence.”

The other layers of coverage are excess layers. Liability under an excess policy attaches only upon the exhaustion of the limits of some other policy or policies.¹⁸ The excess insurer is liable, up to its policy limits, for the amount of covered loss exceeding the limits of the underlying policy or policies, including self-insured retentions or deductibles. Also, in contrast to primary policies, excess

ues by explaining how the loss will be shared, as outlined in the text accompanying this note. *See id.* The clause concludes: “[w]e will share the remaining loss, if any, with any other insurance that is not described in this Excess Insurance provision and was not bought specifically to apply in excess of the Limits of Insurance shown in the Declarations of this Coverage Part.” *Id.* at 447.

16. *See id.* at 446. Specifically, the CGL policy provides that when the insurance is excess, the insurer will not be obligated to defend any claim that any other insurer must defend. *See id.* Further, although the excess insurer will defend in cases where no other insurer will defend, in doing so the excess insurer is entitled to the insured’s rights against all non-defending insurers. *See id.*

17. *Id.* at 447. The pertinent language of the other insurance clause states: Method of Sharing.

If all of the other insurance permits contribution by equal shares, we will follow this method also. Under this approach each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.

If any of the other insurance does not permit contribution by equal shares, we will contribute by limits. Under this method, each insurer’s share is based on the ratio of its applicable limit of insurance to the total applicable limits of insurance of all insurers.

Id.

18. *See General Refractories Co. v. Allstate Ins. Co.*, No. CIV.A. 89-7924, 1994 WL 246375, at *4 (E.D. Pa. June 8, 1994) (explaining that distinction between primary and excess policies “is critical, because unlike primary insurers, excess insurers are not liable merely because of the occurrence of an injury within the scope of the policy”). Exhaustion of the primary insurance is a condition precedent to the triggering of an excess insurer’s liability. *See id.*

liability policies typically do not impose on the insurer a duty to defend.¹⁹

2. Follow-Form Versus Umbrella Excess Policies

Excess insurance, as explained above, is coverage that attaches only after the exhaustion of a predetermined amount of underlying coverage. A follow-form excess policy provides coverage above the underlying limits according to the same terms and conditions as the primary policy. If the policyholder has only primary and excess policies, the excess layer of coverage sits directly above the primary layer or self-insured retention. Follow-form excess policies also commonly contain unique provisions that the underlying primary policy does not contain, such as an additional exclusion. If the policyholder has umbrella liability coverage as well as primary coverage, the excess layer sits above the umbrella layer. An umbrella excess policy may provide broader coverage than scheduled underlying insurance policies. This coverage may occur due to either an exclusion in the primary policy or the primary insurer's insolvency.²⁰ An umbrella policy that "drops down" usually does so subject to the policyholder paying some prescribed retention amount.

III. "HORIZONTAL" VERSUS "VERTICAL" EXHAUSTION OF POLICIES

A. Background

When a claim potentially triggers numerous layers of coverage over multiple policy periods, perhaps the most critical concern from an excess insurer's standpoint is the order in which a court will decide to exhaust the policies at issue.²¹ The two basic methods of exhaustion courts apply are "horizontal" exhaustion, or "exhaustion by layers,"²² and "vertical exhaustion," or "exhaustion by

19. For additional discussion of the excess insurer's duty to defend, see *supra* note 16 and accompanying text.

20. See, e.g., *Federal Ins. Co. v. Scarsella Bros., Inc.*, 931 F.2d 599, 605 (9th Cir. 1991) (explaining that inclusion of insolvency in policy term "exhausted" obligated excess insurer to drop down and cover policyholder in place of insolvent primary insurer).

21. See H. Wesley Sunu et al., *Recent Developments in Excess, Surplus Lines, and Reinsurance*, 31 *TORT & INS. L.J.* 239, 245 (1996) (stating that "[t]he excess carrier's ultimate exposure for contributing . . . is completely dependent upon the determination reached by the courts concerning whether a horizontal or vertical allocation formula will be applied at the primary layer").

22. For a comprehensive discussion of horizontal exhaustion, see *infra* notes 26-45 and accompanying text.

years.”²³ Whether a court applies horizontal or vertical exhaustion determines which policies need to be exhausted before the triggering of a particular excess policy.

Briefly stated, those advocating vertical exhaustion argue that “underlying policies” refer only to those policies *directly under* the excess policy at issue; that is, only the primary or other underlying policies issued during the same policy period as the excess policy at issue must be exhausted before triggering the excess policy.²⁴ Conversely, those advocating horizontal exhaustion assert that *all* triggered underlying policies must be exhausted, regardless of the policy period, before the excess insurer becomes liable. Excess liability policies are often silent regarding whether only the immediate underlying policy or all lower level policies must be exhausted before the excess coverage is triggered. This Part examines exhaustion approaches before discussing allocation theories, as an exhaustion ruling favorable to the excess insurer might fully release that carrier from participation in the allocation process.²⁵

23. For a comprehensive discussion of vertical exhaustion, see *infra* notes 46-51 and accompanying text.

Although most courts have adopted either horizontal or vertical exhaustion, one court recently eschewed both approaches. See *Carter-Wallace, Inc. v. Admiral Ins. Co.*, 712 A.2d 1116, 1123 (N.J. 1998). In *Carter-Wallace*, the New Jersey Supreme Court adopted a hybrid approach, whereby damages were apportioned among the years in which policies were triggered “without reference to the layering of policies in the triggered years.” *Id.* at 1123-24 (citation omitted). Under the hybrid approach, however, each coverage layer must be depleted within any single year before the next level can be tapped. See *id.* at 1124.

24. The policyholder is frequently the party arguing in favor of vertical exhaustion because it leaves other primary policies available, or unexhausted. Vertical exhaustion provides the insured with substantially greater coverage than does horizontal exhaustion, as primary policies usually provide defense costs in addition to the limits of liability, while excess policies generally do not provide for defense costs.

25. The application of a particular exhaustion approach, usually horizontal, can absolve the excess carrier, either in whole or in part, of liability to the policyholder. Such results have led counsel for policyholders to lament, “[i]n order to even get in the door with excess insurers — to ‘tap’ those excess policies for coverage — the insured must overcome the many ‘exhaustion’ hurdles upon which excess insurers rely to deny coverage. The insured does not face these issues with its primary insurers.” David W. Steuber & Michael A. Rossi, *What Difference Can a ‘Layer’ Make?*, COVERAGE, Nov.-Dec. 1994, at 1, 4. For an example of a court’s application of horizontal exhaustion and its subsequent finding that an insured could not recover from its excess insurer without first exhausting all triggered primary policies, see *Continental Cas. Co. v. Armstrong World Indus.*, 776 F. Supp. 1296, 1301 (N.D. Ill. 1991); see also *infra* notes 26-30 and accompanying text for a complete discussion of *Continental Casualty*.

B. “Horizontal Exhaustion” or “Exhaustion by Layers”

Horizontal exhaustion requires each layer of coverage to indemnify the policyholder to the full extent of its respective policy limits before requiring contribution by any policies in the layer above. When an occurrence potentially implicates more than policy layer, each triggered primary policy can be called upon to respond to the claim up to the full limits of that policy. Excess carriers often argue for application of this “exhaustion by layers” approach, which triggers their policies only after the limits of all triggered primary policies have been exhausted.

The court in *Continental Casualty Co. v. Armstrong World Industries, Inc.*²⁶ adopted horizontal exhaustion. In *Continental Casualty*, an action involving thousands of asbestos-related personal injury claims spanning twenty-two years of coverage, the district court held that the policyholder was required to exhaust all of its twenty-four triggered primary liability policies before it called upon Continental Casualty Company’s (CNA’s) two excess umbrella policies for payment.²⁷ The court found that the CNA policies’ “other insurance” clauses stated with reasonable clarity that coverage would only begin after the exhaustion of any applicable primary insurance.²⁸ Consequently, the CNA policies’ plain meaning contradicted the policyholder’s claim that only the underlying primary policies issued during the same policy period need be exhausted before CNA’s excess liability would begin.²⁹ By ruling in favor of the insurer, the court directed that policies were to be exhausted by layers.³⁰

26. 776 F. Supp. 1296 (N.D. Ill. 1991).

27. *Id.* at 1298-99, 1301.

28. *See id.* at 1301. Although schedules of underlying primary policies were attached to both CNA policies, the CNA policies’ “other insurance” clauses did not confine their limitations to the listed policies. *See id.* In addition, each CNA policy defined “ultimate net loss” as excluding amounts other insurance covered. *See id.* Specifically, one excess policy excluded payments that were recoverable “through any other valid and collectible insurance.” *Id.* The other policy allowed deductions for “other insurances . . . other than the [listed] underlying insurance and excess insurance purchased specifically to be in excess of this policy” *Id.* (alteration in original).

29. *See id.* The *Continental Casualty* court reasoned that “[t]he CNA policies are both specifically designated as ‘umbrella’ excess policies, designed to afford coverage only when all other types of insurance are exhausted.” *Id.* (citing 8A APPLEMAN, INSURANCE LAW AND PRACTICE § 4096, at 348 & § 4909.85, at 453-54 (1981)). In addition, because the CNA policies were unambiguous regarding the exhaustion requirement, the doctrine of contra proferentum (construe against drafter) was inapplicable. *See id.* at 1301.

30. *See id.*

When a similar dispute arose in *General Refractories Co. v. Allstate Insurance Co.*,³¹ the United States District Court for the Eastern District of Pennsylvania relied on *Continental Casualty* in applying horizontal exhaustion.³² In *General Refractories*, the policyholder sought a determination of its rights under certain excess policies issued to it by Commercial Union.³³ At issue was whether the policyholder “must exhaust *all* primary coverage before seeking indemnification from any of its excess insurers, or whether it need only exhaust the limits of the [directly] underlying policies.”³⁴ Citing *Continental Casualty*, the *General Refractories* court rejected the policyholder’s contention that Commercial Union became liable immediately upon the exhaustion of the policies directly underlying its excess umbrella policies.³⁵ Instead, the court emphasized that the excess policies at issue specifically provided that Commercial Union “shall not be liable for any ‘ultimate net loss’ so long as ‘other valid and collectible insurance’ exists.”³⁶

The *General Refractories* court advanced as an important additional factor in support of its application of horizontal exhaustion the underlying purpose of the excess insurance policies.³⁷ The court stated that “[u]nlike primary insurance policies, umbrella policies’ *raison d’être* is to provide affordable protection against excess judgments of third parties . . . [which] is underscored by the difference in premiums . . . insurance companies charge for the two types of policies.”³⁸ Specifically, the *General Refractories* court highlighted that premiums for umbrella insurance are significantly less than premiums for primary insurance because the related risks for umbrella policies are substantially less than those for primary policies.³⁹ Further, the court recognized that because to permit the policyholder to seek payment from its excess carrier *before* exhaust-

31. No. CIV.A.89-7924, 1994 WL 246375 (E.D. Pa. June 8, 1994).

32. *See id.* at *8.

33. *See id.* at *1. In *General Refractories*, thousands of individuals sued the insured, a manufacturer of products containing asbestos and silica, claiming that they were injured by the use of the products. *See id.*

34. *Id.* at *7 (emphasis added). In *General Refractories*, as in *Continental Casualty*, each of Commercial Union’s excess policies contained a declaration sheet naming specific underlying policies. *See id.*

35. *See id.* at *8.

36. *General Refractories*, 1994 WL 246375, at *8. As the *General Refractories* court highlighted, Commercial Union’s excess policy provisions “unambiguously provide that even if the stated policy limits are exhausted, [Commercial Union’s] liability will not arise if other insurance is available.” *Id.*

37. *See id.*

38. *See id.* (citation omitted).

39. *See id.*

ing all of its primary insurance would be to subvert the purpose of excess insurance, horizontal exhaustion was appropriate.⁴⁰

State courts in several recent decisions have adopted horizontal exhaustion.⁴¹ In *United States Gypsum Co. v. Admiral Insurance Co.*,⁴² a property damage case, the Illinois Court of Appeals affirmed the trial court's ruling requiring the policyholder to exhaust all triggered primary coverage before it could recover under the excess policies at issue.⁴³ Significantly, the *United States Gypsum* court noted that adopting vertical exhaustion, as the policyholder advocated, "would allow [the policyholder] to effectively manipulate the source of its recovery, avoiding difficulties encountered as the result of its [decisions regarding insurance]."⁴⁴ Consequently,

40. *See id.*

41. *See, e.g.*, *Community Redev. Agency v. Aetna Cas. & Sur. Co.*, 57 Cal. Rptr. 2d 755, 762 (Ct. App. 1996) (applying horizontal exhaustion and finding that umbrella carrier need not drop down to defend policyholder when unexhausted primary policies covered different periods of time during continuing property damage period); *Southern Pacific Rail Corp. v. Certain Underwriters at Lloyd's, London*, No. BC154722 (Cal. Super. Ct. Jan. 23, 1998) (explaining that horizontal exhaustion applies to actual policies and self-insured retentions [SIRs] and that SIR amount applies to each new claim); *Nucor Corp. v. Hartford Accident & Indemnity Co.*, No. CV-97-08308 (Ariz. Super. Ct. Sept. 29, 1997) (finding that horizontal exhaustion is effective method of preserving judicial resources); *Conductron Corp. v. American Employer's Ins. Co.*, Nos. 93-E-149, 93-C-599 (N.H. Super. Ct. Mar. 4, 1997) (rejecting vertical stacking and holding that excess coverage is available only after underlying policies are exhausted); *Schering Corp. v. Evanston Ins. Co.*, No. UNN L 97311-88 (N.J. Super. Ct. Law Div. Jan. 24, 1995) (finding that all primary coverage must be exhausted before policyholder can proceed against excess insurers).

42. 643 N.E.2d 1226 (Ill. App. Ct. 1994).

43. *Id.* at 1262. In *United States Gypsum*, a manufacturer of asbestos-containing building materials moved for a declaratory judgment, seeking insurance coverage for damage to third-parties' real property and buildings caused by asbestos release. *See id.* at 1229. The *United States Gypsum* court based its decision on the plain language of the excess policies' "other insurance" clause, holding that the clause "unequivocally sets forth that the excess insurer will not contribute 'if other valid and collectible insurance with any other insurer is available to the insured.'" *Id.* at 1261 (quoting language of excess insurance policy). The *United States Gypsum* court found the language of the other insurance clause indicated that the excess policy was to "serve as an excess policy to all triggered primary policies, regardless of whether they extend over multiple policy periods or [only] one." *Id.*

44. *Id.* at 1262. The *United States Gypsum* court concluded that if it permitted the policyholder to recover from excess insurance policies upon the exhaustion of a single primary policy, the policyholder could seek indemnification from its excess policies rather than from either itself as a primary self-insurer or from insolvent insurers in other triggered policy periods. *See id.* at 1261. The court further noted that "[s]uch a practice would blur the distinction between primary and excess insurance, and would allow certain primary insurers to escape unscathed when they would otherwise bear the initial burden of providing indemnification." *Id.* at 1262 (citation omitted).

the appellate court affirmed the trial court's adoption of horizontal exhaustion.⁴⁵

C. "Vertical Exhaustion" or "Exhaustion by Years"

While horizontal exhaustion appears to be the dominant exhaustion theory courts apply, some courts have adopted a vertical approach, particularly in recent decisions.⁴⁶ Vertical exhaustion, or "exhaustion by years," is also known as "spiking" due to its precipitous approach. That is, once a primary policy is exhausted, any remaining obligation shifts upward to the policy at the next level of coverage that was on the risk for the same period. Specifically, vertical exhaustion requires each excess policy in a triggered year to contribute to indemnification as soon as its particular underlying coverage is exhausted, even if other triggered primary policies (covering other periods) remain "untapped."

In *Dayton Independent School District v. National Gypsum Co.*,⁴⁷ where asbestos property damage claims were at issue, the District Court for the Eastern District of Texas adopted vertical exhaustion and held that only the policies immediately underlying a given excess policy need be exhausted before the policyholder may call upon that excess policy for indemnification.⁴⁸ The *Dayton* court reasoned that because each triggered policy was required to indemnify the policyholder for its entire liability, up to its coverage limits, the policyholder could select which triggered policy it wished to provide coverage.⁴⁹ Consequently, vertical exhaustion permitted the policyholder to designate the policy year that would cover the

45. See *id.*; accord *Missouri Pac. R.R. Co. v. International Ins. Co.*, 679 N.E.2d 801, 810-11 (Ill. App. Ct. 1997) (applying horizontal exhaustion and holding that policyholder must exhaust all underlying coverage prior to seeking coverage under excess policies); *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740, 755 (Ill. App. Ct. 1996) (holding that second-layer excess carrier was required to indemnify policyholder only after exhaustion of primary and first-layer excess policies).

46. See, e.g., *UNR Indus., Inc. v. Continental Ins. Co.*, Nos. 85-C-3532, 83-A-2523, 1988 WL 121574, at *12 (N.D. Ill. Nov. 9, 1988) (holding that "when underlying coverage is exhausted for any policy period, liability will exist under the terms of an excess policy It is not necessary that underlying coverage be exhausted for an entire policy period before any claim can be made against an excess carrier"); *Westinghouse Elec. Corp. v. Aetna Cas. and Sur. Co.*, No. L-069351-97 (N.J. Super. Ct. Aug. 7, 1998) (explaining that excess policy is triggered and liable to its limits as soon as directly underlying policy is exhausted according to court); *Illinois Power Co. v. Home Ins. Co.*, No. 95-L-284 (Ill. Cir. Macon County Aug. 15, 1997) (finding that policy language gives insured right to exhaust vertically and does not require policyholder to pay pro-rata damage for uninsured years).

47. 682 F. Supp. 1403 (E.D. Tex. 1988).

48. See *id.* at 1411 n.23.

49. See *id.* at 1411.

loss and receive indemnification from excess insurers for that period as the underlying policies were exhausted.⁵⁰ Notably, the *Dayton* court concluded that because the “other insurance” clauses the excess policies contained related only to the rights of each carrier against the others, the clauses did not limit the policyholder’s right to exhaust by years.⁵¹

IV. ALLOCATION OF INDEMNIFICATION OBLIGATIONS AMONG MULTIPLE CARRIERS

When more than one policy period is triggered by a continuous occurrence, a crucial determination is the manner in which claims for indemnity should be allocated or apportioned among the triggered policies.⁵² When an occurrence implicates multiple policies, courts often use one of the following methods to allocate indemnity obligations among insurers: (1) joint and several liability;⁵³ (2) pro-rata by years;⁵⁴ (3) pro-rata by years and limits;⁵⁵ or (4) pro-rata by exposure.⁵⁶

A. “Joint and Several” Liability

“Joint and several,” or “all sums” liability, which policyholders usually assert, allows recovery *in full* under any triggered policy of the policyholders’ choosing and leaves the selected insurer to pursue cross-claims against other carriers whose policies were also available. Under joint and several liability, any policy on the risk for any

50. See *id.* at 1411 & n.23; see also *UNR Indus., Inc. v. Continental Ins. Co.*, Nos. 85-C-3532, 83-A-2523, 1988 WL 121574, at *20 (N.D. Ill. Nov. 9, 1988) (holding that “[policyholder] is entitled to look to excess and umbrella carriers for coverage and indemnity after an underlying carrier has paid its limits for any annual period and need not await full payment by a primary carrier for the entire policy period”).

51. See *Dayton*, 682 F. Supp. at 1411 n.21. The *Dayton* court explained that “because no Carrier has filed a cross-claim in this action, the task of interpreting the ‘other insurance’ clauses is not before the Court. Moreover, the ‘other insurance’ clauses do not establish a basis for allocation to the insured.” *Id.*

52. See *Northern States Power Co. v. Fidelity & Cas. Co.*, 523 N.W.2d 657, 665 (Minn. 1994) (stating, “[w]e do not expect that this case will be the ‘last word’ in this area. Environmental liability insurance law, like any other area of law, will have to develop over time and trial courts must be flexible in responding to new fact situations.”).

53. For a discussion of allocation under joint and several liability, see *infra* notes 57-77 and accompanying text.

54. For a discussion of allocation under pro-rata by years, see *infra* notes 78-87 and accompanying text.

55. For a discussion of allocation under pro-rata by years and limits, see *infra* notes 88-99 and accompanying text.

56. For a discussion of allocation under pro-rata by exposure, see *infra* notes 100-05 and accompanying text.

portion of the period in which the insured sustained property damage or bodily injury is jointly and severally obligated to respond in full, up to its policy limits, for the loss. Courts applying joint and several liability usually focus on a policy's "all sums" language, which commonly states: "[t]he Company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay."⁵⁷ Once a policy is triggered, an insurer becomes liable for all sums that it is legally obligated to pay, which may include those sums attributable to bodily injury or property damage that did not occur during the insurer's policy period.⁵⁸

The leading case adopting joint and several liability is *Keene Corp. v. Insurance Co. of North America*.⁵⁹ In *Keene*, a manufacturer sought a declaratory judgment of its right to indemnification by its CGL insurers for asbestos-related personal injury claims.⁶⁰ The United States Court of Appeals for the District of Columbia held that once a particular CGL policy is triggered, the insurer is required to fully indemnify the policyholder for the entire loss up to its policy limits, even though part of the injury may have occurred during another policy period or while the policyholder was uninsured.⁶¹ Because each policy issued from the date of initial inhalation of asbestos to the date of manifestation of the injury was

57. For the full text of pertinent, typical CGL policy language, see *supra* notes 11-12 and accompanying text. Alternatively, some policies contain a substantially similar clause that states that the insurer will pay the "entire liability," rather than "all sums." Courts apply the same interpretation to either clause. See, e.g., Gillespie, *supra* note 2, at 546 (using *J.H. France v. Allstate Ins. Co.*, 626 A.2d 502 (Pa. 1993)), as example of manner in which court interprets these clauses).

58. See John H. Mathias, Jr. et al., *Winner Take All — Or Nothing: Allocation Issues in Insurance Claim Resolution*, 11 No. 12 CORP. COUNS. 1, May 1997, at *2 (contending that policy language "does not limit the insurer's duty to pay damages to those that result from bodily injury or property damage that takes place during the policy period").

59. 667 F.2d 1034 (D.C. Cir. 1981).

60. See *id.* at 1038. After being named as a co-defendant in over 6000 lawsuits alleging injuries caused by exposure to its asbestos-containing thermal insulation products, the policyholder sought coverage under CGL policies from four carriers issued to it between 1961 and 1980. See *id.*

61. See *id.* at 1047. The *Keene* court reasoned that in a long-term damage claim such as the one before it, when the policyholder is held liable for the entire loss, only part of the injury will have developed during any single policy period. See *id.* The court further stated, "[t]he issue that arises is whether an insurer is liable in full, or in part, for [the policyholder's] liability once coverage is triggered." *Id.* Relying on the "all sums" language in the policy, the *Keene* court concluded that the insurer was liable in full, subject to contribution from other insurers as set out in the policy's "other insurance" clause. See *id.* In so holding, the court declined to characterize the insured's ultimate injury as resulting from a series of discrete injuries, each confinable to an individual policy period. See *id.* Consequently, the *Keene* court concluded that pro-rata by years allocation would be inappropriate. See *id.*

triggered, each insurer in *Keene* had a joint obligation to provide the policyholder with full coverage.⁶² Further, under *Keene*, the policyholder could seek indemnification from any of the triggered policies it chose, with the stipulation that only *one* policy's limits could apply to each injury.⁶³ Several courts, including the Third Circuit,⁶⁴ the Pennsylvania Supreme Court,⁶⁵ and other federal and state courts,⁶⁶ have followed *Keene* in adopting joint and several liability.

The Supreme Court of Washington followed *Keene*, without wholly relying on its rationale, in deciding *American National Fire*

The court based its interpretation "on the terms of the policies themselves," explaining that the policyholder had a reasonable expectation that the function of a CGL policy is to relieve the policyholder of all liability once the policy is triggered. *Id.* at 1047-48. The *Keene* court further described this expectation as consistent "with the . . . underlying principles of the insurance policies at issue in [the] case." *Id.* at 1048. "There 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." *Id.*

62. *See id.* at 1050. The *Keene* court stated that the only logical scheme for allocation is for the policyholder "to be able to collect from any insurer whose coverage is triggered, the full amount of indemnity that it is due . . ." *Id.* The court also found allocation by joint liability to be the only way to afford the policyholder the complete absolution from liability it expected from its CGL policies. *See id.*

63. *See id.* at 1049-50 (emphasizing that "[t]he principle of indemnity implicit in the policies . . . does not require that [the policyholder] be entitled to 'stack' applicable policies' limits of liability").

64. *See, e.g.,* *Koppers Co. v. Aetna Cas. and Sur. Co.*, 98 F.3d 1440, 1449-56 (3d Cir. 1996) (ruling that Pennsylvania law requires joint and several allocation of environmental cleanup costs among multiple triggered insurance policies); *ACandS, Inc. v. Aetna Cas. and Sur. Co.*, 764 F.2d 968, 974 (3d Cir. 1985) (applying joint and several liability and stating that "if a plaintiff's damages are caused in part during an insured period, it is irrelevant to [the policyholder's] legal obligations and, therefore, to the insurer's liability that they were also caused, in part, during another period").

65. *See, e.g.,* *J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502, 507 (Pa. 1993) (stating "[u]nder any given policy, the insurer contracted to pay all sums which the insured becomes legally obligated to pay, not merely some pro rata portion thereof").

66. *See FMC Corp. v. Plaisted & Cos.*, 72 Cal. Rptr. 2d 467, 497-503 (Mar. 3), *modified and reh'g denied* (Mar. 27), *review denied*, (Cal. Ct. App. May 27, 1998) (allowing insured to select which of multiple triggered policies would respond to claim); *Rubenstein v. Royal Ins. Co.*, 694 N.E.2d 381, 388 (Mass. App. Ct. 1998) (affirming trial court's failure to allocate liability among insurers and thereby rejecting plaintiff's claim to allocate damages based on years of coverage); *Benoy Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 679 N.E.2d 414, 416-19 (Ill. App. Ct.), *appeal denied*, 686 N.E.2d 1158 (Ill. 1997) (reversing lower court's proportional allocation of damages and finding that each policy triggered during continuous period of environmental contamination was jointly and severally liable); *Monsanto Co. v. C.E. Heath Compens. & Liab. Ins. Co.*, 652 A.2d 30, 33-35 (Del. 1994) (applying Missouri law and finding that absent specific policy provision for pro-rata allocation, insurers' obligations were joint and several).

*Insurance Co. v. B & L Trucking and Construction Co.*⁶⁷ In *B & L Trucking*, the court held that insurers' liability for continuous injury losses is joint and several.⁶⁸ Consequently, the court concluded that pollution cleanup costs need not be allocated between an insurer and its insured when the pollution occurred over a number of years and the policyholder was uninsured for a portion of that period.⁶⁹ As in *Keene*, the *B & L Trucking* court found that the "all sums" language of the policy warranted this interpretation.⁷⁰

In her dissenting opinion in *B & L Trucking*, Justice Madsen highlighted her perceived shortcomings of the majority opinion by succinctly stating, "[t]he majority requires the insurer in this case to provide insurance coverage it neither contracted to provide nor received insurance premiums for."⁷¹ Furthermore, according to Justice Madsen, the majority's construction of the "all sums" language as suggesting joint and several liability was unreasonable.⁷² Justice Madsen concluded that in cases where environmental damage continues through insured and uninsured periods, it is illogical and inappropriate to analogize insurance allocation to the tort concept of joint and several liability.⁷³

67. 951 P.2d 250 (Wash. 1998) (Madsen, J., dissenting).

68. *See id.* at 254-57.

69. *See id.*

70. *See id.* at 256-57. The *B & L Trucking* court rejected the insurer's argument that because the insured "expected" damage after a certain date, policies triggered before that date could not be found liable for continuing damage after that date. *See id.* at 255-56. Instead, the court found that once an occurrence triggers a policy, the insurer is liable for all continuing damages flowing from the triggering occurrence. *See id.* Moreover, the *B & L Trucking* court reasoned that the insurer was a victim of its own policy language in that because the policy failed to specify whether it provided joint and several or pro-rata coverage, it was ambiguous and had to be construed against the drafter. *See id.* at 256-57. Also, "if Northern intended solely to be liable on a pro rata basis it could have included that language in its policy." *Id.* at 256. Further, the *B & L Trucking* court found that neither principles of fairness nor public policy overcome this construction against the insurer, as "because insurance policies are considered contracts, the policy language, not public policy, controls." *Id.* at 257.

71. *Id.* Recall that the standard CGL policy requires insurers to pay for only those injuries occurring "during the policy period." For the pertinent text of a standard CGL policy, see *supra* note 12.

72. *See B & L Trucking*, 951 P.2d at 258. Justice Madsen found no ambiguity in the policy, explaining:

Because the language of the policy as a whole does not obligate the insurer to pay any and all sums regardless of when the property damage occurred and regardless of the relevant policy period, there is no ambiguity to be construed in favor of the insured and against Northern Insurance.

Id.

73. *See id.* at 259. Justice Madsen stated that "[a]n insured should not be able to shift its responsibility for uninsured years to a carrier which did not contract to

Several commentators have justly criticized joint and several liability because it ignores “two of the most basic components of every insurance policy, the duration of the policy period and limits of liability.”⁷⁴ Moreover, this method of apportionment purports to extract relevant meaning from the “all sums” policy language, even though “[t]he language was never intended to cover apportionment when continuous injury occurs over multiple years.”⁷⁵ Joint and several liability also allows a policyholder to shift the risk of its own bad bargain to those solvent excess carriers who happen to have been on the risk during any triggered period.⁷⁶ Finally, this

provide coverage for that period of time.” *Id.* (citing *Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178 (2d Cir. 1995); *Northern States Power Co. v. Fidelity & Cas. Co. of N.Y.*, 523 N.W.2d 657 (Minn. 1994); *Sharon Steel Corp. v. Aetna Cas. and Sur. Co.*, 931 P.2d 127 (Utah 1997); *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974 (N.J. 1994)).

74. Shaun M. Baldwin & Dawn Midkiff, *Apportioning Indemnity and Defense Costs: The “Other Insurance” Clause and Other Theories of Allocation*, in *SELECTED ISSUES IN INS. COVERAGE AND PRAC.* (Defense Research Inst. 1990). Several courts’ decisions have criticized joint and several liability for essentially ignoring the duration of the policy period and limits of liability in apportioning indemnification costs. *See, e.g.*, *Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1225 (6th Cir. 1980) (stating that “[e]ach insurer is liable for its pro rata share. The insurer’s liability is not ‘joint and several,’ it is individual and proportionate.”); *see also* *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740, 753 (Ill. App. Ct. 1996) (rejecting joint and several liability as inconsistent with plain language of policy).

75. *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974, 989 (N.J. 1994). The *Owens-Illinois* court commented that “to convert the ‘all sums’ or ‘ultimate net loss’ language into the answer to apportionment when injury occurs over a period of years is like trying to place one’s hat on a rack that was never designed to hold it. It does not work.” *Id.* The court also noted that “the argument that all sums to be assessed because of long-term exposure . . . could have been established in any one of the policy years is intuitively suspect” *Id.* Further, the *Owens-Illinois* court found several “anomalies” to be present in the *Keene* court’s application of joint and several liability:

One anomaly in the *Keene* court’s analysis is that a single claim for the cost of cure of a long-term release of contaminants that polluted a city water supply would be limited to one policy’s limits, whereas if 300 residential wells were affected, the limits of multiple policies would be available, though the occurrence (cause) was the same. Another anomaly is that although the opinion’s premise is that all damages can be claimed in any one of the years, it nonetheless calls for contribution from other policies. By definition, if all damages occurred in one of the years (in the sense of that year’s injury establishing the damages), none of the other policies would be triggered.

Id. at 987. *See also* *Montrose Chem. Co. v. Admiral Ins. Co.*, 913 P.2d 878, 903 (Cal. 1995) (rejecting joint and several liability, in part because of the “arbitrariness, from the carrier’s perspective, of telescoping all damage in a continuing injury case in a single policy period”).

76. Such a situation may arise in the case of a policyholder with a self-insured retention, retrospective premium plans, one or more insolvent carriers, no coverage for significant periods or no coverage due to policy exclusions. *See, e.g.*, *General Refractories Co. v. Allstate Ins. Co.*, No. CIV. A.89-7924, 1994 WL 246375, at *7

allocation scheme generates large transaction costs by requiring an increased amount of litigation.⁷⁷

B. “Pro-Ration by Years”

Under “pro-ration by years,” or “time on the risk,” each triggered policy bears a share of the total damages proportionate to the number of years it was on the risk, relative to the total number of years of triggered coverage. Significantly, pro-ration by years usually assigns loss without regard to the primary policies’ limits of liability. For example, if a single continuing occurrence begins in year one and ends in year ten, and there are ten one-year policies, exactly one-tenth of the loss will be assigned to each policy.

Pro-ration by years rejects the basic premise of joint and several liability; namely, that the “all sums” language makes a carrier liable for the full amount of bodily injury or property damage if any portion of the loss occurred during its policy period. Instead, courts adopting pro-ration by years recognize that the definitions of “occurrence,” “bodily injury” and “property damage,” read in conjunction with the “Insuring Agreement,” mandate that the allocation of loss to a particular policy be proportionate to the damage suffered during that policy’s term. Due to the difficulty of establishing the actual amount of loss sustained during an individual policy period, however, these courts reason that a simple calculation based on

(E.D. Pa. June 8, 1994) (holding that underlying insurer’s insolvency did not require excess insurer’s coverage to “drop down”).

77. See Doherty, *supra* note 1, at 271 (explaining that because of additional litigation joint and several liability requires, that allocation method “does not solve the allocation problem; it merely postpones it”). Joint and several allocation necessitates the filing of cross-claims or subsequent actions to fairly determine carriers’ contributions. This approach results in the need for a second lawsuit in which the insurer selected by the policyholder sues the other triggered insurers for contribution.

In support of its rejection of joint and several liability, the Sixth Circuit stated in *Forty-Eight Insulations* that “[t]he only thing on which all parties agree is that there is a need for us to arrive at an administratively manageable interpretation of the insurance policies — one that can be applied with minimal need for litigation.” *Forty-Eight Insulations*, 633 F.2d at 1218. The court in *Owens-Illinois* similarly highlighted that “[o]ne thing is certain: The present system is inefficient.” *Owens-Illinois*, 650 A.2d at 993. Further, the *Owens-Illinois* court emphasized that although legal costs in environmental coverage litigation can represent as much as 70% of total cleanup costs, “once the rules are settled, litigation costs may decline.” *Id.* (citation omitted). One commentator, however, asserts that CERCLA itself must change before litigation costs can decrease. See Chris Roush, *The Hurricane Called Superfund: Cleanup Claims Could Hit \$1 Trillion — and Batter Insurers*, Bus. Wk., Aug. 2, 1993, at 74 (noting that “[o]f the \$15 billion that has already been spent on Superfund cleanups [through 1993], roughly 75% has gone to legal fees and related costs . . . [a]nd fewer than 200 of the 1,300 sites have been cleaned.”).

time on the risk is the most equitable and efficient means of allocating indemnification obligations.⁷⁸

The seminal case adopting pro-ration by years is *Insurance Co. of North America v. Forty-Eight Insulations, Inc.*,⁷⁹ in which an asbestos-related personal injury claim was at issue.⁸⁰ In *Forty-Eight Insulations*, the Sixth Circuit held that indemnification and defense costs should be “prorated . . . among all of the insurance companies which were on the risk while the injured victim was breathing in asbestos.”⁸¹ Furthermore, the court concluded that the insured itself was to be treated as an insurer for those periods of time during which it had no insurance coverage.⁸² Because the *Forty-Eight Insulations* court found the insurers’ liability to be “individual and proportionate,” as opposed to “joint and several,” it ruled that an insurer would not be liable for years in which there could not have been any exposure to asbestos that its insured manufactured.⁸³ The Sixth Circuit explained its holding by stating, “[g]iven the impossibility in most cases of ascertaining which company provided asbes-

78. Pro-ration by years offers several potential benefits. First, it spreads the risk to the maximum number of carriers and to the policyholder for those periods in which the policyholder was uninsured. Second, once the total amount of loss is established, pro-rations by years requires only a relatively simple calculation for allocating indemnification obligations. In light of the costs of insurance litigation in these matters, this ease in application is a substantial consideration. For an estimate of litigation costs in environmental cases, see *supra* notes 3 & 78 and accompanying text. Third, pro-ration by years alleviates the subsequent contribution actions between the various carriers that joint and several liability among the insurers necessarily requires. For a discussion of additional litigation under joint and several liability, see *supra* note 77 and accompanying text.

79. 633 F.2d 1212 (6th Cir. 1980).

80. See *id.* at 1213-14.

81. *Id.* at 1224, 1226. Addressing the insurance companies’ concerns that pro-ration by years would create problems with coverage “stacking,” the Sixth Circuit affirmed the district court’s holding limiting the total amount a carrier would be required to pay. See *id.* at 1226 n.28. The *Forty-Eight Insulations* court also stated that “[i]n any event, no insurer should be held liable in any one case to indemnify [the policyholder] for judgment liability for more than the highest single yearly limit in a policy that existed during the period of the claimant’s exposure for which judgment was obtained.” *Id.* (citation omitted).

82. See *id.* at 1224, 1226 (illustrating by stating that “if insurer A provided 3 years of coverage, insurer B an additional 3 years, and the manufacturer was uninsured for the remaining 3 years, liability would be allocated at 1/3 for each of the three concerns”).

83. *Id.* at 1225. The *Forty-Eight Insulations* court noted that an insurer would similarly not be liable for years in which a worker used an effective respirator. See *id.* In support of its refusal to impose liability on the insurer for those years, the court highlighted that “no bodily injury resulting from [the policyholder’s] products took place during the years in question.” *Id.*

tos products in different years, we think that this is the fairest way to apportion liability.”⁸⁴

Among the courts that have followed the Sixth Circuit’s lead in adopting pro-ration by years are the United States Courts of Appeals for the Second and Fifth Circuits,⁸⁵ the Supreme Court of Minnesota⁸⁶ and several other federal and state courts.⁸⁷ The major flaw of pro-ration by years, however, is that it fails to consider the limits of each policy. Therefore, a policy with very low limits of liability may be liable for the same amount as a policy with much greater limits, despite the likely disparity in the premium that the respective carriers collected from the policyholder.

C. “Pro-Ration by Years and Limits”

As the name suggests, “pro-ration by years and limits” allocates indemnification among policies based on both the number of years a policy is on the risk as well as that policy’s limits of liability. The basis of an individual insurer’s liability is the aggregate coverage it underwrote during the period in which the loss occurred.⁸⁸ Basically, a given insurer’s liability is determined by comparing its particular exposure to the total amount of exposure assumed by all

84. *Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1225 (6th Cir. 1988).

85. *See, e.g.*, *Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1191 (2d Cir. 1995) (approving district court’s application of pro-ration by years allocation of damages); *Porter v. American Optical Corp.*, 641 F.2d 1128, 1145 (5th Cir. 1981) (citing *Insurance Co. of North America v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212 (6th Cir. 1980), and holding that liability should be pro-rated among all carriers). In *Porter*, the Fifth Circuit also recognized that no insurer would be liable for periods when there could not have been exposure. *See id.* at 1145.

86. *See, e.g.*, *Northern States Power Co. v. Fidelity and Cas. Co.*, 523 N.W.2d 657, 662-63 (Minn. 1994) (rejecting joint and several liability in favor of pro-ration by years in soil and groundwater contamination case).

87. *See, e.g.*, *Olin Corp. v. Insurance Co. of N. Am.*, 972 F. Supp. 189, 202 (S.D.N.Y. 1997) (describing pro-ration by years as “a practical approach, although not a literal application of the insurance terms”); *Lafarge Co. v. National Union Fire Ins. Co.*, 935 F. Supp. 675, 689 (D. Md. 1996) (applying injury-in-fact trigger and allocating liability pro-rata by time on risk); *Stonewall Ins. Co. v. City of Palos Verdes Estates*, 54 Cal. Rptr. 2d 176, 208 (Cal. Ct. App. 1996) (ordering lower court to apportion indemnity fairly among insurers, but strongly suggesting “qualified time on the risk” approach); *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740, 748 (Ill. App. Ct. 1996) (holding that environmental damages must be apportioned pro-ration by years among excess insurers, beginning with first layer excess policies); *Conductron Corp. v. American Employer’s Ins. Co.*, Nos. 93-E-149, 93-C-599 (N.H. Super. Ct. Mar. 4, 1997) (allocating loss uniformly to insurers, and policyholder for uninsured periods, throughout exposure period).

88. For an example of the application of pro-ration by years and limits to the allocation of liability, see *infra* note 89. For an example of the application of pro-ration by years and limits to the allocation of defense costs, see *infra* note 112.

carriers of the triggered policies. This comparison yields a percentage that is then applied to the amount of loss the policyholder sustained.⁸⁹

The seminal case adopting pro-ration by years and limits is *Owens-Illinois, Inc. v. United Insurance Co.*⁹⁰ In *Owens-Illinois*, the policyholder sought indemnification from several primary and umbrella excess carriers for tens of thousands of asbestos-related personal injury and property damage claims.⁹¹ Applying a continuous trigger of coverage, the New Jersey Supreme Court ordered an allocation based on each policy's years and limits.⁹² Finding that the policies failed to consider coverage cases involving long-term, mass-exposure toxic torts,⁹³ the *Owens-Illinois* court found it neces-

89. The following illustrates application of pro-ration by years and limits:

For each of the years 1993 and 1994, Insurance Company A (Company A) provided XYZ Chemical Company (XYZ) with general liability insurance under a one-year policy with a \$1 million limit of liability. For 1995, Insurance Company B (Company B) provided XYZ with general liability insurance under a one-year policy with a \$3 million limit of liability. From the beginning of 1993 through the end of 1995, toxic substances leaked from XYZ's factory (assume that none of XYZ's CGL policies contained a pollution exclusion clause). The state in which XYZ was located ordered remediation of the soil surrounding the factory, which cost XYZ \$1 million. XYZ requested indemnification from Companies A and B, which subsequently disagreed regarding their respective obligations and sought declaratory relief. The court applies a continuous trigger of coverage, implicating all three of XYZ's general liability policies, and also decides that a pro-rata by years and limits approach is the most equitable means of allocating indemnification obligations among the insurers.

The amount of each insurer's indemnification obligation is calculated as follows. The total indemnity potentially due to XYZ from Company A is \$2 million (\$1 million limit \times 2 years). The total indemnity potentially due to XYZ from Company B is \$3 million (\$3 million limit \times 1 year). Thus, the sum of all indemnity potentially available to XYZ from Companies A and B is \$5 million. Under pro-ration by years and limits, Company A would be responsible for two-fifths, or 40%, of the obligation (\$2 million aggregate limit \div \$5 million aggregate potential). Company A's proportion, 40%, is multiplied by the policyholder's total claim of \$1 million to yield an allocation to Company A of \$400,000. Company B's proportion, 60% (\$3 million aggregate limit \div \$5 million aggregate potential), is multiplied by the total claim, yielding an allocation to Company B of \$600,000. Therefore, Companies A and B would assume indemnification obligations of \$400,000 and \$600,000, respectively, under pro-ration by years and limits.

90. 650 A.2d 974 (N.J. 1994).

91. *See id.* at 978. Prior to filing its briefs with the *Owens-Illinois* court, the policyholder "had settled 43,000 bodily-injury lawsuits . . . [and] more than 90,000 bodily-injury and 63 property-damage cases were pending." *Id.* In addition, bodily-injury suits were accumulating with the policyholder at a rate of 1700 per month, and the policyholder's unreimbursed costs of defending and settling the cases had already reached \$105 million. *See id.*

92. *See id.* at 984-85, 993.

93. *See id.* at 988. From an insurance litigation standpoint, cases of this type are similar to long-term environmental damage cases.

sary to look to public policy for guidance.⁹⁴ The court noted that the principal consideration was to make “the most efficient use of the resources available to cope with environmental disease or damage.”⁹⁵ Also, recognizing straight annual progression as an inappropriate approach to allocation, the *Owens-Illinois* court rejected pro-ration by years.⁹⁶ Instead, it concluded that allocation among insurance carriers, and potentially the policyholder, should be “on the basis of the extent of the risk assumed, i.e., proration on the basis of policy limits, multiplied by years of coverage.”⁹⁷

94. See *id.* at 992. The court in *Owens-Illinois* stated that it was simply “unable to find the answer to allocation in the language of the policies.” *Id.* at 990. Furthermore, the court found little guidance in “the other usual principles of interpretation of contracts.” *Id.* at 991. Although the *Owens-Illinois* court considered the doctrines of strict construction and contra proferentem, as well as the objectively reasonable expectations of the policyholder and retroactive imposition of absolute liability under CERCLA, it found that the results under those considerations would be inconsistent. See *id.* The court also noted that “[t]o have shifting rules of interpretation that depend on the configuration of insurance coverage is unacceptable Therefore, the public interest factors . . . serve to guide us.” *Id.* at 991-92.

95. *Owens-Illinois v. United Ins. Co.*, 650 A.2d 974, 992 (N.J. 1994). For instance, regarding self-insurance, the *Owens-Illinois* court observed that because the insurance industry can most efficiently spread the costs of damage, the law should create an incentive for parties to acquire insurance. See *id.* Consequently, for the periods in which the policyholder opted not to obtain insurance, the *Owens-Illinois* court held that it chose to become a risk-bearer and should share in the allocation of damages. See *id.* at 992-93. The court explained:

Almost all such insurance controversies are retrospective, and to reflect now on what might have been done if the parties had contemplated today's problem is almost fatuous. Our job, however, is not just to solve today's problems but to create incentives that will tend to minimize their recurrence Future actors would know that if they do not transfer to insurance companies the risk of their activities that cause continuous and progressive injury, they may bear that untransferred risk.

Id. at 992.

96. See *id.* at 993. The *Owens-Illinois* Court supported its rejection of pro-ration by years and limits by observing the failure of the approach to “relate the theory of a continuous trigger causing indivisible injury to the degree of risk transferred or retained in each of the years of repeated exposure to the injurious conditions.” *Id.* The court also implicitly advocated pro-ration by exposure in cases where the amount of injury that occurred in each policy period is ascertainable. See *id.* at 987-88, 993. Noting the difficulty in ascertaining that amount, however, the *Owens-Illinois* court stated, “any allocation should be in proportion to the degree of the risks transferred or retained during the years of exposure.” *Id.* at 993.

For a discussion of pro-ration by exposure, see *infra* notes 100-05 and accompanying text.

97. *Id.* In allocating the costs of indemnification and defense, the *Owens-Illinois* court concluded that it naturally follows that policy limits and exclusions must be considered in determining allocation. See *id.* at 994. Notably, the court did not specify how pro-ration by years and limits was actually to be developed and applied, stating:

We realize that many complexities encumber the solution that we suggest involving, as it does, proration by time and degree of risk assumed — for

Several other courts have adopted pro-ration by years and limits in apportioning liability.⁹⁸ A major criticism of pro-ration by years and limits is, however, that insurers with higher limits may be liable for a disproportionate share of damages based solely on their limits.⁹⁹

D. "Pro-Ration by Exposure"

Under "pro-ration by exposure," courts attempt to apportion liability to each policy period in accordance with the amount of injury or property damage that can be attributed to that specific policy period. The premise of pro-ration by exposure approach is that a CGL policy is required to pay only for bodily injury or property damage taking place during the policy period.

The leading case applying pro-ration by exposure is *Uniroyal, Inc. v. Home Insurance Co.*¹⁰⁰ In *Uniroyal*, a manufacturer of Agent Orange herbicides sought reimbursement from its insurers for both its share of the settlement of the underlying class action litigation as well as for defense costs.¹⁰¹ The *Uniroyal* court applied an injury-in-

example, determining how primary and excess coverage is to be taken into account or the order which policies are triggered Still, we do not believe that the issues are unmanageable [T]he legal system "frequently resolves issues involving considerable uncertainty."

Id. (citations omitted). The *Owens-Illinois* court further noted that lower courts should allow for development of a formula by a "master, one skilled in the economics of insurance." *Id.* See also *Atlantic Mut. Ins. Co. v. Truck Ins. Exch.*, 797 F.2d 1288, 1296 (5th Cir. 1986) (affirming lower court's decision to consider respective policy limits in determining liability); *Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 52 Cal. Rptr. 2d 690, 715 (Cal. App. Ct. 1996) (adopting "non-traditional" allocation approach based on policy limits multiplied by years of coverage after concluding this method was consistent with "other insurance" clause providing for pro-ration by "applicable limit of liability").

98. See, e.g., *Owens-Illinois v. United Ins. Co.*, 650 A.2d 974, 993 (N.J. 1994) (stating, "[t]hat later insurers might need to respond to pre-policy occurrences is not unfair. 'These are "occurrence" policies which, by their nature, provide coverage for pre-policy occurrences (acts) which cause injury or damage during the policy period.'" (quoting *Montrose Chem. Corp. v. Admiral Ins. Co.*, 5 Cal Rptr. 2d 358, 367 (Cal. Ct. App. 1992), *aff'd*, 913 P.2d 878 (Cal. 1995)). But see *Insurance Co. of Tex. v. Employers Liberty Assurance Corp.*, 163 F. Supp. 143 (S.D. Cal. 1958) (apportioning damages resulting from automobile accident based on premiums paid to each insurer).

99. See, e.g., *Northern States Power Co. v. Fidelity & Cas. Co.*, 523 N.W.2d 657, 662 (Minn. 1994) (stating pro-ration by years and limits "effectively makes those insurers with higher limits liable for damages incurred outside their policy periods and is therefore inconsistent with the actual injury trigger theory [which says that each insurer is only liable for damages that occurred during its policy period]").

100. 707 F. Supp. 1368 (E.D.N.Y. 1988).

101. See *id.* at 1369-70. In the action underlying *Uniroyal*, a class of 2.5 million Vietnam War veterans and their family members sued the United States and the manufacturers of Agent Orange. See *id.* at 1369. Between 1961 and 1971, the United States military sprayed 17-19 million gallons of Agent Orange over approxi-

fact trigger and the parties stipulated that any injury resulting from exposure to Agent Orange took place at, or shortly after, a serviceman's exposure to Agent Orange.¹⁰² Based on the case's enormous record, the *Uniroyal* court determined that the damages should be allocated between the policies in proportion to the respective volume of Agent Orange that the policyholder delivered to the military during each policy year.¹⁰³ The *Uniroyal* court found that the pro-ration by exposure allocation scheme was "the only one that comport[ed] with the language of the policies."¹⁰⁴

Several other courts have used pro-ration by exposure to apportion damages among multiple policies.¹⁰⁵ It may, however, be

mately ten percent of the total land area of South Vietnam. *See id.* at 1370. It is likely that over 20,000 aerial spray sorties were flown and many additional coats were applied with hand-held sprayers. *See id.* The plaintiffs in the underlying action alleged that exposure to Agent Orange caused cancers, genetic damage and birth defects, skin diseases and nervous disorders and settled their claim when seven manufacturers agreed to pay the class \$180 million. *See id.* The policyholder in *Uniroyal* sought reimbursement for its share of the settlement, \$9 million, and for its defense costs, \$3 million. *Id.*

102. *See id.* at 1389. The *Uniroyal* court distinguished the "occurrence," which created liability on the part of the policyholder, from the "injury," which triggered the policy. *See id.* at 1387. Uniroyal's deliveries of Agent Orange to the military were held to constitute a single, continuous "occurrence," even though the deliveries were made over the course of 16 months. *See id.* at 1383, 1385, 1389. Regarding the injury, the *Uniroyal* court stated, "[i]n this case there can be no doubt when [it] must be deemed to have taken place [F]or the purposes of this insurance litigation . . . injury in fact took place within a week or so of spraying." *Id.* at 1389. Further, based on "the information gleaned from years of Agent Orange proceedings in this court," the *Uniroyal* court deduced that the injury in fact occurred approximately four months after Uniroyal delivered Agent Orange to the United States military. *Id.* Consequently, because one continuous occurrence, covering two policy periods, caused the injury in fact, both policies were triggered and the net losses therefore needed to be apportioned among the insurers. *See id.* at 1391.

103. *See id.* at 1392. To calculate the proportional loss under each policy from the records of delivery dates and quantities, the *Uniroyal* court held that "[g]allons may be used as a proxy for exposure . . . and exposure may be used as a proxy for injury." *Id.* at 1393.

104. *Id.* at 1392. Although the *Uniroyal* court described the policies as "nearly silent on the allocation issue and [providing] only scant assistance in determining the allocation of numerous injuries from a continuous occurrence," it found "indicia" in them suggesting that a proportional allocation based on exposure was appropriate. *Id.* For example, the court noted that each policy was worded to provide coverage only for injuries that actually triggered that policy. *See id.* In addition, the "other insurance" clauses of the policies suggested a proportional allocation. *See id.* at 1393.

105. *See, e.g.,* Diamond Shamrock Chem. Co. v. Aetna Cas. & Sur. Co., 609 A.2d 440, 467 (N.J. Super. Ct. App. Div. 1992) (finding that pro-ration by exposure, based on New York law as created by *Uniroyal* court, was appropriate in subsequent Agent Orange case); Boeing Co. v. Aetna Cas. and Sur. Co., No. C86-352WD, 1991 WL 575712, at *2 (W.D. Wash. Oct. 16, 1991) (ruling that damages insurer caused by depositing industrial waste at two sites should be allocated in proportion to annual waste deliveries to each site); Northwest Steel Rolling Mills

difficult for courts to apply this approach because it requires a factual basis for quantifying the damages.

V. ALLOCATION OF DEFENSE COSTS

A. Background

If a court determines that more than one policy is triggered by a single, continuous occurrence, a related and potentially costly issue is apportionment of defense costs among the parties involved. Often, carriers involved in these types of cases informally agree to share the underlying defense costs, pending a determination of defense responsibility in the coverage action.¹⁰⁶ Thus, the allocation of defense costs is commonly based on the same theory as the allocation of indemnity obligations.¹⁰⁷

B. Methods of Allocation of Defense Costs

Where allocation of defense costs is permitted, courts usually use one of the following methods in a concurrent coverage situation: (1) pro-ration by years;¹⁰⁸ (2) pro-ration by years and limits;¹⁰⁹ or (3) equal shares.¹¹⁰ Under pro-ration by years, defense costs are allocated to all triggered policies in proportion to each policy's time on the risk for the single, continuing occurrence.¹¹¹ Differ-

Liquidating Trust v. Fireman's Fund Ins. Co., No. C86-376WD, 1991 WL 639662, at *6 (W.D. Wash. Feb. 27, 1991) (ruling that policyholder's damages could be apportioned over 14-year period in proportion to volume of waste shipped in each year, but holding policyholder liable for years in which it expected or intended damage).

106. Contrary to the practice of some insurance companies, in situations where the insurers are unable to agree on an allocation scheme, it is dangerous for a carrier to take the position that, although it has a duty to defend the insured, it will only pay a per year pro-rata share of the defense costs.

107. See, e.g., *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034, 1050 (D.C. Cir. 1981) (explaining that because each insurer is fully liable to its insured, each is similarly fully liable for defense costs); *Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1225 (6th Cir. 1980) (holding that "indemnity costs can be allocated by the number of years [of exposure, and] . . . [t]here is no reason why this same theory should not apply to defense costs").

108. For a discussion of allocation of defense costs under pro-ration by years, see *infra* note 111 and accompanying text.

109. For a discussion of allocation of defense costs under pro-ration by years and limits, see *infra* note 112 and accompanying text.

110. For a discussion of allocation of defense costs under equal shares, see *infra* notes 113-14 and accompanying text.

111. See, e.g., *Gulf Chem. & Metallurgical Corp. v. Associated Metals & Minerals Corp.*, 1 F.3d 365, 372 (5th Cir. 1993) (noting that "insurers need not provide separate defenses, but may be compelled by the insured to share in the cost of providing a complete defense"); *Forty-Eight Insulations*, 633 F.2d at 1226 (finding pro-ration by years to be appropriate allocation method because although insurer

ently, under pro-rata by years and limits, an individual insurer's liability for defense costs is determined by dividing its aggregate policy limits (for all the years it was on the risk for the single, continuing occurrence) by the aggregate policy limits of all the available policies and then multiplying that percentage by the amount of total defense costs.¹¹² Last, some courts have followed an equal shares or per capita approach, regardless of each triggered policy's limits or amount of time on the risk.¹¹³ Courts applying this approach reason that because each carrier has a duty to defend, they should share that obligation equally.¹¹⁴

contracted to pay entire cost of defending claim arising within policy period, it did not contract to pay defense costs for occurrences taking place outside policy period); *Continental Cas. Co. v. Medical Protective Co.*, 859 S.W.2d 789, 792 (Mo. Ct. App. 1993) (explaining that defense costs are inevitable part of claim for damages and should be apportioned in same manner as settlement for claim of damages).

112. See, e.g., *Continental Cas. Co. v. Aetna Cas. & Sur. Co.*, 823 F.2d 708, 712 (2d Cir. 1987) (commenting that "no method of apportioning liability is entirely satisfactory"); *Cooper Lab., Inc. v. International Surplus Lines Ins. Co.*, 802 F.2d 667, 676 (3d Cir. 1986) (noting that "the district court should allocate the fees expended to reflect the [parties'] respective interests"); *American States Ins. Co. v. Angstrom Motors, Inc.*, 343 F. Supp. 576, 587 (D. Mont. 1972) (concluding that "regardless of the outcome of the judgment or settlement, if any, [the insurer] must contribute its pro-rata share of the defense costs"); *Sharon Steel Corp. v. Aetna Cas. & Sur. Co.*, 931 P.2d 127, 140 (Utah 1997) (finding this approach most equitable because "it better reflects what each insurer contracted to provide").

For example, assume a single, continuous occurrence triggers three primary policies: (1) policy A has limits of \$1 million for one year; (2) policy B has limits of \$2 million a year for two years; and (3) policy C has limits of \$5 million for one year. The total amount of defense costs for a single occurrence taking place from the beginning of year one through the end of year four is \$2 million. Under pro-rata by years and limits, the defense costs would be allocated as follows:

Policy A: \$ 200,000 (\$1 mil. + \$10 mil. × \$2 mil.);

Policy B: \$ 800,000 (\$4 mil. + \$10 mil. × \$2 mil.);

Policy C: \$1,000,000 (\$5 mil. + \$10 mil. × \$2 mil.).

113. See, e.g., *New York v. Blank*, 27 F.3d 783, 788-89 (2d Cir. 1994) (finding that policies' "other insurance" and contribution clauses required contribution to defense costs by equal shares); *United States Fidelity & Guar. Co. v. Executive Ins. Co.*, 893 F.2d 517, 520 (2d Cir. 1990) (finding policy's language legally obligated insurers to "contribute in equal shares to defense"); *Federal Ins. Co. v. Cablevision Sys. Dev. Co.*, 836 F.2d 54, 57-58 (2d Cir. 1987) (ruling that although policies' "other insurance" and contribution clauses address indemnification only, they demonstrate insurers' intent to similarly apportion defense costs); *Atlantic Mut. Ins. Co. v. Truck Ins. Exch.*, 797 F.2d 1288, 1296 n.6 (5th Cir. 1986) (affirming district court's decision that applied equal shares allocation of defense costs); *Pacific Indem. Co. v. Linn*, 766 F.2d 754, 765 n.2 (3d Cir. 1985) (focusing on rules of interpretation for contractual language in determination of insurers' ability to pay defense costs); *Argonaut Ins. Cos. v. Medical Liab. Mut. Ins. Co.*, 760 F. Supp. 1078, 1086 (S.D.N.Y. 1991) (apportioning defense costs equally regardless of amount of premium insurer received from defendant).

114. See, e.g., *Atlantic Mut.*, 797 F.2d at 1296 n.6 (explaining that "[b]ecause Truck and Atlantic had equal obligations to defend [the policyholder], defense

VI. ORPHAN SHARES

A. Background

One of the most hotly litigated allocation issues is whether the policyholder must assume responsibility for gaps in coverage that can arise in various circumstances.¹¹⁵ Although the previous discussions of allocation of indemnity payments and defense costs address, to some extent, the allocation of these “orphan shares,” the issue is worrisome enough to both the insurer and the insured to merit a brief, independent analysis.

B. Indemnification Obligations of Orphan Shares

1. Courts Requiring Apportionment to the Insured

Courts imposing liability for orphan shares on the policyholder have often done so with the logic that the policyholder willingly, or through misfortune, “self-insured,” and therefore must be held responsible for all risk in that period.¹¹⁶ For example, in *Uniroyal, Inc. v. Home Insurance Co.*,¹¹⁷ the District Court for the Eastern District of New York allocated liability for uninsured periods to the insured, observing that “[a] firm that fails to purchase insurance for a period . . . is self-insuring for all the risk incurred in that period;

costs should be apportioned equally between them”); *Cablevision*, 836 F.2d at 57 (stating, “each insurer had an equal and unlimited duty to defend”).

115. There are five scenarios that often lead to gaps in insurance coverage. First, after assessing potential risk, the policyholder may make a conscious business decision to not purchase insurance for a certain time period. Second, an uninsured period may occur where the policyholder selected a carrier that subsequently became insolvent. Third, there may be periods for which the policyholder is unable to prove the existence, terms and conditions of its policies. Fourth, an exclusion or limitation may preclude coverage for a specific risk. Fifth, insurance may be unavailable because of market conditions or statutory mandates.

The reasons for which a policyholder does not have responsive insurance for certain time periods can be significant in litigation. *See, e.g.*, *E.I. DuPont de Nemours & Co. v. Admiral Ins. Co.*, Civ. A. No. 89C-AU-99, 1995 WL 654020, at *16 (Del. Super. Ct. Oct. 27, 1995) (highlighting absence of coverage as relevant to determination of policyholder’s liability for uninsured period). Alternatively, it is arguably illogical to consider such factors, because whatever the reason for the gap, making insurers pay for uninsured periods through allocation makes them liable for damages incurred outside their policy periods.

116. *See, e.g.*, *Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1203 (2d Cir. 1995); *modified*, 85 F.3d 49 (2d Cir. 1996) (explaining that for these periods the policyholder either opted to not obtain insurance or failed to procure adequate coverage).

117. 707 F. Supp. 1368 (E.D.N.Y. 1988). For a discussion of the facts of *Uniroyal*, see *supra* notes 100-05 and accompanying text.

otherwise, it would be receiving coverage for a period for which it paid no premium. *Self-insurance is called 'going bare' for a reason.*"¹¹⁸

Similarly, in *Stonewall Insurance Co. v. Asbestos Claims Management Corp.*,¹¹⁹ the Second Circuit allocated orphan shares to the policyholder.¹²⁰ The *Stonewall* court stated that "proration-to-the-insured is a sensible way to adjust the competing contentions of the parties in the context of continuous triggering of multiple policies over an extended span of years."¹²¹ The court thus held that allocation to the insured is appropriate for periods in which the insured either chose not to purchase coverage or obtained insufficient coverage.¹²² Where the period of self-insurance resulted from circumstances entirely beyond the policyholder's control, however, the *Stonewall* court found it inappropriate to apportion liability to the insured.¹²³ Consequently, the court refused to apply "proration-to-the-insured" to policy years when asbestos liability insurance was unavailable to insureds because of uniform application of asbestos exclusions.¹²⁴ In recent years, the courts in several federal and state cases have apportioned liability for orphan shares to policyholders, generally applying the same rationale as the *Uniroyal* and *Stonewall* courts.¹²⁵

118. *Id.* at 1392 (emphasis added) (citing *Developments in the Law - Toxic Waste Litigation VIII: Bankruptcy and Insurance Issues*, 99 HARV. L. REV. 1458, 1584 (1986)).

119. 73 F.3d 1178 (2d Cir. 1995), *modified*, 85 F.3d 49 (2d Cir. 1996).

120. *See id.* at 1203.

121. *Id.*

122. *See id.* As the district court explained in *Stonewall*:

It was [the insured] that chose to place its insurance with those companies which are now insolvent, and [the insured] that bargained away coverage by accepting asbestos exclusion clauses. There is no possible justification for shifting the economic consequences of [the insured's] decision to the remaining insurers. Relying on social policy to justify imputing an expectation of complete coverage to the insured is legally . . . insupportable.

Stonewall Ins. Co. v. National Gypsum Co., No. 86-CIV-9671, 1992 U.S. Dist. LEXIS 8898, at *6 (S.D.N.Y. June 22, 1992).

123. *See Stonewall*, 73 F.3d at 1203.

124. *See id.* (reasoning that, unlike situations where insured voluntarily declined to purchase insurance or purchased insufficient amounts, insureds were not afforded choice of acquiring asbestos coverage after 1985).

125. *See, e.g.*, *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740, 748-49 (Ill. App. Ct. 1996) (allocating liability pro-rata by years and holding that policyholder was responsible for pro-rata share for periods of no insurance or self-insurance). The *Outboard Marine* court noted that if liability were not allocated to the policyholder, the policyholder could "avoid absorbing the cost resulting from its position as a self-insurer in the other triggered policy periods . . ." *Id.* at 748 (quoting *United States Gypsum Co. v. Admiral Ins. Co.*, 643 N.E.2d 1226, 1261 (Ill. App. Ct. 1994)); *see also* *Domtar, Inc. v. Niagara Fire Ins. Co.*, 552 N.W.2d 738, 745 (Minn. Ct. App. 1996), *rev'd in part on other grounds*, 563 N.W.2d 724 (Minn. 1997) (affirming trial court's pro-rata allocation to policyholder for periods during

2. Courts Rejecting Apportionment to the Insured

Some courts have refused to assign orphan shares to the policyholder. These courts reason that a gap in coverage is not equivalent to self-insurance.¹²⁶ Consequently, they hold that such a concept should not be grafted onto the policies.¹²⁷

The most significant case to reject apportionment to the policyholder is also the seminal case adopting a joint-and-several allocation of indemnification obligations: *Keene Corp. v. Insurance Co. of North America*.¹²⁸ In declining to apportion orphan shares to the insured, the *Keene* court explained:

We have no authority upon which to pretend that [the insured] also has a "self-insurance" policy that is triggered for periods in which no other policy was purchased. Even if we had the authority, what would we pretend that the policy provides? What would its limits be? There are no self-insurance policies, and we respectfully submit that the contracts before us do not support the judicial creation of such additional insurance policies.¹²⁹

which it did not have responsive insurance). In holding that the trial court could allocate liability to the policyholder "for damage during periods of time when [the policyholder] could not establish coverage," the *Domtar* appellate court closely followed the reasoning of the Minnesota Supreme Court in *Northern States Power Co. v. Fidelity & Casualty Co.*, 523 N.W.2d 657 (Minn. 1994). See *Domtar*, 552 N.W.2d at 743. The *Domtar* court found that, under the *Northern States Power* decision, the supreme court clearly approved of distributing damage from the initial point of contamination to the end of the last self-insured period, thereby including the periods in which there was no insurance. See *id.* at 744.

Accord *Commercial Union Ins. Co. v. Sepco Corp.*, 918 F.2d 920, 924 (11th Cir. 1990) (finding as reasonable district court's holding that each entity was only responsible for pro-rata share of defense costs and making Sepco responsible for these costs when it was uninsured); *NL Indus., Inc. v. Commercial Union Ins. Co.*, 926 F. Supp. 446, 465-66 (applying New York law and explaining that pro-rata approach is preferred method of sharing); *E.R. Squibb & Sons v. Accident & Cas. Co.*, 860 F. Supp. 124, 127 (S.D.N.Y. 1994) ("Pro rata sharing of cost among carriers is appropriate and called for to avoid placing any carrier at a special disadvantage, perhaps as a settlement device commonly employed in cases involving joint and several liability to induce a rush to settle early in the course of a litigation."); *Northern States Power Co. v. Fidelity & Cas. Co.*, 523 N.W.2d 657, 664 (Minn. 1994) (stating that "insured bears the burden of proving the total amount of damages for which coverage may exist"); *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974, 995 (N.J. 1994) (holding that where company chose to retain risk by being uninsured, company will be factored into allocation formula as risk-bearer).

126. See, e.g., *J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502, 508 (Pa. 1993) (concluding that to treat *uninsured periods* as *self-insured* periods is to "create a judicial fiction which cannot be supported").

127. See *id.*

128. 667 F.2d 1034 (D.C. Cir. 1981). For a discussion of the facts of *Keene*, see *supra* notes 60-63 and accompanying text.

129. *Id.* at 1048-49.

Although several state courts have followed *Keene* in refusing to assign liability for coverage gaps to the policyholder,¹³⁰ such holdings yield not only unfair results for insurers, but also adverse public policy consequences.¹³¹

C. Assignment of Defense Costs

Even when a court requires an insured to pay a portion of the damages, the question of whether the insured must also pay a portion of defense costs sometimes remains. The leading pre-*Owens-Illinois* case assigning orphan shares of defense costs to a policyholder is *Insurance Co. of North America v. Forty-Eight Insulations, Inc.*¹³² In *Forty-Eight Insulations*, the Sixth Circuit reasoned that because the insurer contracted to pay the cost of defending only those claims that arose within the policy period, the policyholder was required to pay for the defense of the non-covered risk.¹³³ Although several other federal and state courts have similarly apportioned de-

130. See *J.H. France Refractories*, 626 A.2d at 508 (relying heavily on *Keene* in concluding that uninsured and self-insured periods are not equivalent); *Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 52 Cal. Rptr. 2d 690 (Cal. Ct. App. 1996) (holding that policyholders did not have an obligation to pay pro-rata share for any uninsured or self-insured periods of time).

131. See *Owens-Illinois v. United Ins. Co.*, 650 A.2d 974, 991-992 (N.J. 1994) (explaining that “[b]ecause insurance companies can spread costs throughout an industry and thus achieve cost efficiency, the law should, at a minimum, not provide disincentives to parties to acquire insurance.”). One commentator asserts that allowing policyholders to avoid responsibility for uninsured periods fails to advance the important public policy consideration of encouraging parties to purchase insurance. See *Doherty*, *supra* note 1, at 265-66. That commentator also notes that although some long-term environmental damages will occur whether parties are insured or not, insurance helps reduce their cost to society in three ways. See *id.* First, it spreads the risk to those who are “more efficient risk bearers.” *Id.* Second, “[b]y tailoring premiums to the level of risk incurred, insurance forces insured companies to . . . assess and manage the risks involved in their activities.” *Id.* at 266. Third, insurance “reduces the costs of progressive injuries by decreasing the risk of bankruptcy . . . due to the threat of tremendous liability.” *Id.* By affording the same degree of coverage to policyholders who allow gaps to form in their insurance plans and policyholders who consistently maintain adequate insurance programs, courts provide companies with a disincentive to obtain insurance. See *Owens-Illinois*, 650 A.2d at 992 (explaining theory of transfer of risks as it relates to insurance).

132. 633 F.2d 1212 (6th Cir. 1980). For a discussion of the facts of *Forty-Eight Insulations*, see *supra* notes 80-84 and accompanying text.

133. See *id.* at 1224-25. The *Forty-Eight Insulations* court highlighted that failing to apportion costs to the policyholder for uninsured periods conveys an unfair benefit to the policyholder at the expense of its insurers. See *id.* The court also explained that refusing to allocate these costs to the policyholder would mean that “a manufacturer which had insurance coverage for only one year out of 20 would be entitled to a complete defense . . . the same as a manufacturer which had coverage for 20 years out of 20. Neither logic nor precedent support [sic] such a result.” *Id.* at 1225.

fense costs for uninsured periods to the policyholder, some courts have held that the policyholder is not responsible for paying a portion of the costs of the defense.¹³⁴ That court reasoned that “although such defense costs may be allocated among insurers, such ‘duty to apportion’ does not apply to deny a policyholder its contractual right to a complete defense where the policyholder was not insured at all times.”¹³⁵

VII. CONCLUSION

Although it seems that the media and commentators have been forever chronicling the continuing legal battles of long-tail, multiple-trigger environmental claims, courts have had a relatively brief period in which to determine liability in the coverage context. Clearly, when drafted, the standard form CGL policy was not intended to cover these environmental liabilities. As courts continue to establish their positions regarding allocation issues, parties have at least some basis for predicting how a jurisdiction will apportion liability.

134. *See, e.g., Gulf Chem. & Metallurgical Corp. v. Associated Metals & Minerals Corp.*, 1 F.3d 365 (5th Cir. 1993) (holding that “the insured must bear its share of those [defense] costs determined by the fraction of the time of injurious exposure in which it lacked coverage”); *Budd Co. v. Travelers Indem. Co.*, 820 F.2d 787, 791 (6th Cir. 1987) (ruling that policyholder was obligated to reimburse its insurer for defense costs of claims found to have occurred outside of insurer’s policy period). *But see, e.g., Scottsdale Ins. Co. v. Homestead Land Dev. Corp.*, 1992 U.S. Dist. LEXIS 19525, at *21 (N.D. Cal. Dec. 3, 1992) (stating that “it would be patently unreasonable to expect an insurer to protect its insured against liabilities for which the insured did not bargain . . . [a]ny conclusion to the contrary would lead to a windfall to the insured”).

135. *County of San Bernadino v. Pacific Indem. Co.*, 56 Cal. App. 4th 666, 669 (1997). Significantly, because only the issue of the “duty to defend” was present, neither the appellate nor the trial courts reached the issue of whether the policyholder was responsible for paying the damages that occurred during the period of self-insurance. *See id.* at 671-72, 675-77.

