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PRIMARY LIABILITY UNDER EXCESS INSURANCE CLAUSES: STATE CAPITAL INSURANCE CO. V. MUTUAL ASSURANCE SOCIETY AGAINST FIRE ON BUILDINGS

I. INTRODUCTION

Insurance is a contract by which the insurer undertakes to indemnify the insured against loss arising from the destruction of or injury to the insured's property as a result of certain causes.[1] By its very nature an indemnity contract obligates the insurer to reimburse the insured for the amount of actual loss suffered by the insured.[2] There are, however, situations in which multiple insurance coverage exists; that is, the same interest and the same risk are insured at the same time by more than one separate and distinct insurance contract, each presumably liable in the event of loss of or destruction to the insurable interest.[3] Where multiple insurance exists, a loss occurs, and every policy meets its obligation to reimburse the insured for loss suffered, the insured gets a windfall, and the indemnity principle underlying the insurance concept is violated.[4] A perplexing problem then arises in determining which insurer should be held primarily liable for reimbursing the insured for the loss suffered, and, if all insurers are primarily liable, how to apportion the loss among them.

In response to this problem, insurance companies developed form insur-

1. Continental Cas. Co. v. Fleming, 46 Ill. App. 2d 276, 197 N.E.2d 88 (1964). Brand Distrib., Ins. v. Ins. Co. of N. America, 532 F. 2d 352 (4th Cir. 1976). *See also* R. KEETON, INSURANCE LAW § 1.2(a)-(b) (1971) [hereinafter cited as *Keeton*] where the author provides a seven prong test for determining what constitutes insurance, and W. VANCE and B. ANDERSON, VANCE ON INSURANCE § 1 (3d ed. 1951) [hereinafter cited as VANCE] where a five prong test for establishing an insurance contract is set forth.

2. Brand, 532 F.2d at 359. Note that, if the insured has a valued policy which is clearly stated as such, the face amount of the policy will be reimbursed. A valued policy is one in which an agreed value is fixed on the property and, in the event of loss, the stated value is paid regardless of the amount of actual loss. In order to constitute a valued policy, the policy, on its face, must state specifically that it is intended to be a valued policy. Houston Fire and Cas. Ins. Co. v. Nichols, 435 S.W.2d 140, 142 (Sup. Ct. Tex. 1968).

3. Smith v. Northern Ins. Co. of N.Y., 232 App. Div. 354, 250 N.Y.S. 30 (1931). Note that dual or multiple insurance must be distinguished from insurance coverage procured by two parties on the same property but where each has a separate interest in the property, i.e., mortgagor—mortgagee or vendor—vendee. This does not constitute multiple insurance as used in this article. However, two people may have more than one distinct policy, but if those policies cover the same interest it is multiple insurance. The most common example of this is a permissive user of an automobile who is covered by both the insurance procured by the owner of the auto which is applicable to him under the omnibus clause and his own insurance.

4. The indemnity principle, as a general rule, has no application to life, accident, health, and medical insurance. Policies covering these areas are absolute, and the insurer agrees to pay the face value of the policy even though other similar coverage exists. Keckly v. Coshocton Glass Co., 86 Ohio St. 213, 99 N.E. 299 (1912).

ance contracts which contained restrictive clauses.[5] Initially, these took the form of "moral hazard" clauses.[6] The intent was to preclude the insurer's liability under the contract in the event that a claim arose if the insured had any other insurance contract covering the same insurable interest at the time of the loss.[7] The "moral hazard" clause was subsequently displaced as a standard feature of insurance contracts in favor of the no liability clause,[8] the pro rata clause,[9] or the excess insurance clause.[10] These latter clauses remain the predominant form of restrictive clauses found in the standard insurance contract today.

The object of these clauses was to implement the principle of indemnity[11] and to reduce the incidence of moral hazard due to over insurance.[12] However, because nearly all standard insurance contracts included some form of restrictive clause, there was an increase in insurance litigation focusing on the construction of these clauses when multiple insurance existed to

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5. A restrictive clause is merely a clause in an insurance contract which purports to limit the liability of the insurance company.

6. VANCE, *supra* note 1, at § 144. At 840 Vance reprints a typical "moral hazard" clause as follows: "Unless otherwise provided by agreement in writing added hereto this Company shall not be liable for loss of damage occurring while the insured shall have any other contract of insurance, whether valid or not, on property covered in whole or in part by this policy."

7. *Id.*

8. KEETON, *supra* note 1, at § 3.11(a). The author illustrates a typical no liability clause by citing lines 25 to 27 of the New York Standard Fire Insurance policy: "Other insurance may be prohibited or the amount of insurance may be limited by endorsement attached hereto." *See also* N.Y. Ins. Law § 168(1) (McKinney 1966).

9. KEETON, *supra* note 8. A standard pro rata clause is illustrated by lines 86 to 89 of the New York Standard Fire Insurance policy: "This Company shall not be liable for a greater proportion of any loss than the amount hereby insured shall bear to the whole insurance covering the property against the peril involved, whether collectible or not."

10. Language exemplifying an excess insurance clause is: "If there is any other insurance available to the insured there shall be no insurance afforded hereunder, except that if the applicable limit of liability of this policy is in excess of the applicable limit provided by the other insurance available this policy shall afford excess insurance." Insurance Co. of America v. State Farm Ins. Co., of 75 Wash. 2d 200, 499 P.2d 391 (1969). *See also* 44 Am. Jur. 2d INSURANCE § 1815 which has a similar clause.

11. Myers, *Insurance,* 4 St. Mary's L. J. 444, 445 (1975). Basically, the insurance companies are attempting to limit recovery to a specific amount.

12. 8 APPLEMAN INSURANCE LAW AND PRACTICE § 4912 n.15. [hereinafter cited as Appleman]. Keeton and Vance both state that, after loss or destruction of the property, the jury is unable to examine it and fix its proper value. To the dishonest person this presents a temptation to intentionally destroy the insured property which is known to be over-insured with the intent of recovering insurance proceeds greater than the actual value of the insured property. While the honest person may not succumb to this temptation, he, nevertheless, is aware of the over-insurance and his awareness of the potential recovery in the event of loss or destruction may result in the insured not exercising as great an amount of care and diligence in protecting the property as he normally would. KEETON, *supra* note 1, at § 3.11(a), and VANCE, *supra* note 1, at § 144.

cover the insured's loss and each policy contained such a clause purporting to limit its liability for the loss.[13] A strict and literal construction of the restrictive clauses in each policy where multiple coverage exists would result in the absence of valid coverage for the insured in spite of the fact that in the absence of these clauses each insurer would be liable.[14] To avoid this harsh result, the courts have fashioned rules to resolve conflicts between restrictive clauses in two or more insurance contracts which cover the same interest and to afford the insured coverage consistent with the indemnity principle.[15]

This article examines the resolution of this conflict where multiple insurance policies each contain an excess insurance clause.[16] The examination includes a discussion of how various jurisdictions resolve the conflict, the rationales involved, and the methods of loss apportionment available. The focus then shifts to the state of the law in Virginia and a review of the most recent developments in the relevant Virginia case law.

II. The Varying Positions On Excess Insurance Clauses

As noted above, when there is multiple insurance coverage of the same insurable interest and each policy contains an excess insurance clause, a literal construction of these clauses precludes coverage by either policy

13. Generally, the various restrictive clauses are not found in life, health, accident, medical or hospital insurance. Keeton opines that the reasons for their absence in these forms of insurance are that the indemnity principle is not as strictly applied in these areas and because the risk of over-insurance on an individual's life is not as great as it is with insurance on other interests. Keeton, *supra* note 1, at § 3.11(a).

14. Comment, *"Other Insurance" Clauses Conflict,* 5 Stanford L. Rev. 147, 148 (1952).

15. If the conflict in other insurance clauses arises between an excess insurance clause in one policy and a no liability clause in the other policy the courts generally hold that the no liability clause is inoperative, that the excess insurance clause is operative, and that the policy containing the former is primarily liable. The rationale is that the policy containing the excess liability clause is not valid collectible insurance so as to trigger the no liability clause, therefore it is ineffective. New Amsterdam Cas. Co. v. Certain Underwriters, 34 Ill. 2d 424, 216 N.E. 2d 665 (1966). Note that there is a minority rule stating that the policy first in time is primary. Kearns Coal Corp. v. United States Fidelity & Guar. Co., 118 F.2d 33 (2d Cir. 1941), *cert. denied.* 313 U.S. 579 (1941). Where the conflict between the clauses in the double insurance coverage policies involves no liability and a pro rata clause, the courts generally find the pro rata clause without effect making that policy primarily liable. McFarland v. Chicago Express, Inc., 200 F.2d 5 (7th Cir. 1952). If a conflict arises between a pro rata clause in one policy and an excess insurance clause in a second policy, the courts disregard the proration clause, honor the excess insurance clause and hold the policy with the proration clause primarily liable. Vianca v. Aetna Ins. Co., 95 Idaho 22, 501 P.2d 706 (1972). Where two proration clauses are in conflict, the courts generally give both of them effect. Continental Cas. Co. v. Fleming, 46 Ill. App.2d 276, 197 N.E.2d 88 (1964); Consolidated Shippers, Inc. v. Pacific Employees Ins. Co., 18 Cal. 2d 169, 114 P.2d 34 (1941).

16. *See* note 6 *supra.*

resulting in the insured being without valid coverage.[17] Just as the courts have constructed rules to resolve conflicts between other inconsistent restrictive clauses,[18] the courts have refused to invalidate otherwise valid insurance policies merely because each contained a boilerplate excess insurance clause.[19] The general rule has been to hold each insurance policy primarily liable,[20] and not as excess insurance. This rule extends to instances in which the policies were procured by different persons on the same insurable interest.[21] Courts have found little difficulty in rationalizing these results. The difficulty, however, lies in the method of loss apportionment among the multiple insurance carriers.

Apparently, the majority rule involves proration of liability.[22] Most jurisdictions hold the conflicting excess insurance clauses to be mutually repugnant and therefore inoperative[23] so as to trigger coverage by each policy. The rationale underlying this conclusion varies, however, among jurisdictions. Some courts hold that it was not the intent of the parties to provide that a subsequent policy should void the first;[24] others state that an attempt to construe the policies in order to hold one primarily liable and the other(s) secondarily liable would involve circuity of reasoning and dubiety of obligations;[25] still others opine that holding one policy primarily liable and the other(s) secondarily liable would be to add non-existent terms;[26] and a last group holds that neither policy, by its terms, provides for primary coverage because they are impossible of accomplishment.[27] At least

17. This occurs if the courts give the clause a literal interpretation and application, since both are excess insurance coverage they offer no coverage at all in the absence of a primarily liable policy. *See* note 14 *supra.*

18. See note 15 *supra.*

19. Pacific Indem. Co. v. Federal Am. Ins. Co., 76 Wash. 2d 249, 456 P.2d 331 (1969). *See* 167 N.W. 2d 163 (1969).

20. *Id. See also* Federal Ins. Co. v. Atlantic Nat. Ins. Co., 29 A.D. 2d 204, 287 N.Y.S.2d 212, *rev'd.*, 25 N.Y.2d 71, 302 N.Y.S.2d 769, 250 N.E.2d 193 (1969); State Farm Mut. Auto. Ins. Co. v. Union Ins. Co., 181 Neb. 253, 147 N.W.2d 760 (1967).

21. Continental Cas. Co. v. General Accident Fire and Life Assurance Co., 179 F. Supp. 535 (D. Ore. 1960); Pacific Indem. Co. v. Federated Am. Ins. Co., 7 Wash. App. 241, 499 P.2d 247 (1972), *aff'd,* 82 Wash. 2d 412, 511 P.2d 56 (1973). Generally, dual insurance coverage where there are two persons procuring the policy arises in cases involving a permissible permittee and an omnibus clause. Cosompolitan Mut. Ins. Co. v. Continental Cas. Co., 28 N.J. 554, 147 A.2d 529 (1959).

22. Argonaut Ins. Co. v. Transport Indem. Co., 6 Cal. 3d 496, 492 P.2d 673, 99 Cal. Rptr. 617 (1972).

23. *See* notes 24-27 *infra.*

24. Rouse v. Greyhound Rent-A-Car, Inc., 506 F.2d 410 (5th Cir. 1975).

25. Continental Ins. Co. v. Insurance Co. of North America, 224 Tenn. 306, 454 S.W.2d 709 (1970).

26. *Id.*

27. Cosmopolitan Mut. Ins. Co. v. Continental Cas. Co., 28 N.J. 554, 147 A.2d 529 (1959).

one other jurisdiction adheres to the proration method but simply holds each insurer liable for his pro rata share without resort to the repugnance rationale.[28]

There is a minority trend which holds that the excess insurance clause of each policy is repugnant to such clause of the other(s) rendering each inoperative, but, rather than prorating the lost,[29] the insurers are obligated to share the loss incurred.[30] Another minority view deems the mutually non-covering excess insurance clauses repugnant and holds each insurer fully liable to the insured.[31]

The actual apportionment of the loss among the multiple insurance carriers presents no difficulty to courts adhering to the minority views referred to above,[32] since the former requires an equal distribution of the loss among the insurance companies and the latter full liability of each company.[33] Keeton, however, recognizes four distinct methods of proration of the loss insured by two or more companies.[34]

Where the policies to be prorated are of equal face value, proration is realized merely by dividing the loss equally among the insurers.[35] If the face value of the policies differs, then the court can prorate the loss by (1) holding each company equally liable up to the face value of the policy;[36] (2) comparing the premiums paid on each policy;[37] or (3) holding each insurer liable for the loss proportionate to the face value of the policy.[38] The last method is the most widely recognized.

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28. Federal Ins. Co. v. Atlantic Nat'l. Ins. Co., 29 App. Div. 2d 204, 287 N.Y.S.2d 212 (1968).

29. *See* note 22 *supra.*

30. State Farm Mut. Auto. Ins. Co. v. Union Ins. Co., 181 Neb. 253, 147 N.W. 2d 760 (1967).

31. National Car Rental Sys., Inc., v. Sonesta Int. Hotels Corp., 313 So. 2d 108 (Fla. App. 1975).

32. *See* notes 29 and 30 *supra.*

33. *Id.*

34. KEETON, *supra* note 1, at § 3.11(b).

35. Truck Ins. Exch. v. Maryland Cas. Co., 167 N.W.2d 163 (1969).

36. Cosmopolitan Mut. Ins. Co. v. Continental Cas. Co., 28 N.J. 554, 147 A.2d 529 (1959).

37. Insurance Co. of Tex. v. Employers Liab. Assurance Corp., 163 F. Supp. 143 (S.D. Cal. 1958). The court stated that in its opinion it is more equitable to prorate liability according to premiums paid. The rates for the first twenty-five or fifty thousand dollars of liability insurance are higher than the charge for an additional fifty thousand or million dollars. *Id.* at 147. *But see* Cosmopolitan Mut. Ins. Co. v. Continental Cas. Co., 28 N.J. 554, 147 A.2d 529, 534 (1959). The court rejected the premium method of apportionment because there are too many variables affecting premiums to permit them to form an adequate basis for an equitable adjustment.

38. Liberty Mut. Ins. Co. v. Truck Ins. Exch., 245 Or. 30, 420 P.2d 66 (1966). Each insurance company's share of the loss is that proportion of its coverage of its policy to the total

Where proration is the appropriate method of loss apportionment, the insured has the right to look to either insurer for satisfaction of this obligation.[39] The insurers are severally, not jointly, liable.[40] If the insured seeks full payment by one insurer and if the insurer responds by satisfying the claim, then that insurer has a right to contribution from the other insurer(s).[41] The various methods of loss apportionment discussed above are then aplied in determining the amount of contribution.

III. The Position in Virginia

Until recently,[42] neither the Supreme Court of Virginia nor the Fourth Circuit Court of Appeals, applying Virginia law,[43] had the opportunity to decide a multiple insurance case in which each policy contained an excess insurance clause.[44] The state of the law was unsettled. Apparently, when such conflicts arose in the past in this jurisdiction, they were resolved either informally or at the trial court level.

In *State Capital Insurance Co. v. Mutual Assurance Society Against Fire on Buildings*,[45] the Virginia Supreme Court, in a case of first impression,

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coverage afforded by all valid and collectible policies. For example, the plaintiff Liberty Mutual had a policy limit of $25,000 and the defendant Truck a policy limit of $100,000—total coverage $125,000. Liberty's liability is 1/5 ($25,000/125,000) of the loss, whereas Truck's share of the loss is 4/5 (100,000/125,000).

39. Clow v. National Indem. Co., 54 Wash.2d 198, 339 P.2d 82 (1959).

40. New Amsterdam Cas. Co. v. Hartford Accident & Indem. Co., 18 F. Supp. 707 (1937).

41. United States Guarantee Co. v. Liberty Mut. Ins. Co., 244 Wis. 317, 12 N.W. 2d 59 (1944). The fact that an insurer who is subject to suit to force payment of an obligation pays the obligation does not make it a voluntary payment so as to preclude contribution. *See* note 39 *supra*.

42. *See* State Capital Ins. Co. v. The Mutual Assurance Soc'y Against Fire on Buildings, ___ Va. ___, 241 S.E.2d 759 (1978).

43. In State Farm Mut. Auto. Ins. Co. v. United States Fidelity & Guaranty Co., 490 F.2d 407 (4th Cir. 1974), applying West Virginia law, the Fourth Circuit found an escape (no liability) clause repugnant to an excess insurance clause and prorated the loss among the two insurers. The implication is that, if the Fourth Circuit were to be faced with a case involving conflicting excess insurance clauses, it would find them mutually repugnant and apportion the loss by proration among the two insurers. This assumption can reasonably be extended to Virginia cases even though the court has not been faced with such a case.

44. Both the Virginia Supreme Court and the Fourth Circuit Court of Appeals have dealt with other conflicting restrictive clauses where dual insurance exists. Generally, these cases involved an excess insurance clause in conflict with a no liability clause in a situaion in which the omnibus clause was applicable. The courts honor the excess insurance clause but hold the no liability clause void as being repugnant to the omnibus clause of Va. Code Ann. § 38.1-381(a)(Cum. Supp. 1978). See American Motorist Ins. Co. v. Kaplan, 209 Va. 53, 161 S.E.2d 675 (1968); Hardware Mut. Cas. Co. v. Celina Mut. Ins. Co., 209 Va. 60, 161 S.E.2d 680 (1968); Aetna Cas. and Sur. Co. v. State Farm Mut. Auto. Co., 212 Va. 15, 181 S.E.2d 615 (1971).

45. ___ Va. ___, 241 S.E.2d 759 (1978).

was faced with this issue. *State Capital* involved a boating accident in which a swimmer sustained injuries. The individual operating the boat which caused the injury was a permissive user and not the owner of the boat. He was covered by three separate and distinct insurance policies.[46] Two policies were standard homeowner policies, protecting the named insured and any relatives resident in his household from personal liability for bodily injury and property.[47] The third policy was issued to the boat owner. Each policy contained a standard excess insurance clause purporting to limit its liability to excess insurance where other valid and collectible insurance was available to the insured.

The injured party sued the boat operator, and the three insurance companies agreed to a $30,000 settlement. Each company reserved the right to litigate the issue of liability. Two insurance companies—State Capital Insurance Co. and The Mutual Insurance Co. of Fredrick, Maryland (hereinafter referred to as State Capital and Frederick, respectively)—instituted suit on the issue of liability against the insurance company that issued the policy to the boat owner—The Mutual Assurance Society Against Fire on Buildings (hereinafter referred to as Mutual).[48] State Capital and Frederick claimed that Mutual was primarily liable. The trial court held for Mutual and prorated the loss.[49] Only State Capital appealed.[50] Their argument was that Section 38.1-381(a) of the Code of Virginia required a boat policy to contain a provision insuring the named insured and any other person using the boat and that Section 38.1-381 (a) (2) of the Code of Virginia voids any endorsement, provision, or rider that attempts to limit or reduce the coverage afforded by the former statute. State Capital argued that the policy issued by Mutual to the boat owner was a boat policy within the scope of Section 38.1-381 of the Code of Virginia.

The Virginia Supreme Court construed the policy to be a general liability policy,[51] and, thus, not governed by the specific code section. Accord-

46. The companies were State Capital Insurance Co., The Mutual Insurance Co. of Frederick, Maryland, and The Mutual Assurance Society Against Fire on Buildings. The policies provided coverage of $25,000, $100,000, and $50,000 respectively.

47. 241 S.E.2d at 760.

48. Initially the suits for contribution were separate, but they were consolidated. *Id.*

49. Each company was liable proportionately 1/7, 4/7, 2/7. *Id.*

50. *Id.*

51. State Capital claimed that Mutual's policy was a specific boat policy rather than a general liability policy because the latter's policy contained a special watercraft endorsement which provided coverage for boats with oversized engines. The general policy offered by Mutual covered boats but only up to a specified engine size. The boat involved in this case had an oversized engine which precipitated the endorsement. The court held that the endorsement did not render the policy a specific policy of the boat in question so as to invoke VA. CODE ANN. § 38.1-381(a) and (a)(2)(Cum. Supp. 1978). 241 S.E.2d at 761.

ingly, each policy's excess insurance clause was operative, and a literal application would leave the insured without valid and collectible coverage.[52] The court, however, adopted the majority view and stated that "the two excess insurance clauses, therefore, are in irreconcilable conflict with one another. In this situation both must be disregarded, with the result that neither policy provides primary coverage for the loss in question."[53] The court then affirmed, without further discussion or elaboration, the trial court's decision to prorate the loss proportionately among the three insurance companies.[54]

In rendering this decision the Virginia Supreme Court did not settle with finality in Virginia this area of the law which has generated vast amounts of litigation in other jurisdictions. The unusual and unsettling aspect of this case is that the court devoted very little of its opinion to the resolution of the conflict between the excess insurance clauses and the method of loss apportionment.

The court clearly adopted the majority view that the mutually noncovering excess insurance clauses are inoperative, but it did not offer any underlying rationale or public policy statements to support or justify its adoption of this stance. This aspect of the decision was based on a single Georgia case as precedent.[55]

The finding and apparent adoption of the proration method of loss apportionment was not an independent decision on the Virginia Supreme Court's part. State Capital based its appeal on the validity of Mutual's excess insurance clause.[56] The court reasoned that "[i]mplicit in State Capital's position is the concession that, if Mutual of Virginia's policy did not specially insure the specific boat in quesion, then the policy was not subject to the requirements of § 38.1-381."[57] The court concluded stating:

> Also implicit in State Capital's position is the concession that, if the Mutual of Virginia policy did not provide primary coverage for the loss involved in this case, then the pro rata distribution ordered by the trial court was appropriate. Accordingly, because we find no error in the trial court's ruling that Mutual of Virginia was not primarily liable for the loss, we affirm the judgment of the trial court.[58]

52. 241 S.E.2d at 762.
53. *Id.*
54. *See* note 31 *supra.*
55. State Farm Fire and Cas. Co. v. Holton, 131 Ga. App. 247, 248, 205 S.E. 2d 872, 874 (1974).
56. 241 S.E.2d at 760.
57. 241 S.E.2d at 761.
58. 241 S.E.2d at 762.

IV. CONCLUSION

While at first glance, the Virginia Supreme Court resolved the issue of multiple insurance coverage among insurance carriers, a closer examination reveals that, even though the resolution of the dual insurance clauses was addressed, the issue of loss apportionment was never at issue. The issue on appeal was the applicability of Section 38.1-381 (a)(2) of the Code of Virginia. State Capital conceded that the trial court's decision to employ a pro rata apportionment of the loss was proper if Section 38.1-381 (a)(2) was not applicable.[59]

The court clearly held that, where an insurable interest is the subject of multiple policies, each containing an excess insurance clause, the excess insurance clause of each policy is inoperative and no one policy is primarily liable.[60] However, the state of the law in Virginia with regard to loss apportionment among insurance contracts containing excess insurance clauses remains uncertain. The Virginia Supreme Court tangentially recognized the pro rata method of loss apportionment, although the failure to do so in an affirmative manner will certainly give rise to future litigation until the issue is conclusively resolved. In light of the abundance of litigation on this issue in other jurisdictions, it was incumbent upon the Virginia Supreme Court to resolve this issue in order to forestall future unnecessary and expensive litigation.

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59. *Id.*
60. 241 S.E.2d at 762.