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# Allocation in Continuous Damage Claims[1]

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**Abstract**

*Allocating or apportioning financial responsibility in continuous damage claims can be challenging. Not only are there different theories and very fact-sensitive situations, the duties to defend and indemnify may be treated differently, and a consensus must be reached among the parties, including the policyholder.*

*This article explains the various trigger and allocation theories, and offers a proposal to reduce the number of controversies and the attendant costs of litigation.*

## Introduction

Allocation in continuous damage claims can be quite challenging as anyone handling such claims, like construction defects, can attest. How indemnity or expense is to be allocated depends on the jurisdiction, the policy, and the characteristics of the damage and the cause of the damage. This article will address several of the more common and, frequently, controversial issues, and the prevalent allocation theories. A practical approach to allocation in continuous damage claims will also be proposed.

## Allocation

"Allocation" in continuous damage claims refers to the process of allocating indemnity and expense to more than one "period," generally corresponding to insured policy periods, and uninsured periods. The periods are generally in one-year increments but the duration could be less. This could involve one insurer with more than one policy in play, more than one insurer, or the insured that is uninsured ("bare") or self-insured for a part of the time in question.

Allocation is not easy given the variety of approaches that exist, and can be particularly frustrating in a state where there is no definitive authority to rely upon. My intent is to keep this simple, to the extent that it is possible; to present the core issues that hopefully facilitate an understanding of the various states' laws, and to be able to apply them in a reasonable way to a particular set of facts, even if some of the court rulings appear unreasonable, or at least inconsistent. In my experience, understanding the theories and their rationale is not the most challenging part of the process. Rather, it is the application of the theories to the underlying facts and then trying to reach consensus with the other parties with whom you are attempting to apportion financial responsibility.

First, what do we mean by "continuous damage claims?"

## Continuous Damage Claims

In the context of insurance claims, a dichotomy exists between continuous damage that occurs over a long period of time and that remains hidden, along with its cause, and visible damage that can be traced to a specific cause at an identifiable point in time. "Occurrence" in a Commercial General Liability ("CGL") policy is defined as, "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." In an occurrence-based policy the property damage or bodily injury must occur during the policy period.[2]

For example, a "slip and fall" in a supermarket is specific as to time and place, including both the cause, e.g. a discarded banana peel on the floor, and the effect, or injury. It is, therefore, fairly easy to identify the liability insurance policy that should respond. Not so in continuous damage claims.

In continuous damage claims, damage occurs over an extended period of time and, for our purpose, over more than one period, insured and uninsured. Latent, continuous, and progressive injury or damage claims can trigger or activate more than one policy. For example, in a construction defect claim it may be alleged that the foundation in a building was defectively designed and/or constructed. The defect exists from the moment of construction. However, a failure in the foundation may cause property damage at any time between the initial installation and the first perceptible symptoms of the failure, such as significant cracking in a basement wall.

Continuous damage claims typically include environmental claims involving damage caused by contamination, and toxic tort claims arising out of exposure to asbestos, silica, latex gloves, lead, benzene and other toxins. Construction defect claims, as we have seen, fit squarely within the reach of continuous damage claims. Such claims encompass premises and operations, and products and completed operations hazards that are covered by the CGL policy.

But not all continuous damage claims are created equal so different creative and convenient theories have developed to determine not only when the damage or injury occurs and to satisfy the definitions of property damage and bodily injury in the CGL policy, but also to allocate financial responsibility among different insurers and perhaps the insured in an equitable manner. Not only are different theories found among the states, but also which theory is applied in a given state is fact-sensitive and depends on the characteristics of the underlying claim.

For example, pollution claims, because of the long-term and hidden nature of the damage, are conducive to a continuous trigger, pro-rata allocation approach, which will be explained later. The premise is that it is virtually impossible to determine when damage occurred, so to assume that it occurred continuously and in equal amounts over a period of time is not unreasonable.

## Concurrent v. Continuous Other Insurance

Our focus is on the allocation of defense costs and indemnity payments related to continuous damage claims to multiple periods involving multiple policies or uninsured periods ... a "continuous other insurance" approach. In other words, at issue is the availability of more than one policy to a loss resulting in property damage or bodily injury that occurred over an extended period of time.

In contrast, a "concurrent other insurance" situation refers to the availability of more than one policy in the same policy period. In this instance allocation generally depends on the policies' other insurance clause that contains specific rules and formulas.[3]

In continuous other insurance situations, issues concerning equity generally come into play (but that is not to say that the other insurance condition in a policy is never included in the analysis). Like the trigger of coverage, various allocation methods are in use throughout the U.S. Determining the appropriate allocation may be very fact-sensitive.

Bodily injury resulting from the inhalation of asbestos presents a prime example. An asbestos injury or disease has its own unique process. The Pennsylvania Supreme Court, in *J.H. France Refractories Company et al. v. Allstate Insurance Company*, et al., 534 Pa. 29 (1993), ruled that a continuous trigger is appropriate, basing its decision on the expert's medical testimony that was stipulated to by all parties:

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> ... In summary, he testified that "injury" is a "process, which alters structure," and the term is applicable in reference to a cell, a tissue, an organ, or the entire body. "Disease" means "an injury and a response to that injury." The presence of asbestos in the lungs stimulates a wide range of reactions, which Dr. Craighead divides into three responses.
>
> First, characterized as "direct injury," asbestos fibers in the respiratory tract interact with the membranes of the cells lining the trachea and cause the release of enzymes and superoxides, which either damage or kill individual cells. If sufficient cells are damaged, tissue (an accumulation of cells) is damaged or destroyed ... This injury occurs within minutes after asbestos fibers enter the cells.
>
> Second, characterized as "indirect injury," the presence of asbestos fibers stimulates macrophages to accumulate. Macrophages are scavenger cells, which attempt to envelope foreign particles. As microphages attempt to ingest the fibers...there is a release of enzymes, which have a damaging effect on tissue. There is also a chemical reaction, which scars the injured tissue. The accumulation of scar tissue in the respiratory system prevents the lung from performing its normal oxygen-carbon dioxide gas exchange. The process of macrophage accumulation, tissue scarring, and functional impairment of the lungs begins to occur within a month of exposure.
>
> The third response in the asbestosis process is a change in the form of the cells lining the bronchial tree. The normal lining, designed to move dust particles out of the body, is replaced by cells lacking cilia, resulting in a tendency toward accumulation of asbestos particles.
>
> The asbestosis process continues to progress even after exposure to asbestos ceases. Medical authorities differ on the reasons for this fact. Substantial authority regards this as the nature of the asbestosis pathogenesis. Another view theorizes that disease progression may be attributable to the eventual, and inevitable, decrease in the respiratory function involved in aging, and also to other factors such as cigarette smoking or infection. In either view, the injury process continues after exposure and may culminate in "manifestation," such severe functional impairment that asbestosis is finally diagnosed, and of course, the disease may be fatal. (534 Pa. at 35-36)

The asbestos disease or injury process is unique. This case demonstrates the need to closely examine the injury or damage to determine whether or if a multiple trigger approach is appropriate. In this case, the Court ruled that the continuous trigger applies to include all policies on the risk from the initial exposure to asbestos through to manifestation, or "recognizable incapacitation." (534 Pa. at 40)

The Court ruled that all insurers on the risk should indemnify but the Court did not agree with a pro-rata allocation, as a matter of course. All carriers were required to indemnify because the "all sums" language in each policy means that if any of the injury occurs during a specific policy period, that policy must respond in full. But the disease progression is not linear, "To apportion liability among the insurers on a strictly temporal basis in direct proportion to the length of time each insurer was on the risk, however, notwithstanding its surface attractiveness, assumes a linearity of disease progression which this record does not support." (534 Pa. at 40) The Court determined that any allocation to J.H. France was, "a judicial fiction which cannot be supported." (534 Pa. at 40) The Court treated each insurer as a primary insurer in the sense that each was responsible for the entire injury.

**It is important to differentiate concurrent from continuous loss scenarios.**

Before delving into allocation law and methodology a few concepts must be addressed.

## Duty to Defend v. Duty to Indemnify

It is axiomatic that the duty to defend is broader than the duty to indemnify. Simply, if there is a reasonable potential for coverage under the policy (the benefit of the doubt accrues to the insured) there is a duty to defend a suit. In many instances, particularly continuous damage claims, the duty to defend is more valuable than the duty to indemnify. Defense costs can be enormous because of the complexity of the claim. While indemnity is subject to limits, supplementary payments, which include defense expenses, typically have no limit, terminating only when the indemnity limit is paid.

The duty to indemnify, on the other hand, requires more than just a potential for coverage. There has to be actual coverage for the loss. In other words, it must be demonstrated that the loss is covered, not just potentially covered. Defense and indemnity, as we shall see, may be treated differently as to allocation.

**It is important to distinguish the duty to defend from the duty to indemnify.**

## Trigger of Coverage

There would be no need for a discussion of allocation in continuous damage claims if multi-triggered policy approaches did not exist and only one policy was activated for these loss situations.

"Trigger" is a term of art used by legal and insurance practitioners that you will not find in the CGL policy. It is a useful term that simply describes how and when coverage is activated. "Trigger" is ...

> The event that must occur before a particular liability policy applies to a given loss. Under an occurrence policy, the occurrence of injury or damage is the trigger; liability will be covered under that policy if the injury or damage occurred during the policy period. Under a claims-made policy, the making of a claim triggers coverage. Coverage triggers serve to determine which liability policy in a series of policies covers a particular loss.[4]

In the CGL occurrence-based form property damage or bodily injury must occur during the policy period. (Contrast that with the claims-made policy wherein the activating event is when the claim is first made subject to a retroactive date, which is the date on or after which the property damage or bodily injury must occur.)

In the context of insurance claims most of the time there is no controversy. The cause (occurrence) and effect (damage) are definite and proximate in time and place and readily apparent. It is simple to pinpoint when damage occurred and the trigger of coverage is determined when the damage occurred, not when the insured's work was done, for example, in construction defect claims. In some cases, however, the property damage is progressive and remains undetectable for a period of time before the property damage is discovered. These claims are not simple in terms of trigger and allocation.

In the case of latent (hidden) damage, the effect may not become apparent until sometime later so the timing of the damage is unclear and the controversy begins. Furthermore, latent damage can be characterized by a continuous and progressive process (and indivisible if there are multiple causes). Such is the nature of continuous damage claims. It is noteworthy that even the experts often do not agree on when damage occurs in such claims. Building foundation failures causing damage to the structures, contamination of underground water due to leaking underground storage tanks, damage to copper pipes and electrical wiring caused by tainted drywall from China and exposure to benzene-containing products causing disease are just a few examples.

A coverage analysis should begin with the requirement that property damage or bodily injury occurs during the policy period as the result of an occurrence. The burden to demonstrate this, or at least demonstrate a potential for this, is on the insured. The

trigger analysis includes an analysis of the underlying facts and an examination of the case law in a particular state.

Because of the challenge in determining when property damage or bodily injury occurs in continuous damage situations, various trigger theories have developed. The impetus for these theories comes from the proliferation of asbestos and environmental claims that provided a fertile ground for controversies concerning when damage actually occurs, so these theories evolved to allay these controversies. The parties to the claim present different theories depending on vested interests. Typically, policyholder attorneys present theories that maximize coverage; insurers present theories that minimize coverage.

## The Trigger Theories

Under any theory attention must be paid to the cause and effect dynamics in the claim, and the definitions of property damage, bodily injury and occurrence. And, as always, this analysis is within the context of the specific jurisdiction's treatment of the trigger of coverage and the facts of the underlying case. The theories are convenient, and useful, but they should not be automatically applied without an analysis of the underlying facts.

For example, the underlying facts may involve defectively installed roof flashing causing water intrusion during a rainstorm, which results in property damage to attic insulation. Or the faulty flashing causes water damage and the eventual growth of mold as the result of one rainstorm. Or the faulty flashing, and resulting damage, is subject to several rainstorms. The point is that while the trigger theories are convenient and useful, you need to go beyond the label in your analysis of when damage occurs. Brief descriptions of the theories follow.

### *Manifestation*

The manifestation trigger requires that the policy, which is in effect at the time the damage becomes apparent, either subjectively or objectively, is then activated. A subjective manifestation occurs when the damage actually is discovered. On the other hand, an objective manifestation is one in which the damage becomes apparent and *should* have been discovered, regardless of when it was actually discovered. For example, an inadequately designed foundation on expansive soil, i.e. soil that expands and contracts, will start to fail before the symptoms become apparent and eventually are discovered. In either a subjective or objective manifestation case involving one occurrence only one policy is triggered.

A recent federal district court ruling in Florida involving two residential projects and water intrusion made clear that the appropriate trigger of coverage in such cases is manifestation and not discovery. In *Mid-Continent Casualty Company v. Frank Casserino Construction, Inc.*, et al., 2010 U.S. Dist. LEXIS 59636 (M.D. Fla. June 16, 2010), the Court stated:

> ... That no one saw or "discovered" damage caused by water intrusion during the policy period is of no moment. Under Florida's applicable "trigger" theory and the unambiguous language of the CGL policies at issue here, the only relevant question is whether physical injury to the buildings manifested itself during the period of coverage.

### *Exposure*

The exposure trigger requires that all policies in effect during the period that the property or person is exposed to the harmful, damage-causing agent be activated. Consequently, more than one policy can be triggered. For example, the ingestion of lead paint chips over a period of two years would trigger the policies in effect at the time of the ingestion, or exposure, regardless of the date of diagnosis of lead poisoning.

***Continuous Injury***

In the continuous injury trigger, the broadest trigger, continuous, progressive damage can begin with, for example, the time of the defective work through to the manifestation of the damage, and possibly beyond (See the discussion of the *Montrose* case in the Known Loss section of this article). More than one policy is triggered. In the case of environmental contamination, the trigger of coverage could begin with the date of first exposure to the contaminants through to the manifestation of the damage.

***Injury-In-Fact***

Finally, injury-in-fact stays true to the policy requirement that only property damage or bodily injury that occurs during the policy period is covered, whether detectable or not. In the context of latent, continuous and progressive damage, more than one policy is triggered. Application of this theory is very fact-sensitive.

**It is important to determine the appropriate trigger of coverage.**

## Number of Occurrences

Given the nature of latent, progressive and cumulative injury or damage, and within the context of the definition of occurrence, it is frequently challenging to determine how many occurrences you are dealing with in a continuous damage claim. This determination is important because the limits of liability and deductibles, or self-insured retentions, are impacted by the number of occurrences. In addition, more than one occurrence can complicate an already-challenging allocation scheme (among the carriers and potentially the insured with respect to defense cost- and indemnity-sharing).

The cause and effect paradigm is useful, and, in fact, is the basis for determining number of occurrences. But it must be applied with flexibility given the variety of fact situations with which you will be confronted.

Most jurisdictions look to the cause to determine number of occurrences but what constitutes a particular cause is highly fact-specific and not without controversy, the controversy occurring generally in the application of the definition of occurrence to the underlying facts. Suppose that hazardous substances are migrating from a landfill to adjoining properties and into groundwater, and this has been occurring for 30 years. Suppose further that the migration has been intermittent, and at its most intense during periods of heavy rainfall. Recall that occurrence means, "... an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Does an interruption in the migration constitute the end of one occurrence and the beginning of another? Are the heavy rainfalls intervening, superseding causes and new occurrences? What about the contamination to the groundwater and contamination to neighboring property? Is each the result of the same or substantially the same conditions, or different conditions?

The point is that while the cause determines the number of occurrences in a particular jurisdiction the following issues must also be addressed: are the effects, e.g. property damage, the result of the same or substantially the same conditions? Is exposure of the property to these conditions repeated or continuous, and not unbroken by an intervening or superseding cause or causes? Are the exposures, while substantially similar, separated by time or distance to such an extent that to conclude that there is one occurrence pushes the envelope of reason?

There is also a result-oriented consideration, the result being maximizing coverage:

> The overwhelming majority rule is that the number of occurrences is determined by focusing on the cause or causes of injury and not the effects, such as the claims or injuries. However, application of this rule can produce drastically different results, depending on what the court finds is the underlying cause. Moreover, notwithstanding

**Does a Tree Falling in a Forest When No One Is Around Make a Sound?**

Until property damage is discovered, has it occurred? Remember that the policy requires that property damage occur during the policy period. It does not say that the property damage has to be seen, heard or discovered. So, it must be conceded that property damage can begin before it is discovered or becomes manifest. But what does the law of a particular state say? In other words, while it is easy to conceptualize that property damage can begin the moment of the creation of the defect and continue undetected, it is necessary to determine when the law says the property damage occurred.

And don't forget logic and common sense. For example, suppose a roof is installed but flashing at the chimney is not. Three months later water damage is discovered. The damage occurred before discovery but did it occur during the entire three months? Suppose it did not rain for the first two months?

Try not to get so mired in theories and legal concepts that logic and common sense are trumped by an automatic, mechanistic approach to a claim.

> the general rule, some courts appear to decide their cases in such a way as to maximize coverage. In such instances, where there is a large number of relatively small individual claims and the policy contains a per occurrence deductible that exceeds the amount of the claim, some courts tend to find a single occurrence, to avoid the limiting effect of the deductible. On the other hand, if the case involves per occurrence liability limits, some courts find multiple occurrences.[5]

On Nov. 30, 2006 the Supreme Court of Illinois addressed the difference between the cause and effect theories in *Nicor, Inc., et al. v. Associated Electric and Gas Insurance Services Limited*, et al., 223 Ill. 2d 407 (2006). At issue in the case was the obligation of Nicor's insurers to indemnify Nicor for the remediation of mercury contamination caused by the replacement of gas meter regulators at 195 homes between 1961 and 1978:

> The replacement process was normally safe and unremarkable. In a very small number of cases, however, regulators were tilted or tipped in a way that allowed mercury to spill out and contaminate the customer's home. The problem of contamination surfaced during the summer of 2000, when Nicor learned that a contractor it had hired had spilled mercury in a customer's home while removing one of the old regulators.
>
> The initial contamination report was followed by revelations that additional mercury spills had occurred in the homes of other Nicor customers. (223 Ill 2d. at 411-412)

Nicor maintained that the contamination at all of the homes was one occurrence, subjecting it to only one self-insured retention (SIR). The "London Insurers" asserted that contamination at each home was an occurrence and that 195 separate SIRs applied.

The only issue before the Court was the number of occurrences and, while confirming that the cause theory is appropriate, it affirmed the Appellate Court's decision that there were 195 separate occurrences:

> ... American courts have developed two basic approaches for assessing the number of occurrences that took place within the meaning of policies such as those at issue in this case, the cause theory and the effect theory. The effect theory, as its name implies, determines the number of accidents or occurrences by looking at the effect an event had, i.e., how many individual claims or injuries resulted from it. Under the cause theory, on the other hand, the number of occurrences is determined by referring to the cause or causes of the damages. (223 Ill 2d. at 418)
>
> ... The liability for which Nicor sought indemnification from the London Insurers did not arise from any inherent defect in the old-styled gas regulators or the manner in which they were installed in customers' homes. Nor did it derive from any systemwide policy or procedure regarding the methodology employed for removing the regulators between 1961 and 1978, the period covered by the London Insurers' policies. To the contrary, the record indicates that the methods employed by Nicor for removing the regulators during the period in question were the same as those ultimately approved by the court after the Attorney General filed suit against the company in the year 2000.
>
> Liability was incurred only when mercury happened to spill as an old-style regulator was being replaced with one of the new mercury-free units. Such spills were extremely rare. Impermissibly high levels of mercury contamination were discovered in one-half of 1 percent of the homes where physical inspections were undertaken. The spills had no common cause. Mercury escaped from the regulators under a variety of circumstances, including unique physical circumstances in particular homes, which required technicians to tilt gas meters in order to remove them. One spill was reported to have resulted when the Nicor technician accidentally stumbled or tripped. Sometimes technicians were careless and neglected to follow Nicor's safe mercury-handling procedures. In addition, the spills occurred at different times over a 17-year period in the case of the spills subject to the London Insurers' policies. No temporal or geographical pattern to these spills was established, and no claim was made that any particular technician or group of technicians was responsible for the spills. The technicians did not even share a common

> employer. Some were apparently Nicor employees while others worked for the company's subcontractors. To say that each of the 195 spills emanated from a single cause would, under these circumstances, be completely untenable. (223 Ill 2d a4 at 432 - 434)

On March 28, 2008 the Supreme Court of Kansas ruled that causation determines the number of occurrences but the "time space continuum" could impact whether the initial cause is nullified by a subsequent cause, adopting both the cause and unfortunate event tests. While this case involved a motor vehicle accident and a policy that did not define an occurrence, which the Court found to be ambiguous, the syllabus in *American Family Mutual Insurance Company v. Stacy Wilkins*, 285 Kan. 1054, (2008) is instructive. The Court explained the three approaches to determining the number of occurrences, i.e. the cause of the injury or damage, the number of effects and the event. In the case before it, the Court ruled that the cause determines the number of occurrences. And it is the immediate cause, and not any antecedent cause, a cause that precedes the immediate cause:

> When multiple vehicles are involved in multiple collisions, the number of occurrences is based on the time-space continuum between the collisions and the insured driver's level of control over the vehicle. Collisions with multiple vehicles constitute one occurrence when the collisions are nearly simultaneous or separated by a very short period of time and the insured does not maintain or regain control over his or her vehicle between collisions. When collisions between multiple vehicles are separated by a period of time or the insured maintains ... or regains control of the vehicle before a subsequent collision, there are multiple occurrences. (2008 KAN. LEXIS 73 at Syllabus 8)

In a construction defect setting the immediate cause of water damage to insulation may be the absence of roof flashing around a chimney and consequential failure to prevent water intrusion during a heavy rainstorm. An antecedent cause may be the faulty installation of flashing around a plumbing vent pipe at roof level that leaked during prior storms that caused damage to the insulation.

In a continuous damage claim sufficient analysis of the cause requires a close examination of the underlying facts and the dynamics, including timing, of the damage-producing process. And this may require the assistance of various experts.

**It is important to determine whether you are dealing with one occurrence or multiple occurrences.**

## Known Loss

The concept of fortuity is the cornerstone of insurance and its operation. Unless a loss is fortuitous, it is not insurable. Otherwise, those that knew a loss would occur would buy insurance and those who knew that a loss would not occur would not buy it.

It is that simple. Or is it? We will consider the unprecedented *Montrose* decision shortly.

Consider the following:

> Implicit in the concept of insurance is that the loss occurs as a result of an event that is fortuitous, rather than planned, intended, or anticipated. This principle is involved in the liability insurance requirements of an accident, occurrence, or the like, as well as in the rules prohibiting property insurance recovery for an insured who sets fire to the insured property, and life insurance recovery on the part of a beneficiary who intentionally kills the insured.[6]

## Montrose

In July 1995 California's Supreme Court turned the concept of fortuity on its head and compelled the insurance industry to respond with significant policy modifications. *Montrose Chemical Corporation v. Admiral Insurance Company,* 10 Cal. 4th 645, (1995), involved an environmental contamination claim. The Court's rulings cast a wide net that also impacted construction defect claims. See Warfel, "Coverage Disputes in Construction Defect Cases, *CPCU Journal*, Winter 1998, pp. 238-247.

From 1947 to 1982, Montrose Chemical Corporation manufactured the pesticide DDT at its plant in Torrance, Calif. Contamination inevitably resulted and in August 1982, Montrose received a "PRP (Potentially Responsible Party) letter." Admiral's policies incepted October 1982 and expired March 1986.

A continuous trigger was applied in the case, and the issue was the termination of the trigger period. Given the dates of operations, the termination of which occurred before the first Admiral policy, and the manifestation of the contamination occurring before the Admiral policy (certainly no later than Montrose's receipt of the PRP letter) it seemed reasonable that any trigger period should not extend beyond the date of the PRP letter. At that point the loss became known and was not insurable.

But the Court disagreed:

> According to Admiral, Montrose's knowledge of the problems at the Stringfellow site defeats coverage. In particular, Admiral points to the fact of Montrose's receipt of the PRP letter from the EPA on August 31, 1982, prior to the inception of the first of Admiral's four successive CGL policies issued to Montrose. Admiral misses the point. The PRP notice is just what its name suggests — notice that the EPA considered Montrose a "potentially" responsible party. *While it may be true that an action to recover cleanup costs was inevitable as of that date, Montrose's liability in that action was not a certainty. There was still a contingency, and the fact that Montrose knew it was more probable than not that it would be sued (successfully or otherwise) is not enough to defeat the potential of coverage (and, consequently, the duty to defend).* (10 Cal. 4th at 690) [Emphasis added]

Citing the "loss-in-progress rule as codified in sections 22 and 250", the Court posited that the loss in question in a liability policy is legal liability and that known liability is not insurable. When liability is known occurs when liability is "established" with certainty:

> We therefore hold that, in the context of continuous or progressively deteriorating property damage or bodily injury insurable under a third party CGL policy, as long as there remains uncertainty about damage or injury that may occur during the policy period and the imposition of liability upon the insured, and no legal obligation to pay third party claims has been established, there is a potentially insurable risk within the meaning of sections 22 and 250 for which coverage may be sought. Stated differently, the loss-in-progress rule will not defeat coverage for a claimed loss where it had yet to be established, at the time the insurer entered into the contract of insurance with the policyholder, that the insured had a legal obligation to pay damages to a third party in connection with a loss.
>
> Montrose's receipt of the PRP letter prior to its purchase of Admiral's policies did not establish any legal obligation to pay damages or cleanup costs in connection with the contamination at the Stringfellow site, such as would implicate the loss-in-progress rule and preclude Montrose from seeking to obtain the liability coverage sought. The PRP letter did no more than formally place Montrose on notice of the government's asserted position and initiate proceedings that could result in subsequent findings and orders. (10 Cal 4th at 693)

California's Insurance Code, Sections 22 and 250 state:

> 22. Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a **contingent or unknown event.**
>
> 250. Except as provided in this article, any **contingent or unknown event,** whether past or future, which may damnify a person having an insurable interest, or create a liability against him, may be insured against, subject to the provisions of this code.
>
> [Emphasis added]

The Court pushed the envelope in its interpretation of what constitutes a contingent or unknown event in the context of liability. Furthermore, the Court cast its net broadly and brought construction defect claims within its decision by nullifying the previously-applied manifestation trigger in such claims.

The industry first reacted with a variety of so-called "Montrose" exclusions and ISO subsequently amended the insuring agreement in the CGL policy. The manuscripted exclusions varied but the common thrust was that losses in progress (known and, sometimes, unknown) were not covered.[7]

ISO modified the insuring agreement to preclude coverage for known losses and was less draconian than the "known and unknown" version of the Montrose exclusion. The burden is on the insured to demonstrate that the loss was not known. On the other hand, in the case of the exclusion, the insurer has the burden to demonstrate that the loss is excluded.

**It is important to determine when the trigger period begins and ends.**

## Allocation

So how are indemnity payments and defense costs allocated among several parties, insurers and insured, in continuous damage claims?

Here are some key questions to consider:

- What multi-trigger theory applies? Exposure? Continuous? Injury-in-fact?
- When does the triggered period begin and end? First exposure to manifestation? Diagnosis date? Filing of lawsuit? Date liability is established?
- How many occurrences are there? Is it the cause or effect that determines the number? If the former, are there intervening or superseding causes?
- Does allocation differ between the duty to defend and the duty to indemnify?
- Does the amount allocated to a party depend on its position in the coverage continuum? In other words, does an insurer at the beginning of the continuum have more exposure than an insurer at the end of the continuum?[8]
- How are indemnity and/or defense allocated to insurers participating on a named insured and additional insured basis?
- Does the other insurance clause in a policy apply, or is allocation a matter of equity? Is there a different basis for allocating among continuous period policies as opposed to concurrent policies?
- Does allocation depend on the extent of coverage available in a particular year, including excess coverage?
- How do vertical and horizontal exhaustion fit in? In other words, in a multi-trigger approach does an excess carrier participate when the direct underlying insurer

exhausts (vertical) or only when all underlying insurance in every period exhausts (horizontal)?

- How are deductibles handled? SIRs?
- Does the insured participate in bare years? Does the reason for lack of insurance matter? Is the insured's participation different as between indemnity cost sharing and defense cost-sharing?
- How is allocation calculated when a claims-made policy is involved with occurrence-based policies?
- Can the limits in triggered policies be stacked, i.e. added together in a continuous loss? Can deductibles and/or SIRs be stacked?

## The Approaches[9]

> Allocation among consecutive insurers allows courts to be creative because most policies, being contracts between insurers and policyholders, seldom specify the rights of nonparties (other than through limited "other insurance" clauses ...). This issue has recently been reduced to a struggle between variations of the "pro rata" allocation method and the "joint-and-several" approach. According to a recent nationwide survey of all American jurisdictions to have addressed the issue, fifteen states have adopted the pro rata (or "horizontal exhaustion") allocation theory, while eight states have adopted the rival "joint and several" allocation theory.[10]

### Joint and Several

Also known as the "All Sums" approach, the premise is that a carrier's obligation is joint and several if its policy is triggered. In other words, the insuring agreement obligates the insurer to respond in full assuming the policy is triggered.

> The rationale behind this approach is that each policy promises indemnification to the insured for *"all sums"* for which the insured is legally obligated to pay as damages. Further, this method comports with the insured's reasonable expectations in purchasing insurance: "that it was covered for all future liability, except liability for injuries of which [the insured] could have been aware prior to its purchase of insurance." *Keene* at 1044.[11]

### Pro Rata

This approach recognizes that the insurer should only be responsible for the damage occurring during its policy period, contrary to the Joint and Several, or All Sums approach.

> Insurers prefer pro rata allocation because it limits their responsibility to only liability incurred during their policy period, above all applicable deductibles. However, some courts have applied joint-and-several allocation instead. This method allows policyholders to select one particular insurer on the risk and hold it liable for the entire loss up to the limits of that insurer's policy limits. The insurer "elected" by the insured then has the burden of collecting contribution from other insurers on the risk. Policyholders prefer joint-and-several allocation because it gives them control, allows less finger-pointing among potentially liable insurers, and permits an insured to avoid problematic terms in one insurer's policy (e.g., exclusions, conditions, and especially deductibles) by relying in full on another insurer's nonproblematic policy.[12]

### Methodology

Generally the approach, i.e., pro-rata or joint and several, will determine which method of calculation is used and whether the insured will participate in bare years, years for which coverage was not applicable.

Should the insured contribute in years that it has no insurance, either in part or total? For example, the insured's policy may not afford coverage, or perhaps the limits are exhausted. The insurance carrier may be insolvent. Or the insured carries a self-insured retention.

> The most significant difference between joint-and-several and pro rata allocation variations is the treatment of uninsured time periods. If joint-and-several allocation is used, the insured can escape some or all liability by forcing an insurer to pay the entire loss. If pro rata allocation is used (especially strict "time on the risk" allocation), the insured could be left exposed for the proportion of liability incurred during uninsured periods.[13]

## Equal Shares

The joint and several approach is conducive to an equal share allocation among insurers whose policies are triggered, without any contribution from the insured in bare years. Many practitioners interpret Equal Shares to mean that each carrier must share on an equal basis regardless of the number of policy periods in play. For example, Insurer A has nine policy periods, Insurer B, one. Equal Shares is interpreted to mean that each carrier shares on a 50 percent basis, i.e. two carriers, two shares.

The better approach, in my opinion, is that the basis for equal shares is still preserved if each policy period shares on an equal basis. In other words, Insurer A has an equal share times nine and Insurer B has an equal share times one, or 90 percent and 10 percent respectively.

## Time-On-Risk

This method requires that the specific policy period be compared to the total triggered period of time, and the loss is then shared based on the proportion of the specified period compared to the total period. In this approach the insured is responsible for bare periods, i.e. periods for which insurance was not applicable. It is important to determine whether the lack of insurance is voluntary, for example, the policyholder decided to self-insure, or involuntary, for example, the carrier goes bankrupt, and whether the jurisdiction permits allocation to the insured in either instance. Furthermore, defense and indemnity may be treated differently.

> Several courts also have applied pro rata allocation to defense costs as well as to indemnity payments. The contractual language provides less support for pro rata allocation of defense costs because, whereas insurers promise to indemnify for "bodily injury" or "property damage" that occurs within their policy period, the duty to defend is broader and (under the law of almost all states) applies to noncovered claims if covered claims also are raised. Nevertheless, it has been seen as more equitable to enforce sharing of this cost as well.[14]

## Time-On-Risk Times Limits

Some courts may include the amount of limits available in the time on risk allocation, the premise being that there is a greater assumption of liability by the policy with higher limits. While this can be justified in a concurrent loss situation, in a continuous loss case such an approach fails to recognize the fundamental premise that it is damage, and the amount of such damage, that occurs during the policy period that is covered or potentially covered for which the insurer should pay. The limits are relevant only to the extent that the amount of damage that is covered is finite. To include limits as a factor creates the inequitable result of one insurer paying more than another when their time on risk is the same. Of course, as always the state's law controls. (For an interesting "spin" see *Carter-Wallace, Inc. v. Admiral Insurance Company,* et al., 154 N.J. 312 (1998), and have a calculator handy.)

### Premium Received

Similarly, it is argued that the amount of premium received determines the extent to which a carrier should participate in a given period. For instance, if the carrier receives a higher premium a higher amount of indemnity and defense should be allocated to it. A lower premium received should result in a lower allocation. This approach suffers from the same flaw as the limits approach, namely that an insurer should only be responsible for the amount of the damage or injury that occurs during the policy period. Otherwise, the same inequity as the limits approach would result. Furthermore, while the amount of coverage purchased, both as to terms and limits, certainly is a major determinant, premium is often a function of what the market will bear. A soft market will yield lower premiums and higher premiums will be paid in a hard market.

### Other Methods

Another method, the "Flexible" or "Weighted" Pro Rata Allocation, recognizes that there may be other factors that require a non-linear approach to when damage occurs. In other words, it may be reasonable to assert that property damage occurred in different amounts at different times.[15] This approach recognizes that these cases are very fact-sensitive and the differences in facts must be taken into account to achieve an equitable apportionment. A landfill, for example, may be experiencing a steady, slow migration of pollutants onto adjoining property except at times of unusually heavy rainfall when the amount of contamination accelerates.

The Tier Approach often used in construction defect claims is to allocate defense and indemnity based on the extent to which a particular trade has contributed or is alleged to have contributed to the loss. For example, a roofer may be judged to be 20 percent responsible/potentially responsible and, therefore, should pay 20 percent of the defense and/or indemnity. This 20 percent share then would be further shared by the roofer's insurers based on equal shares or a pro rata approach.

## Other Issues

How are deductibles handled?

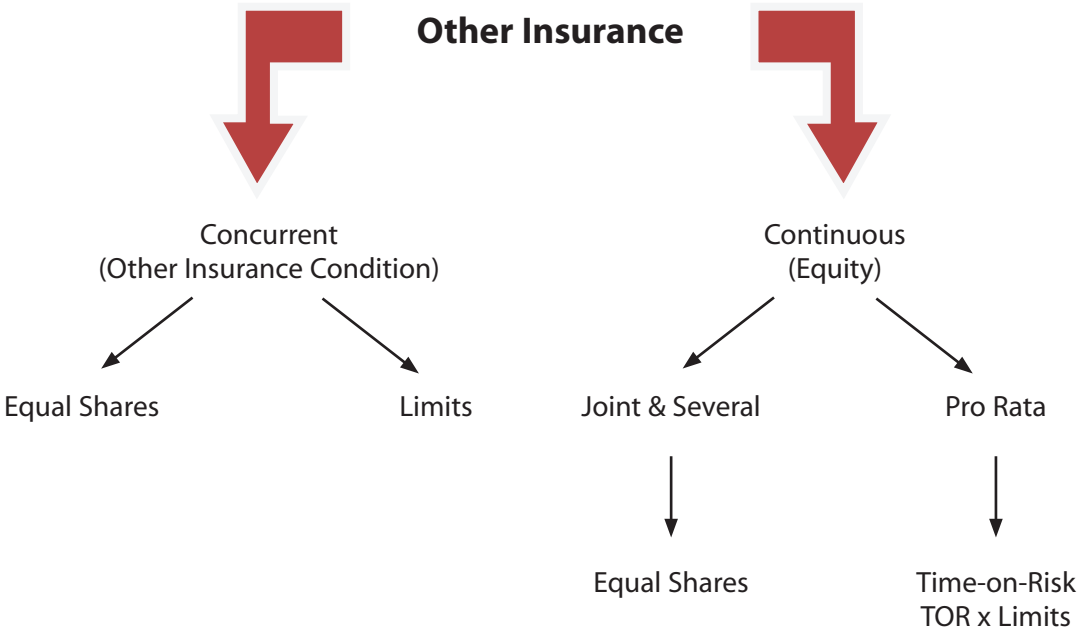
> ... the insured is better off in joint-and-several jurisdictions. By pushing all liability into one policy period, the insured can avoid the effect of deductibles of multiple policies by paying only one. If the insured chooses wisely, it will select the policy period with the lowest deductible (thus avoiding the consequences of paying lower premiums for policies with higher deductibles).[16]

Should the insured contribute to defense? In most jurisdictions the duty to defend is complete. In other words, if there is a potential for coverage, then the entire lawsuit must be defended, notwithstanding the fact that the complaint includes uncovered allegations as well as covered allegations. (In this instance, some jurisdictions hold that the insurer has the right to reimbursement for those claims that are not even potentially covered.)

When does excess insurance participate?

> ... With some exceptions, courts that apply pro rata allocation tend to exhaust a policyholder's insurance program "horizontally," i.e., exhausting all primary policies, then all first-layer excess policies, and so on. Conversely, courts that apply joint-and-several allocation tend to apply "vertical" exhaustion, looking to all policies in one "policy period" at a time before moving to policies covering other periods.

Courts are much more likely to apply horizontal exhaustion when allocating the costs of defense counsel.[17]




## A Proposal

Allocating costs among carriers and sometimes the insured is endemic to continuous damage claims. It requires time, effort, a fundamental grasp of the issues, and the ability to apply a set of specific facts to a constantly changing and sometimes-hazy landscape and in a consistent manner. To achieve an equitable apportionment in this context is quite a challenge. Fortunately, in the majority of cases insurers are able to work together and achieve a result that everyone can live with. However, in my opinion there is still far too much litigation engaged in, with its attendant transaction costs, to resolve disputes. The following proposal is an attempt to reduce the number of these disputes.

### Defense

Whether a policy is in effect a day, a week or a year, if the duty to defend is triggered, it is triggered. The amount of time that a policy is in effect is not relevant. If more than one policy is triggered because there is a potential for coverage, the insurers should share the cost of defense on an equal share basis based on the number of policies. This stays true to the "all sums" approach, but also recognizes that the number of policies matters.

For example, if Insurer A has three triggered policies, whether a particular policy be in effect for one day or 365 days, and Insurer B has one, Insurer A is triggered three times and Insurer B, once. Insurers A and B should share in the defense at 75 percent and 25 percent respectively. And the insured should not participate in bare years because the defense obligation of each insurer is a complete one.

### Indemnity

The following principles should form the foundation for allocating indemnity payments:

(1) An insurer is not responsible for damage that occurs prior to the policy inception date.

(2) An insurer is responsible for damage that begins during its policy and continues beyond the policy expiration, if the same occurrence.

(3) Vertical exhaustion applies. In other words, when the primary insurer's policy is exhausted in a particular year the excess/umbrella insurer steps in at the same percentage share, unless there is specific unambiguous policy language requiring horizontal exhaustion of all available primary insurance in all years. The exhaustion of other primary policies in other periods is not required in a continuous damage claim. (This goes for defense as well if a duty exists in the excess umbrella policy to drop down and defend when the primary insurance is exhausted).

(4) Limits are not relevant to the percentage allocation in a given period in a continuous damage claim. Neither is the amount of premium received by the carrier relevant.

(5) Notwithstanding the *Montrose* decision in California, the termination of the triggered period and allocation in that period should be no later than the date that the loss is known (regardless of whether liability is formally determined).

If it is impossible to pinpoint the amount of property damage (or bodily injury) to a specific time, in other words, if the damage is latent, continuous, progressive, indivisible, etc., then the time-on-risk method should be employed. Indemnity depends on actual coverage, not potential coverage. The number of months, or weeks or even days, should be included in the calculation of time on risk. Furthermore, the policyholder should participate in bare years, regardless of the reason for lack of insurance. While seemingly harsh, the lack of insurance, because, for example, an insurer becomes insolvent, is a risk that all policyholders face. And it is unfair to the insurers to have to pick up coverage for a period in which they received no premium.

## Conclusion

In continuous damage claims several periods, insured or not, are in play. Where there is more than one policy or more than one party, resolving allocation typically turns on adapting an allocation theory to the unique facts so that an equitable result is achieved. While vested interests, of course, determine one's perception of what is an equitable result, more often than not such results are achieved through negotiation. It is hoped that the proposal advanced will facilitate more agreement and less litigation.

## Endnotes

1. For the purpose of this article, "continuous damage claims" include both property damage and bodily injury claims.

2. Policy language is from ISO's form CG 00 01 12 04, ©ISO Properties, Inc., 2003. The Insurance Services Office is "(a)n organization that collects statistical data, promulgates rating information, develops standard policy forms, and files information with state regulators on behalf of insurance companies that purchase its services." (From *IRMI Online Glossary*) The focus here is on the "occurrence-based" policy as opposed to claims-made coverage that requires that a claim be first made during the policy period and is usually subject to a retroactive date. In order for there to be coverage on a claims-made policy, the property damage or bodily injury must occur on or after the retroactive date, which could be the policy inception date or earlier, and prior to the expiration of the policy period.

3. The CGL policy contains the following Other Insurance Condition, in part:

   **4. Other Insurance**

   If other valid and collectible insurance is available to the insured for a loss we cover under Coverages **A** or **B** of this Coverage Part, our obligations are limited as follows:

   **a. Primary Insurance**

   This insurance is primary except when b. below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in c. below.

   **b. Excess Insurance**

   This insurance is excess over:

   **(1)** Any of the other insurance, whether primary, excess, contingent or on any other basis:

   **(a)** That is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work";

   **(b)** That is Fire insurance for premises rented to you or temporarily occupied by you with permission of the owner;

   **(c)** That is insurance purchased by you to cover your liability as a tenant for "property damage" to premises rented to you or temporarily occupied by you with permission of the owner; or

   **(d)** If the loss arises out of the maintenance or use of aircraft, "autos" or watercraft to the extent not subject to Exclusion g. of Section **I** — Coverage **A** — Bodily Injury And Property Damage Liability.

   **(2)** Any other primary insurance available to you covering liability for damages arising out of the premises or operations, or the products and completed operations, for which you have been added as an additional insured by attachment of an endorsement.

   When this insurance is excess, we will have no duty under Coverages A or B to defend the insured against any "suit" if any other insurer has a duty to defend the insured against that "suit". If no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers.

   When this insurance is excess over other insurance, we will pay only our share of the amount of the loss, if any, that exceeds the sum of:

   **(1)** The total amount that all such other insurance would pay for the loss in the absence of this insurance; and

   **(2)** The total of all deductible and self-insured amounts under all that other insurance.

   We 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.

   **c. 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.

4. *IRMI Online Glossary*, 10th ed. (Dallas, TX: International Risk Management Institute, www.irmi-online.com).
5. Richard M. Shusterman, Anthony L. Miscioscia, Peter F. Rosenthal, Liability Insurance Coverage for Construction Defect Claims (*FDCC Quarterly*/Summer 2005) pp. 503–504.
6. *Couch on Insurance Third Edition*, Part VI, Subpart A, Chapter 102, Introduction and General Principles, B Coverage of Existing Losses, Westlaw, Database updated December 2005.
7. In May 2010 Colorado enacted House Bill 10-1394 which invalidated, as against public policy, the exclusion of "claims involving loss in progress not known to insured," at least with respect to policies issued to "construction professionals."
8. To illustrate, it is well established that property damage beginning during a policy period and that progresses/continues after the policy expires does not relieve the insurer at the time the damage begins of responsibility for the entire loss. Conversely, should the insurer later in the continuum be responsible for property damage that begins prior to the inception of the policy?
9. See Warfel, "Environmental Insurance Coverage Disputes: Is State Legislation the Solution? *CPCU eJournal*, September 2005, pp. 1–12.
10. J. Stephen Berry and Jerry B. McNally, Allocation of Insurance Coverage: Prevailing Theories and Practical Applications, *Tort Trial & Insurance Practice Law Journal* Summer 2007, American Bar Association.
11. R. Steven Rawls and Rebecca Appelbaum, Allocation of Damages for Ongoing Losses over Multiple Policies: Who Pays and How Much? January 2006 (http://www.irmi.com/Expert/Articles/2006/Rawls01.aspx).
12. J. Stephen Berry and Jerry B. McNally.
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15. J. Stephen Berry and Jerry B. McNally.
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