Client Alert

August 2012

California Supreme Court Holds That the "All-Sums-With-Stacking" Rule Applies to Continuous Losses

In a long-awaited decision, the California Supreme Court in *State of California v. Continental Ins. Co.*, Super. Ct. No. 239784 (Aug. 9, 2012), held that in a "continuous trigger" loss, the State of California could secure the full policy limits of each applicable policy "so long as the carriers insured the subject property at some point in time during the loss itself." The Supreme Court affirmed the appellate court's application of the "all-sums-with-stacking" rule.

BACKGROUND

The State of California (the "State") designed and operated an industrial waste facility (the "Site") from 1956 to 1972. Commercial General Liability ("CGL") policies issued to the State by multiple insurers between 1963 and 1978 applied to the Site. No CGL coverage existed for the Site prior to 1963 or beyond 1978.

In 1955, a geologist working for the State identified the Site as an appropriate industrial waste storage facility. In 1956, the State began to use the Site to receive and store industrial waste. Over the years of its operation, the Site "received more than 30 million gallons of industrial waste." The geologist's report turned out to be overly optimistic. Waste escaped from the Site and contaminated groundwater "for miles" away, which the State discovered in 1972, when it closed the Site.

In 1998, the State was found liable for "inter alia, negligence in investigating, choosing, and designing the site, overseeing its construction, failing to correct conditions at it, and delaying its remediation." The State was "held liable for all past and future cleanup costs," which, the State argued could total around $700 million. The insurers disputed the amount of potential liability, but agreed it would be at least $50 million.

Each policy contained essentially the same language. The carriers agreed to indemnify the State for "all sums which the [State] shall become obligated to pay by reason of liability imposed by law for damages because of injury or destruction of property, including loss of use thereof." Damages would be paid in the amount of the "ultimate net loss [of] each occurrence," subject to specified policy limits. "Ultimate net loss" was "the amount payable in settlement of the liability of the Insured arising only from hazards covered" by the policies and "after making deductions for all recoveries and for other valid and collectible insurance."

The trial court held that each carrier was liable for damages. The trial court further found, based on *FMC Corp. v. Plaisted & Cos.*, (1998) 61 Cal. App. 4th 1132, that "the State could not recover the policy limits in effect for every policy period, and could not 'stack,' or combine, policy periods to recover more than one policy's limits of recovered occurrences." Rather, the State "had to choose a single policy period for the entire loss coverage, and it could recover only up to the specific single policy limit in effect at the time the loss occurred."

The coverage trial occurred in phases. In 2005, a jury found that the carriers had breached their policies. The State had already settled with three of its carriers for a total of $120 million, which the trial court held must reduce the other carriers' liability as "setoffs." "Under the trial court's one-occurrence, no-annualization and no-stacking rules, the most the State could recover from all insurers was $48 million."

Therefore, even though the carriers were found to have been in breach, a judgment of $0 was entered since the State had already recovered in excess of that amount through settlement.

The Court of Appeals reversed the anti-stacking ruling, holding that *FMC* was "flawed and unconvincing." The carriers then filed the instant Petition for Review to the California Supreme Court.

APPEAL & HOLDING

The California Supreme Court affirmed based on the "continuous injury" trigger of coverage articulated in *Montrose Chem. Corp. v. Admiral Ins. Co.*, (1995) 10 Cal. 4th 645, 655 and the "all sums" rule adopted in *Aerojet-General Corp. v. Transport Indem. Co.*, (1997) 17 Cal. 4th 38, 55-57. Under *Montrose*, "property damage that is continuous or progressively deteriorating throughout several policy periods is potentially covered by all policies in effect during those periods." Noting that, where losses are continuous, it is difficult — if not impossible — for the policyholder to point to the exact moment of a loss, the Court explained: "*Aerojet* understood *Montrose* as extending the insurers' indemnity obligations beyond the expiration of the policy period where there has been a continuous loss." Thus, "as long as the property is insured at some point during the continuing damage period, the insurers' indemnity obligations persist until the loss is complete, or terminates." Under *Aerojet*, the carriers are liable for "all sums" — subject to policy limits — stemming from covered "occurrences." Furthermore, precedent declining to hold carriers jointly and severally liable did not invalidate application of the "all sums" rule; rather, each carrier would be "severally liable on its own policy and up to its policy limits."

The Court rejected the carriers' "pro rata" or "apportionment" method of allocation, which it explained "assigns a dual purpose to the phrase 'during the policy period' in the CGL policy's definition of 'occurrence.' The phrase serves both as a trigger of coverage and a limitation on the promised 'all sums' coverage." Different jurisdictions have adopted different variations of pro rata allocation, assigning liability to each insurer based on its "time on the risk" and other factors. The Supreme Court noted that "all pro rata allocation methods assign liability to the insureds for those years of the continuous injury that the insureds chose not to purchase insurance," and held that allowing the insureds to bear such a burden would contravene the language promising indemnity for "all sums." The Court agreed with the State that, the "all sums" language was not modified by a phrase such as, "accruing during the policy period," and it would not impose any such modification on the policies. Thus, each insurer was liable, up to its policy limits, "as long as some of the continuous property damage occurred while each policy was 'on the loss.'"

Finally, the Supreme Court considered the Court of Appeals' holding that allowed the State to "stack consecutive policies and recover up to policy limits of the multiple plans." The Court explained:

> "The all-sums-with-stacking indemnity principle properly incorporates the *Montrose* continuous injury trigger of coverage rule and the *Aerojet* all sums rule, and effectively stacks the insurance coverage from different policy periods to form one giant 'uber-policy' with a coverage limit equal to the sum of all purchased insurance policies. Instead of treating a long-tail injury as though it occurred in one policy period, this approach treats all the triggered insurance as though it were purchased in one policy period."

Based on principles of fairness and pragmatism, the Court approved the all-sums-with-stacking rule, concluding that it "means that the insured has immediate access to the insurance it purchased. It does not put the insured in the position of receiving less coverage than it bought. It also acknowledges the uniquely progressive nature of long-tail injuries that cause progressive damage throughout multiple policy periods." Calculation of proceeds under a rule that allows stacking is "uncomplicated" and coverage is resolved "as equitably as possible." Finally, the plain language of policies extending indemnity for "all sums" the insured becomes liable to pay should allow for stacking; therefore, only if policy language specifically prohibits "stacking" shall California courts prohibit stacking; absent such language, California courts shall not impose anti-stacking provisions.

IMPLICATIONS

The *State of California v. Continental* decision clarifies California law on allocation of losses in cases involving continuing environmental damage. It rejects the anti-stacking rule articulated in *FMC Corp. v. Plaisted & Cos.*, and re-affirms the coverage-maximizing "continuous trigger" and "all sums" rules articulated in *Montrose Chem. Corp. v. Admiral Ins. Co.*, and in *Aerojet-General Corp. v. Transport Indem. Co.* Policyholders may look to any and all of their carriers for indemnity for covered, continuous losses, subject only to limitations that are made explicit in their policies. This rule makes potentially highly complex coverage and allocation questions relatively uncomplicated, and extends to policyholders the full extent of coverage they bargained for.

Contacts

Walter J. Andrews
wandrews@hunton.com

Lon A. Berk
lberk@hunton.com

Lawrence J. Bracken II
lbracken@hunton.com

John C. Eichman
jeichman@hunton.com

Robert J. Morrow
rmorrow@hunton.com

Curtis D. Porterfield
cporterfield@hunton.com

Syed S. Ahmad
sahmad@hunton.com

Michael S. Levine
mlevine@hunton.com

Sergio F. Oehninger
soehninger@hunton.com

William T. Um
wum@hunton.com