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All Sums, All Policies: Full Coverage Recognized for 'Long Tail' Claims Under California Law

By Robert M. Horkovich and Edward J. Stein

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A recent decision in the California Supreme Court clarifies the full extent to which policyholders facing environmental clean-up costs or other "long tail" claims can tap their historic policies to help pay for those costs.

California's highest court recognized that all insurance policies triggered by continuing damage must pay "all sums" of resulting liability. The decision is cause for all policyholders with liability for "long-tail" claims under California law, such as environmental property damage, asbestos injury, toxic tort, or construction defect, to reassess their coverage carefully. Even if you previously settled your insurance claim, you now should check your settlements to see if coverage may be available under rules recognized by this decision.

Two Restrictions on Coverage Rejected

The new opinion, reported in *State of California v. Continental Insurance Company, et al.*, 55 Cal.4th 186, 145 Cal. Rptr.3d 1, 281 P.3d 1000 (2012), eliminates two restrictions on coverage for long-tail claims that the insurance industry long has asserted. Insurance companies denied indemnification up to the limits of all the triggered policies, arguing that each triggered policy only should pay a pro-rata fraction of the liability, not "all sums." Many insurance companies also relied on a 1998 intermediate appellate court decision involving FMC Corporation to argue that even if policies during several successive policies were triggered by continuing damage or injury, the policyholder only could recover from the insurance in a single period and could not "stack" the coverage purchased for other periods when the injury or damage also had occurred.

Court Affirms 'All Sums' Coverage Principles

The California Supreme Court first affirmed that each insurance company had to pay up to its policy limit for all sums of liability because of damage during the policy period. Rejecting the insurance companies' "equitable" argument that each policy should be allocated only a pro-rata fraction of the full amount of liability in proportion to the full time span of the loss, the court found that "the language of the applicable policies…supports adoption of the all sums coverage principles." Like most "occurrence"-based comprehensive general liability insurance policies, the state's policies promised to pay "all sums which the insured shall become obligated to pay…for damages…because of injury to or destruction of property.…"

> "Even if you **previously settled** your insurance claim, you now should **check your settlements** to see if coverage may be available under rules recognized by this decision."

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The California Supreme Court agreed with the state of California that this grant of coverage "does not limit the policies' promise to pay 'all sums' of the policyholder's liability solely to sums or damage 'during the policy period,'" as insurance companies have argued. The court noted that the "during the policy period" language on which the insurance companies relied does not appear in the policy's insuring agreement, and therefore is neither logically nor grammatically related to the "all sums" language in the insuring agreement.

The California Supreme Court ruled that "the policies at issue obligate the insurers to pay all sums for property damage attributable to the Stringfellow site, up to their policy limits, if applicable, as long as some of the continuous property damage occurred while each policy was 'on the loss.'" Once a policy is triggered by damage during its period, "[t]he coverage extends to the entirety of the ensuing damage or injury," which "best reflects the insurers' indemnity obligation under the respective policies, the insured's expectations, and the true character of the damages that flow from a long-tail injury." The court also observed that "a growing number of states have similarly adopted this interpretation of the "all sums" language," while acknowledging that others have taken the pro-rata position.

Policyholder May 'Stack' Policies from Different Periods

Next, the California Supreme Court turned to the so-called "stacking" issue, which arose because the state's liability exceeded the limits available during a single policy period, and it therefore sought to collect from more than a single period's insurance.

The California Supreme Court explained that "stacking" policy limits simply means that "when more than one policy is triggered by an occurrence, each policy can be called upon to respond to the claim up to the full limits of the policy." Emphasizing that this provides the benefit of the parties' bargain, the California Supreme Court explained that stacking gives the policyholder "immediate access to the insurance it purchased," while the anti-stacking decision in *FMC* had "put the insured in the position of receiving less coverage than it bought." The California Supreme Court expressly disapproved of the *FMC* decision, finding that it "disregarded the policy language" and resorted to unwarranted "judicial intervention."

The California Supreme Court noted several advantages to the all-sums-with-stacking indemnity rule. Requiring indemnification of all sums under all applicable policies is consistent with standard insurance policy language; it acknowledges the progressive nature of long-tail injuries that continue through multiple policy periods; and it provides an equitable resolution of the scope of coverage under each policy and the allocation of coverage between different policies. The rule comports with reasonable expectations, in that each insurance company reasonably expects to indemnify liability because of property damage occurring during a long-tail loss it covered, but only up to its policy limits, and the policyholder reasonably expects indemnification for all the periods in which it purchased insurance coverage. Thus, the court found "nothing unfair or unexpected in allowing stacking in a continuous long-tail loss."

Value of Historic Insurance Assets Recognized

Now that the California Supreme Court definitively has spoken on the right to all sums under all policies, any liability insurance policy which has not paid its full indemnity limit, and which has not been settled with a policy release or buy-back, remains a valuable asset for any policyholder with liability for long-tail claims under insurance policies to which California law may apply. Policyholders seeking to resolve environmental, asbestos, toxic tort or construction defect claims in California should expect to recover all limits under all available policies during the period of damage or injury, so that the policyholder's entire loss is covered. Such a recovery is neither unfair nor overreaching; it simply is the benefit of the bargain for which policyholders paid the premiums asked by their underwriters.

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State Laws May Preclude the Arbitration of Insurance Disputes

By Alexander D. Hardiman and Rene F. Hertzog

Insurance companies increasingly include arbitration clauses in their policies and tout arbitration as a more economical and efficient way to resolve insurance coverage disputes than litigation. In many cases, however, arbitration can put policyholders at a significant disadvantage. Arbitration clauses may contain conditions mandating application of a particular state's law that is unfavorable to policyholders or requiring that the arbitrators have an insurance industry background. Moreover, in contrast to a court, arbitrators are not generally required to follow the law strictly, and the circumstances in which an arbitrator's decision can be overturned by a court are severely limited. A recent decision from the New York State Supreme Court, however, provides a good example of how policyholders can successfully challenge unfavorable arbitration clauses.

The often-cited policy favoring arbitration of disputes was codified in 1925 by Congress in the Federal Arbitration Act, 9 U.S.C. § 1. Because states are vested with the power to regulate the business of insurance, many states have statutes that directly or indirectly prohibit or limit the arbitration of insurance disputes under certain circumstances, despite the federally legislated presumption in favor of upholding arbitration agreements. Currently, approximately 26 states have enacted legislation that expressly limits or wholly restricts submitting claims arising out of insurance disputes to binding arbitration.

Courts have found that a state's insurance code operates to invalidate a policy's arbitration clause where to impose arbitration would otherwise directly or indirectly impair a state law regulating insurance. A recent decision from the Supreme Court of the State of New York, New York County highlights how a state's Insurance Code may trump and invalidate an arbitration provision. Last summer, that court held that the Federal Arbitration Act did not preempt the California Insurance Code so as to compel arbitration of a dispute involving alleged funds owed under a workers' compensation insurance program,

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where the insurance company failed to file the policy documents containing the arbitration provision with the relevant state agency. *See National Union Fire Ins. Co. of Pittsburgh, Pa v. Source One Staffing, LLC*, Index No.: 652366/2010, July 27, 2011. In that decision, the court concluded: "if the court were to find that arbitration is contractually mandated under the FAA, despite the provisions' undisputed non-compliance with the Insurance Code, then the court would be disregarding the Insurance Code on the basis of the FAA." Based on this rationale, the court denied the insurance company's motion to compel arbitration.

The court reaffirmed its ruling on July 25, 2012, by denying the insurance company's motion to reargue the issue of the applicability of the Federal Arbitration Act to the dispute and additionally finding the arbitration clause at issue unenforceable because the insurance company had failed to abide by California's statutory insurance policy filing requirements. *See National Union Fire Ins. Co. of Pittsburgh, Pa v. Source One Staffing, LLC*, 36 Misc.3d 1224(A), 2012 WL 3156438 (N.Y. Sup. Ct. July 25, 2012).

In rejecting the insurance company's argument that the Federal Arbitration Act made arbitration of the parties' dispute compulsory, the court considered California's interests in regulating insurance and the regulatory framework surrounding that insurance. Recognizing the importance to California of regulating insurance and interpreting and enforcing its own laws, the court held that the insurance company was required to file the policy documents that contained the arbitration clause with the California Department of Insurance and because it had not, the arbitration clause was invalid.

Accordingly, while disputes arising out of an insurance policy containing an arbitration clause may appear to be subject to mandatory arbitration, policyholders should be aware that good arguments may exist to support a challenge to that arbitration clause based on the applicable state insurance laws and regulations.

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