Court Sides With Policyholders in Complex Case

Rulings on allocation obligations could have impact in Conn.

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A 2014 New Jersey Appellate Court decision, addressing pro rata allocation obligations among the policyholder and multiple insurers, made at least three significant rulings favorable to policyholders. The rulings in *IMO Industries v. Transamerica*, 101 A.3d 1085 (2014), may provide persuasive authority here since the Connecticut Supreme Court adopted pro rata allocation in *Security Insurance Co. of Hartford v. Lumbermens Mutual Casualty*, 264 Conn. 688 (2003), and did so by relying on New Jersey authority.

IMO Industries Inc. was a defendant in thousands of mass tort cases involving personal injury claims from exposure to asbestos. IMO, together with its insurers, vigorously defended the cases. Although several insurance companies had provided indemnity and defense coverage over several decades under sharing arrangements, a claim of exhaustion of policy limits by various insurers led to the declaratory judgment action against numerous primary and excess insurers regarding allocation of indemnity and defense costs.

As to the first significant ruling in *IMO*, the New Jersey Appellate Court rejected certain insurers' "covered claims" argument. In essence, these insurers contended that they were not obligated to reimburse or indemnify defense costs unless those costs were attributable to a "covered occurrence." The insurers then interpreted a "covered occurrence" as a loss that the policyholder becomes obligated by adjudication or compromise to pay under their respective definitions of "ultimate net loss." In other words, the insurers refused to pay defense costs for claims that the policyholder successfully defended or for which it managed to obtain a dismissal. The policyholder maintained that the "effective defense of meritless claims is part and parcel of the defense of covered claims" when faced with mass tort litigation. The court held that the excess insurers had an obligation to cover IMO's ultimate net losses, which include all defense costs, because the payments relate to an "occurrence" that triggered the insurers' policies.

The *IMO* court reasoned, in part, that the nature and purpose of pro rata allocation was developed "to reduce the litigations costs and judicial inefficiencies attendant to resolving insurance coverage for long-term environmental damages." Tracking defense costs as to each individual claim would be burdensome and defy the objective for efficiency. Allowing insurers to categorize claims as covered and uncovered would potentially add a layer of dispute that "would increase litigation and require additional judicial attention." Therefore, the appellate court affirmed the trial court's ruling that defense costs are subject to pro rata allocation "even if a portion of them ultimately were devoted to defending against claims that were determined not to be covered under the insurance policies."

As to the second significant ruling favorable to policyholders, the *IMO* court affirmed the trial court in its determination that, with respect to a declaratory judgment as to exhaustion of the primary policy limits, coverage issues would not be re-litigated for each individual underlying asbestos claim. The court held that allowing excess insurers that either failed or refused to be involved in the defense of the underlying claims to contest coverage is "not feasible for long-tail, multi-claim coverage cases." Moreover, such an approach would compromise the allocation methodology mandated by the New Jersey Supreme Court in *Owens-Illinois v. United Insurance*, 138 N.J. 437 (1994). *Owens-Illinois* was cited favorably by the Connecticut Supreme Court in its *Security* case.

Because the policyholder typically bears the burden of establishing that a claim lies within a policy's scope of coverage, the excess insurers argued that, for purposes of establishing trigger of their policies, the policyholder needed to prove that claims that had been paid by primary insurers were covered under the terms of their policies. The trial

judge had found that it was reasonable for the policyholder and the insurers to have settled the underlying claims. Of the tens of thousands of asbestos-related claims that had been filed, IMO obtained a dismissal twice as often as it paid a settlement. In 1989, when there was still ample primary insurance coverage available, the policyholder started putting its excess insurers on notice of the asbestos-related suits. The excess insurers had declined to involve themselves in the defense of claims, although their policies permitted them to be associated in the defense. That declination was considered "tantamount to a refusal" by the excess insurers to involve themselves in presented-claims defense.

The court noted that, in *Owens-Illinois*, while primary and excess insurers were involved in the case, the New Jersey Supreme Court did not explicitly condition its directive prohibiting re-litigation of coverage issues to the primary insurers' affirmative duty to defend. Rather, the *Owens-Illinois* court stated: "In future cases insurers aware of their responsibility under the continuing-trigger theory might minimize their costs by assuming responsibility for or involving themselves in the defense of the actions." The Appellate Court further noted that: "It stands to reason that accommodating a challenge to coverage in tens of thousands of individual claims would not only prove daunting but would compromise the integrity of the framework *Owens-Illinois* offers for efficient and equitable allocation of losses among policies."

Third, the *IMO* court addressed policy limits. Specifically, the court held that the imposition of a single policy limit for multiyear policies would contravene the goals of pro rata allocation. Certain insurers argued that their multiyear policies provided a single per-occurrence limit for the duration of the policy, although the policies provided aggregate limits for each annual period. IMO sought a blanket ruling that every year of a multiyear policy should be treated as if a separate annual limit is available for asbestos claims. The court agreed with the policyholder and affirmed the trial court's ruling: The single occurrence position of the insurers contravened the premise of continuous trigger theory that the progressive injury constitutes an occurrence within each of the triggered policy years, as set forth in *Owens-Illinois*, and accordingly, is unenforceable.

Additionally, the court affirmed the trial court's holding that the policy limits of a "stub policy" should not be pro-rated and that the full policy limits are available for pro rata allocation across the shorter policy timeframe. (A "stub policy" is so-called because the policy is issued or extended for only part of a year.) The court reasoned that treating such a stub policy as providing only a pro-rated limit would result in the loss allocated to the policy being reduced twice, once by its time on the risk and a second time by the pro-rating of the policy limit. The court also noted that the policy did not include specific policy language to indicate that the annual aggregate limits are pro-rated.

The issues decided in *IMO* have not been specifically addressed by the Connecticut Supreme Court. Given the logic of *IMO* and the history of *Security*'s reference with approval to the New Jersey Supreme Court's *Owens-Illinois* case, the *IMO* case has potentially broad implications for the developing law on pro rata allocation here in Connecticut and elsewhere.

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