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Environmental Law

New Piece Added to Insurance Recovery Puzzle

Deductibles for all accessed policies must be satisfied before the insurer is required to make any payments

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On March 24, 2004, the New Jersey Supreme Court addressed the application of insurance policy deductibles in environmental exposure cases—adding a new piece to the insurance recovery puzzle.

In previous cases, the Court adopted a continuous-trigger liability theory as a means of allocating the costs associated with long-term environmental exposure to multiple years of insurance policies. In *Benjamin Moore & Co. v. Aetna Casualty & Surety Company*, 179 N.J. 87 (2004), the Court held the deductible in each insurance policy accessed by the insured must be satisfied before the insurer is required to make any payments. Benjamin Moore brought a declaratory judgment action for defense and indemnity from its comprehensive general liability (CGL) insurance carriers for claims associated with two class-action lawsuits related to lead paint exposure. Benjamin Moore had purchased five CGL policies covering a period of 11 years, between 1990 and 2001. The CGL policies had limits of $1 million per occurrence, with deductibles of either $250,000 or $500,000. The CGL policies included a "deductible liability endorsement," under which the insurer was only obligated to pay up to the insurance limit minus the deductible, which is applied on a per occurrence basis.

Benjamin Moore argued that it should be allowed to choose the specific CGL policy accessed for its defense, and thus pay only the deductible under that policy. Alternatively, Benjamin Moore argued that it should only be responsible for a percentage of the deductibles in each of the triggered policies, with that percentage being the same pro-rata share of the overall liability allocated to each triggered policy. The insurers argued, of course, that each deductible in each triggered policy must be fully satisfied prior to any payments up to the permit policy limits.

Owens-Illinois

In *Owens-Illinois, Inc. v. United Insurance Co.*, 138 N.J. 437 (1994), the New Jersey Supreme Court created a new template for addressing long-term environmental exposure in the context of insurance recovery. In *Benjamin Moore*, the Court reaffirmed the validity of *Owens-Illinois* by discussing the history and necessity of special rules to deal with long-term environmental exposure liability cases. The Court noted that "[i]n general, CGL policies are designed to respond to easily identifiable and quantifiable losses occurring within the policy period. Because progressive environmental injury claims offer neither of those indicia of certitude, and because historically CGL policies provided no guidance regarding the point at which a long-tail environmental injury becomes an occurrence, it was left to courts to resolve the issue." *Benjamin Moore*, 179 N.J. at 97.

The *Owens-Illinois* Court adopted a continuous-trigger approach to address such environmental exposure cases. Under the *Owens-Illinois* approach, a "progressive environmental injury is an occurrence in each policy year thus triggering all relevant primary and excess policies in effect during the period." Id. at 98. After determining that there is a separate occurrence in each year, the Court adopted a pro-rata methodology to determine the exposure/obligation of each policy. In this equation, the numerator is the insurer's "time on the risk" (i.e., the years of policy coverage) and the denominator is the total years of exposure years to the environmental harm.

For illustration, assume a case in which there was a 10-year environmental exposure period, with 10 CGL policies. Under the *Owens-Illinois* approach, there is a distinct and separate occurrence in each of the 10 years of exposure. Assume further that in a 10-year exposure case, there are two insur-

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ers, A and B, each having issued policies for five years. Under *Owens-Illinois*, each insurer's pro-rata share is 50 percent (five years on the risk/10-year exposure). Now assume that the exposure period was 15 years, and insurers A and B each still issued only five years of CGL coverage, and the insured "went bare" (i.e., uninsured) for the remaining five years. In this case, insurers A and B and the insured would each be responsible for one-third of the exposure (five years on the risk/15-year exposure).

However, the *Owens-Illinois* methodology only addresses which policies are implicated, and what an insurer's pro-rata share of exposure should be. These questions were not at issue in *Benjamin Moore*.

Application of Insurance Policy Deductibles

In *Benjamin Moore*, the New Jersey Supreme Court noted that, notwithstanding the *Owens-Illinois* approach, Benjamin Moore was making its arguments as though the progressive environmental damage was a single occurrence. The Court stated, "Benjamin Moore's refusal to accept that progressive environmental injuries are multiple occurrences is a pediment on which its argument stands. We rejected that view in *Owens-Illinois* and our rejection of it was not a slip of the tongue or a mere formalism. The multiple occurrence template is a matter of substance that is at the heart of *Owens-Illinois*. It is what triggers multiple policies, thus maximizing resources available for toxic tort cases." Id. at 104. Benjamin Moore's argument was essentially that only one policy's deductible ought to apply. However, because *Owen-Illinois*' template implicates multiple policies with a single occurrence during each policy year, the Court found *Benjamin Moore*'s approach to be at odds with *Owens-Illinois*.

During oral arguments, Benjamin Moore also adopted the proposed approach presented by the "Friend of the Court." Based on this approach, Benjamin Moore argued, "[A]n insured in a continuous-trigger case only should be required to satisfy the deductibles for the number of policies necessary to provide coverage for the total loss. The example given is a loss of $3 million, allocated under *Owens-Illinois* over 10 years, during which an insured is covered by ten $1 million policies, each with a $100,000 deductible. According to [the Friend of the Court] CSR, the insured should only have to pay the deductible on three policies ($300,000) because three policies would cover the total loss." Id. at 96.

The Court rejected the approach as inconsistent with the overall *Owens-Illinois* approach. The Court reiterated, "*Owens-Illinois* is a several step process. The first is the continuous-trigger that assesses all relevant policies. The second is the painstaking allocation of losses to each individual policy period in order to fit the long-tail environmental case into an ordinary insurance model. The third is the invocation of the insurance contract provisions in each triggered policy, so long as they are not in conflict with *Owens-Illinois*." Id. at 106.

With respect to other key insurance contract terms, the Court noted, "*Owens-Illinois* was never intended to displace the basic provisions of the insurance contract so long as those provisions are not inconsistent with the underlying methodology specifically adopted in that case." Id. at 101. Thus, once the *Owens-Illinois* allocation methodology has been used to establish each policy's allocated share of the total risk, all other terms of the insuring contract are back in play. For instance, if the share allocated to one CGL policy is $1.5 million, but the policy limit is only $1 million, the insured is only obligated to pay up to the policy limit of $1 million. At "step three," the insurance policy language controls.

The Court stated that a policy's deductible must also be satisfied for each specific CGL policy that is being accessed. For instance, assume again a 10-year environmental exposure period with 10 CGL policies, each policy has a $100,000 deductible and a $1 million limit. Assume the total claim or loss is $1 million. Each policy will be allocated a pro-rata share of the entire loss, or $100,000. However, because each policy has a $100,000 deductible, the insured will receive nothing. While this may seem inequitable, the Court argued that "[d]eductibles constitute a bargained-for aspect of the insurance contract that affects the premiums the insured pays. … Sometimes the deductibles will eat up the loss and sometimes not. That is the way insurance works. Insureds purchase policies with deductibles that are directly related to their premiums, risking the possibility that the loss will be low and the deductible will equal or exceed it. When that occurs, the insured gets exactly what it has bargained for." Id. at *107.

The Dissent

Justice Barry Albin, joined by Justice James Zazzali, dissented from the Court's opinion. According to the dissent, the Court's decision frustrates the goals of *Owens-Illinois*. "It is true that the Court's approach will protect policyholders in the event of catastrophic loss. However, for those policyholders unable to pay the multiple deductibles before accessing insurance coverage, this Court's decision will be catastrophic. People and businesses buy insurance to protect against losses that might otherwise bankrupt them. The Court's decision denies the policyholder the very benefit that comes with the promise of insurance coverage." Id. at 114-15.

The dissent seemed to note, with some irony, that the Court had adopted the *Owens-Illinois* methodology "not because it flowed from the language of the insurance policies at issue, but because equity and notions of simple justice demanded that we do so." Id. at 112. That is in contrast with the *Benjamin Moore* Court's view that once the *Owens-Illinois* pro-rata allocation scheme has been addressed, all remaining policy terms and conditions are to be used, regardless of what that means for the insured's coverage, or lack of coverage.

Decision's Impact

It is beyond doubt that with *Benjamin Moore*, the Court has drastically altered the insurance landscape in

New Jersey. Before *Benjamin Moore*, a standard approach by practitioners was to negotiate the pro-rata share of each "on-the-risk" insurer and then subtract from each insurer's liability roughly the pro rata "share" of the deductible. Now, insurers will obviously be more aggressive in their negotiations to require that all deductibles be fully paid before any insurance claim is settled and payment made. It seems fair to assume that under this "new" rule, those insureds who paid more at the outset (via higher premiums and lower deductibles) might fare better than those insureds who assumed more risk via a larger deductible. It also seems clear that insureds will be paying far more through their deductibles than they might have expected for progressive environmental injury claims. ■