Insurance and Reinsurance Alert: The Supreme Judicial Court of Massachusetts Adopts Pro Rata/Time-on-the-Risk Allocation Rejecting Efforts to Apply an "All Sums" Allocation

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In what can only be described as a major victory for insurers, the Massachusetts Supreme Judicial Court (SJC)—Massachusetts's highest court—responded to certified questions from the United States Court of Appeals for the First Circuit by rejecting a joint and several (also known as "all sums") approach to liability allocation for progressive injuries, and instead adopting a *pro rata* method of liability allocation.[1] In addition, the SJC adopted the time-on-the-risk method of prorating liability in the "absence of evidence more closely approximating the actual distribution of property damage."[2] Finally, the SJC concluded that an insured must bear a *pro rata* share of the losses for all time periods where it was self-insured.[3]

Boston Gas Company (Boston Gas) operated a manufactured gas plant in Everett, Massachusetts from 1908 until 1969.[4] During this time period, Boston Gas purchased CGL policies from several different insurers, including three policies from Century Indemnity Company (Century).[5] In 1995, after pollution was discovered at the Everett site, Boston Gas notified Century and sought indemnification for investigation and remediation costs.[6] Century "reserved its rights," and consequently Boston Gas sought a declaratory judgment as to Century's obligations under its insurance policies and damages for breach of the policies.[7] Century counterclaimed and brought third-party claims against Boston Gas's other insurers.[8] After a three-week jury trial, Century was found liable and ordered to pay over $6 million in damages for investigation and remediation costs.[9]

After the verdict, Boston Gas urged the trial court to apply a joint and several approach to the liability allocation, under which Century would be liable for the full damage award and would then be entitled to seek contribution from Boston Gas's other insurers.[10] Century argued that damages should be allocated *pro rata*, and sought certification on the allocation question to the SJC.[11] The trial court, reasoning that certification was not appropriate because the allocation issue was not outcome determinative, denied Century's request for certification and concluded that case law from the Massachusetts Court of Appeals compelled the adoption of the joint and several allocation method.[12] The trial court then entered separate and final judgment pursuant to Federal Rule of Civil Procedure 54(b).[13]

Century appealed to the First Circuit, challenging the application of joint and several liability allocation.[14] After finding "no controlling [SJC] precedent on the allocation question" and that

"the issue is determinative of the scope of Boston Gas'[s] claim," the First Circuit certified the following three questions to the SJC:

1. Where an insured protected by standard CGL policy language incurs covered costs as a result of ongoing environmental contamination occurring over more than one year, and the insurer provided coverage for less than the full period of years in which contamination occurred, should the direct liability of the sued insurer be prorated in some manner among all insurers "on the risk," limiting the direct liability of the sued insurer to its share, but leaving the insured free to seek the balance from other such insurers?
2. If some form of *pro rata* liability is called for in such circumstances, what allocation method or formula should be used?
3. If a single insurer in such circumstances is subject to liability under more than one policy, and each policy has a separate deductible or self-insured retention, should the insured be able to collect covered losses from a single policy subject only to that policy's deductible or self-insured retention, or should liability be reduced by the sum of the applicable self-insured retentions, effectively allocating total liability across the policies of that insurer in effect during the contamination period?[15]

Pro Rata Allocation

After reviewing the characteristics of both the joint and several allocation and *pro rata* allocation methods, the SJC said its analysis was governed by the policy language and not the insured's argument, which overlooked the "limitation that the phrase 'during the policy period' places on the scope of the coverage."[16] Noting that none of the clauses in the policy implied or reflected an intention to cover losses from damage outside the policy period, the Court stated that it doubted "that an objectively reasonable insured reading the relevant policy language would expect coverage for liability from property damage occurring outside the policy period."[17] Indeed, the SJC concluded that "[n]o reasonable policyholder could have expected that a single one-year policy would cover all losses caused by toxic industrial wastes released into the environment over the course of several decades. Any reasonable insured purchasing a series of occurrence-based policies would have understood that each policy covered it only for property damage occurring during the policy year."[18] Thus, "a *pro rata* allocation of losses is consistent with, if not compelled by, the most reasonable construction of the policies at issue."[19]

The SJC also distinguished two Massachusetts Court of Appeals cases, *Rubenstein v. Royal Insurance Company*[20] and *Chicago Bridge & Iron Company v. Certain Underwriter's at Lloyd's, London*,[21] which had adopted the joint and several allocation method.[22] The SJC first characterized the treatment of the allocation issue in *Rubenstein* as "cursory" and underscored that the decision focused "solely on the policy's 'all sums' language to the exclusion of any other policy language."[23] As for *Chicago Bridge*, the SJC noted that *Chicago Bridge* was decided under Illinois law, and that two key differences in policy language caused the Appeals Court to reach a different result.[24] First, the *Chicago Bridge* policy included a "noncumulation clause" which expressly provided coverage in certain circumstances for property damage occurring after the policy period ended.[25] Second, unlike Boston Gas's policy, the *Chicago Bridge* policy did not contain a "policy period, territory" provision which limits the applicability of the policy to property damage occurring during the policy period. Given these key distinctions in both

Rubenstein and *Chicago Bridge*, the SJC was not persuaded to apply a joint and several liability allocation.

Finally, the SJC noted that, in addition to being more consistent with the policy language, a *pro rata* allocation served important public policy objectives.[26] Specifically, the *pro rata* allocation resolves the allocation problem instead of merely separating it into two suits, thereby decreasing litigation costs and conserving judicial resources.[27] Otherwise, under an "all sums" outcome, there would remain the inefficient and costly second lawsuit between insurers for contribution. In addition, the *pro rata* allocation results in the insured bearing the risk of an insurer being unable to pay—a more equitable result considering the insured purchased the defaulting insurer's policy and the other insurer was a stranger to the selection process.[28] Finally, the *pro rata* allocation method forces an insured to absorb losses for periods during which it self-insured, preventing an insured from benefitting from coverage for injuries that occurred when it was not paying a policy premium.[29]

Time-on-the-Risk Measurement Method

Concerning the issue of how to apply *pro rata* allocation, the Court first noted that "[t]he ideal method is a 'fact-based' allocation, under which courts would 'determine precisely what injury or damage took place during each contract period or uninsured period and allocate the loss accordingly.'"[30] The SJC recognized, however, that courts are frequently unable to make such an exact determination because of the factual complexities, and thus are often forced to use "various proxies for deriving fair apportionment" such as "time on the risk" or "prorating losses by years and limits."[31] Under a *pro rata* allocation by time on the risk, "an insurer pays its percentage of loss attributed to its policy period" in that each triggered policy bears a share of the total damages [up to its policy limit] proportionate to the number of years it was on the risk [the numerator], relative to the total number of years of triggered coverage [the denominator]."[32] In contrast, "[u]nder pro-ration by years and limits, loss is allocated among policies based on both the number of years a policy is on the risk as well as that policy's limits of liability" and "an insurer's proportionate share is established by dividing its aggregate policy limits for all the years it was on the risk for the single, continuing occurrence by the aggregate policy limits of all the available policies and then multiplying that percentage by the amount of indemnity costs."[33]

Ultimately, the SJC concluded that the "inherent simplicity" in the time-on-the-risk method of *pro rata* allocation promotes predictability, reduces incentives to litigate, and ultimately reduces premium rates."[34] In contrast, prorating by years and limits "disproportionately assigns liability to generous policies, disproportionately increasing their price, thus making them more difficult to purchase."[35] Thus the SJC held that the time-on-the-risk method "is more appropriate where the evidence will not permit a more accurate allocation of losses during each policy period."[36]

Significantly, the SJC also determined that it would not be equitable for an insured to recover losses for policy periods where it was self-insured, and therefore did not pay policy premiums.[37] Rather, allowing the insured to recover under such circumstances would effectively provide "insurance where insurers made the calculated decision not to assume risk and not to accept premiums. In effect, because the policyholder could not buy insurance, it is treated as though it

did by passing those uninsurable losses to insured periods."[38] "Therefore, unless the policy language unambiguously provides otherwise, the policyholder's self-insured retention should be prorated on the same basis as the insurer's liability in the case of environmental contamination."[39]

As a result, when determining each insurer's *pro rata* allocation—where a fact-based allocation of losses attributable to each policy period is not feasible—"[t]he total amount of damages should be divided by the total number of years to yield the amount of damage that is fairly attributable to each year. For example, if an insured's liability for a decade of pollution is one million dollars, then one tenth of the total liability, or $100,000, is fairly attributable to each policy-year."[40] In addition, the insured is responsible for any periods where it did not purchase insurance and is liable for the "prorated portion of its per occurrence self-insured retention for each triggered policy period, to be prorated on the same basis as the insurer's liability."[41]

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Because environmental contamination generally occurs across policy periods, this ruling may now be cited by insurers as well-reasoned authority that squarely refutes any notion that the "all sums" phrase can be read in isolation to require one insurer to shoulder the burden of paying for the insured's complete pollution liability where the insurer was on the risk for only a portion of the time during which the contamination took place. If you would like to discuss the *Boston Gas* decision or other matters concerning insurance or reinsurance, please contact any member of Mintz Levin's Insurance and Reinsurance Practice Group listed to the left.

Endnotes

[1] *Boston Gas Co. v. Century Indem. Co.*, SJC-10246, slip op. at 2 (Mass. Jul. 24, 2009).

[2] *Id.*

[3] *Id.*

[4] *Id.* at 2

[5] *Id.*

[6] *Id.* at 4.

[7] *Id.* at 5.

[8] *Id.*

[9] *Id.*

[10] *Id*.

[11] *Id*.

[12] See *Rubenstein v. Royal Insurance Company*, 44 Mass. App. Ct. 842, 852-53 (1998); *Chicago Bridge & Iron Company v. Certain Underwriter's at Lloyd's, London,* 59 Mass. App. Ct. 646, 648 (2003).

[13] *Boston Gas Co.*, SJC-10246, slip op. at 5.

[14] *Id*.

[15] *Id*. at 1-2, 5

[16] *Id*. at 10.

[17] *Id*. at 11.

[18] *Id*.

[19] *Id*. at 9.

[20] 44 Mass. App. Ct. 842, 852-53 (1998).

[21] 59 Mass. App. Ct. 646, 648 (2003).

[22] *Boston Gas Co.*, SJC-10246, slip op. at 12.

[23] *Id*.

[24] *Id*.

[25] *Id*.

[26] *Id*.

[27] *Id*.

[28] *Id*.

[29] *Id*. at 13.

[30] *Id*.

[31] *Id*. at 13-14.

[32] *Id*. at 13.

[33] *Id*. at 14.

[34] *Id*.

[35] *Id*.

[36] *Id*.

[37] *Id*. at 15.

[38] *Id*.

[39] *Id*.

[40] *Id*.

[41] *Id*.

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