

# Special Bulletin

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## California Court of Appeal Allows Stacking of Limits; Declines to Annualize Limits in Multi-Year Policies and Require Mitigation of Damages

by Linda Tai Hoshide and Linda Bondi Morrison

On January 5, 2009, the California Court of Appeal for the Fourth Appellate District issued its opinion in the matter of *State of California v. Continental Insurance Company, et al.*, Case No. E041425. The Court of Appeal addressed multiple issues concerning the interpretation and application of liability policies issued to the State. It ruled that the State was allowed to recover “all sums” up to the total limits of all triggered policies and that it may stack limits across multiple policy periods. It also affirmed the trial court’s finding of a single “occurrence” for a disposal site, and declined to annualize “occurrence” limits in multi-year policies. In addition, the Court of Appeal found that the State had no duty to mitigate its loss and further addressed issues relating to lost policies. All but two parts of the opinion have been certified for publication

### BACKGROUND

In 1955 and 1956, the State designed and built an industrial waste disposal site (now called the Stringfellow Superfund Site) at a former rock quarry in a canyon in Riverside County, after a state geologist concluded that the site would not pose a pollution risk once a concrete barrier dam was constructed to enclose it. Over 30 million gallons of industrial waste were subsequently deposited into unlined ponds at the site, contaminating the underlying groundwater through an underground stream channel. The concrete barrier dam overflowed during heavy rains in 1969, and

the State closed the site in 1972 after discovering the groundwater contamination.

In 1993, the State filed a declaratory relief action against its insurers for liabilities arising out of the site. In 1998, the State was held liable for remediation costs at the site, which were claimed to be as high as \$700 million. The State sought to recover those costs from its liability insurers, each of which issued policies on the same master liability policy form required by the state. Several insurers settled with the State for a total of approximately \$120 million.

Several legal rulings at the trial court level impacted the ultimate jury verdict in the coverage action. The trial court ruled:

- that each insurer was potentially liable for the total amount of the loss, up to its policy limits;
- that the State’s recovery would be limited to the “occurrence” limit for only one of the triggered policy periods;
- that the remediation costs arose from a single “occurrence;”
- that the “occurrence” limits in the multiyear policies in question were not annualized;
- that the \$120 million in settlements from other insurers would be set off

against the liability of the insurers remaining in the case; and

- that the State had no duty to mitigate its damages.

In light of these rulings and the jury verdict finding that the insurers had breached the terms of their respective policies, the trial court determined that the maximum available policy limits for the State under those policies was \$48 million. Applying the \$120 million in setoffs for prior settlements, the trial court entered judgment in favor of the State in the amount of \$0. An appeal and cross-appeals followed. Six insurers were parties to this appeal.

### THE COURT OF APPEAL RULINGS

#### The “All-Sums” Ruling

The Court of Appeal affirmed the trial court ruling that “[O]nce coverage for . . . continuous . . . damage . . . is triggered under a liability policy, the insurer is required to pay for all sums (up to the policy limits) of the insured’s liability—not just liability specifically allocable to damage during the policy period.” The Court of Appeal rejected a pro rata, time-on-the-risk allocation, relying primarily on what it considered to be well-settled law under *Montrose Chemical Corp v. Admiral Ins. Co.*, 10 Cal.4th 645 (1995); *Armstrong World Industries, Inc v. Aetna Casualty &*

*Surety Co.*, 45 Cal.App.4th 1 (1996); and *Aerojet-General Corp. v. Transport Indemnity Co.*, 17 Cal.4th 38 (1997). The Court of Appeal stated:

To summarize, then, in California, when there is a continuous loss spanning multiple policy periods, any insurer that covered any policy period is liable for the entire loss, up to the limits of its policy.

It therefore concluded that the insurers were liable for “property damage that actually occurred before or after their policy periods.”

#### The “No Stacking” Ruling

The Court of Appeal next addressed the stacking of policy limits across different policy periods. It recognized that under the Sixth Appellate District’s decision in *FMC Corp. v. Plaisted & Companies*, 61 Cal. App.4th 1132 (1998), stacking of limits had been rejected. However, the Court of Appeal declined to follow *FMC*, finding that the *FMC* court’s “judicial intervention” to read anti-stacking language into policies was unsupported and improper.

Neither the policies at issue in *State of California* nor in *FMC* contained express anti-stacking provisions. The Court of Appeal rationalized that under the plain meaning of the policies at issue, the language only purported to limit each insurer’s liability under each policy, and that the dollar amount each policy may be liable to pay was clearly worded.

The Court of Appeal also criticized *FMC* for failing to recognize the fact that certain policies include anti-stacking language, which supports an interpretation that stacking is permitted absent such language. It held that the standard language in an insurance policy does provide for the stacking of insurance limits, and contrary to *FMC*’s rationale for “judicial intervention,” that is “exactly what the insured has bargained and paid for.” The Court of Appeal further concluded that the anti-stacking rule applied in *FMC* resulted in an improper windfall to insurers. As a result, it ruled that the trial court’s “no-stacking ruling” was erroneous and concluded that the State was entitled to stack the limits of all triggered policies across all applicable policy periods.

#### The “One Occurrence” Ruling

The State contended that the trial court erred by ruling there had been only a single “occurrence” for purposes of limiting the insurers’ liability. The State sought a ruling that each of four separate causes of the contamination amounted to a separate “occurrence,” but admittedly could not

allocate any of the property damage to one particular “occurrence.” The trial court found there to be, at most, two “occurrences:” the State’s original failure to discover the deficiencies in the site and the 1969 rains that led the dam to overflow. It ruled that the State bore the burden of showing the cause and the amount of property damage that resulted from each “occurrence.” Consequently, the trial court granted a motion *in limine* barring any argument that any portion of the damage was due to the 1969 rains because of the State’s inability to allocate any property damage to that cause.

The Court of Appeal stated that an “occurrence” has generally been held to mean the underlying cause of the injury, rather than the injury or claim itself. Although the State focused on various conditions at the site as giving rise to separate “occurrences,” the Court of Appeal indicated that the State had ignored a different condition, without which the State’s conditions could not have caused property damage: the deposit of waste at the site. It found that the State had failed to meet its burden of proof to show multiple “occurrences” and affirmed the trial court’s single “occurrence” ruling.

#### The “No-Annualization” Ruling

In this part of the decision, which has not been certified for publication, the Court of Appeal determined whether annual “occurrence” limits were available to the State under multi-year policies. The State relied upon the following policy provisions to contend that the limits applied on an annual basis: 1) the policies contained no aggregate limits; 2) premiums were paid annually; and 3) the underwriters had a right to increase premiums or cancel the policies on an annual basis. It also presented extrinsic evidence in support of its position.

The trial court ruled that language in the “Limits of Liability” section of the policies did not support the contention that the “occurrence” limits applied annually. Rather, they clearly stated that the limits apply per “occurrence” during the policy period. The Court of Appeal affirmed. It noted that the policies did not say that the “per occurrence” limit applied “per year” and that the policies clearly stated that the limit of liability under the policy shall not exceed a stated amount. It stated that under the policies, aggregate limits applied if there were multiple “occurrences” during a single policy period. It also found that the absence of policy aggregate limits would be irrelevant, and that the State’s extrinsic evidence failed to shed any light on the specific provisions of the policies.

#### The “Setoff” Ruling

The State also contended that the trial court erred in allowing the Insurers a setoff, or a credit, for settlements paid by other insurers, because for many of the settlements, the State also released bad faith claims and claims involving other sites or types of injuries. In light of its reversal of the trial court’s no-stacking ruling, the Court of Appeal found that this issue was moot. Based on the total loss alleged by the State, the Court of Appeal stated that it would not matter whether the insurers were allowed a setoff.

#### The “Duty to Mitigate” Ruling

The insurers contended that the trial court erred by ruling that the State could recover portions of its loss that were caused by its own unreasonable delay in cleaning up the site. They claimed that this delay violated the State’s duty to mitigate the damage for which it sought coverage. The Court of Appeal rejected the insurers’ arguments and concluded that the State was not obligated to mitigate its loss pursuant to any specific provision in the insurers’ policies, and that such a duty has not been recognized under third party liability policies.

The Court of Appeal made clear, however, that an insured could not recover any portion of a loss that it had caused willfully. It noted that the jury had specifically found that the contamination arising from the selection, design and construction of the site did not result from a “willful act” of the State. As to whether the State’s failure to mitigate was “willful,” the Court of Appeal stated that since the insurers had failed to raise this issue in their opening brief, it was not properly before the Court for consideration.

#### The “Lost Policy” Ruling

The Court of Appeal addressed evidentiary issues impacting the admission of evidence to support the existence and terms of a “lost” policy purportedly issued by one of the insurers. In doing so, it reversed the ruling by the trial court that certain documents offered by the State were admissible to prove the policy, finding that the State had failed to meet its burden to prove that the documents fell within an exception to the hearsay rule. One part of the Court of Appeal’s decision in this regard was not certified for publication.

## CONCLUSION

One of the most significant parts of this decision is the holding on the “stacking” issue and the Court’s criticisms of the *FMC* decision. California now has conflicting Court of Appeal authority addressing the stacking of limits of successive policies

which do not contain express anti-stacking provisions, for losses which trigger multiple policy periods. This case seems to suggest that anti-stacking provisions in policies, if clear and conspicuous, should be upheld. We also note that certain rulings contained in the decision were reached as a result of specific admissions and/or evidentiary rulings and therefore, close scrutiny is required prior to relying on portions of this decision. Finally, the Court of Appeal's ruling on annualization of limits, while significant, may be of limited value in an action pending in California state court due to the fact that it appears in a part of the decision that has not been certified for publication.

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