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Borkenhagen; Montrose Chemical Corp. v. Admiral Insurance Co. and Its Effects
**MONTROSE CHEMICAL CORP. V. ADMIRAL INSURANCE CO.
AND ITS EFFECTS ON CONSTRUCTION DEFECT LITIGATION**

INTRODUCTION

In July of 1995, the Supreme Court of California handed down a decision which will have a significant effect on construction defect litigation. In *Montrose Chemical Corp. v. Admiral Insurance Co.*,¹ the court held that in cases of continuous or progressively deteriorating bodily injury or property damage,² all commercial general liability (CGL)³ insurance policies in effect during the period of the injury have potential liability. Therefore, the insurance companies have the duty to defend.⁴

California courts have long been divided regarding the insurance issues discussed in *Montrose*.⁵ While *Montrose* left many related questions unanswered, it did give the final word on two points. First, *Montrose* decided when the potential for liability begins in cases of continuous injury.⁶ Second, based on its interpretation of the loss-in-progress rule, *Montrose* decided when the potential for liability ends.⁷

While the issue of continuous or progressively deteriorating injury may arise in a variety of contexts, this Note will focus on *Montrose*'s effects on construction defect litigation, which has exploded in California in the past decade.⁸ Part I discusses the development of construction defect law and the

1. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1 (Cal. 1995).

2. Continuous or progressively deteriorating injury is injury or damage which continues over a period of time, such as asbestos related disease, shifting soils, or toxic contamination from buried chemicals. This is in contrast to an injury which is sudden or of short duration, such as a hail storm or car accident.

3. Commercial General Liability insurance is third party insurance which protects the insured against potential tort liability to others. Prior to 1985, this type of insurance was known as a "comprehensive general liability" policy, but the name change did not affect the policy's coverage. Eugene R. Anderson & Catherine A. Plunkett, *Trigger of Coverage: A Policyholder's Perspective*, 1994 INS. LITIG. REP. 252, 253 n.6. Basic CGL insurance provides broad coverage for bodily injury or property damage which the policyholder becomes legally obligated to pay as damages, unless specifically excluded. CGL insurance usually provides indemnification for investigation and defense costs, as well as for liability. *Id.* at 253.

4. *Montrose*, 897 P.2d at 3.

5. See *California Union Ins. Co. v. Landmark Ins. Co.*, 193 Cal. Rptr. 461, 467 (Ct. App. 1983) ("It is difficult, if not downright impossible, to reconcile the foregoing authorities").

6. Nationwide, a majority of the states have already adopted the continuous injury trigger which California finally adopted in *Montrose*. Anderson & Plunkett, *supra* note 3, at 264. See also Appellant's Answer Brief at 24 n.4, *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1 (Cal. 1995) (lists cases in Florida, Colorado, Delaware, Washington, D.C., Michigan, New Jersey, Ohio, Texas, Minnesota, Washington, New York, Pennsylvania, and Maryland).

7. *Montrose*, 897 P.2d at 29.

8. Construction defect litigation is a thriving industry in California. The California homebuilding industry is currently pursuing legislative reform in which it seeks to stem the tide of what it believes is an abusive system. Among the changes being contemplated by the California State Legislature are: (1) statutorily defining what a "construction defect" is, A.B. Res. 2952, 1996 Leg. Sess.; (2) shortening the statute of limitations, A.B. Res. 2077, 1996 Leg. Sess.;

role of insurance in the system. Part II provides background information for the main insurance issues raised in *Montrose*, including a discussion of how the courts decided these matters prior to *Montrose*. Part III introduces the facts of *Montrose*, and analyzes the Court's reasoning.

Montrose raises a number of questions which must be addressed by the courts before the ruling can translate into a clear and workable system by which continuous injury insurance disputes can be resolved. Part IV discusses those problems, and proposes some solutions.

I. THE DEVELOPMENT OF CONSTRUCTION DEFECT LAW AND THE ROLE OF INSURANCE IN THE LEGAL SYSTEM

Construction defect litigation is a relatively recent phenomenon. Until approximately thirty-five years ago, buyers of real property in California had no protection under the law for defectively built housing.⁹ Previously, the rule was *caveat emptor*, or let the buyer beware.¹⁰ Today there are numerous common law causes of action which can be asserted in a construction defect claim. These include strict liability, negligence, and breach of express and implied warranties.

The rise in the number of construction defect actions in the courts is only partly due to availability of legal recourse. Another significant factor is the number of residences which are part of a condominium, planned development, or other common interest communities.¹¹ The homeowner's associations which govern these entities bring together large numbers of home owners with a common interest and a common pocketbook.¹² While it would often be prohibitively expensive for a single owner to bring a construction defect action against a developer, once a few dozen, or a few hundred are joined, the costs become more manageable. Although the costs of litigation are high, the settlements or judgments often make a suit worthwhile; they are typically in the millions of dollars due to the high costs of repairing and replacing defective construction.¹³

(3) limiting attorney's contingency fees, A.B. Res. 3281, 1996 Leg. Sess.; (4) holding the homeowner and builder harmless from changes in the building codes following the issuance of the original building permit, A.B. Res. 2552, 1996 Leg. Sess.; (5) mandating arbitration of the disputes, A.B. Res. 3009, 1996 Leg. Sess.; (6) reducing the liability of Homeowners Association directors so that they will not feel compelled to initiate suits, A.B. Res. 1317, 1996 Leg. Sess.; S.B. Res. 1711, 1996 Leg. Sess.

9. THOMAS E. MILLER, CALIFORNIA CONSTRUCTION DEFECT LITIGATION, RESIDENTIAL AND COMMERCIAL § 4.1 (2d ed. 1993).

10. *Id.*

11. *Id.* § 1.2. See also Caty Van Housen, *Life Among the Ruins*, SAN DIEGO UNION TRIB., June 19, 1994, at H1 (stating that "[a]ttorneys, insurance brokers, builders and property managers questioned for this article say the likelihood that a condo project will be involved in construction defect litigation is nearly 100 percent").

12. Interview with Alan Johnston, Partner, Duke, Gerstel, Shearer & Bregante, in San Diego, Cal. (Sept. 1995).

13. MILLER, *supra* note 9, § 1.2.

Like homeowners, few developers, builders, or subcontractors could afford the considerable cost of litigation and repairs on their own.¹⁴ Often, a plaintiff's only hope of recovery is the defendant's liability insurance.¹⁵ Because a judgment is usually collected from an insurance company, it is essential that counsel representing either side of a construction defect claim be familiar with insurance law.

The doctrine of strict liability was developed hand in hand with the idea that the manufacturer of a product would not bear the full cost of liability but would spread it through society by purchasing insurance.¹⁶ Over the years, the courts have continued to expand the strict liability doctrine based on the expectation that the businesses thus exposed would and should purchase insurance.¹⁷

The *Montrose* court's opinion can be interpreted as an extension of this public policy. *Montrose* suggests that liability costs should be distributed not only through society, but also throughout the insurance community itself by spreading liability between a number of different policies.

II. BACKGROUND OF INSURANCE ISSUES DISCUSSED IN *MONTROSE*

A. First and Third Party Policies

The distinction between first and third party policies is the threshold issue in *Montrose*.¹⁸ First party property damage insurance is the type with which most people are familiar. An example of this is a homeowner's policy, where the homeowner is insured against injuries which happen to his person or property.¹⁹ Third party liability insurance insures against injuries caused to others.²⁰ This is typical in construction defect litigation where a homeowners association files a claim against a developer or a contractor for damage

14. *Id.* § 6.1.

15. *Id.*

16. *See Escola v. Coca-Cola Bottling Co.*, 150 P.2d 436, 441 (Cal. 1944) (Traynor, J., concurring) ("[T]he risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business."). *See also* RESTATEMENT (SECOND) OF TORTS § 402(a), cmts. a, b, and c ("The burden of loss caused by defective products should be borne by those responsible for marketing of the product and should be treated as a cost of production against which liability insurance could be obtained.").

17. *See Rowland v. Christian*, 443 P.2d 561, 564 (Cal. 1968) (In balancing a number of items in order to determine whether liability should be extended, the court lists "the availability, cost and prevalence of insurance for the risk involved.").

18. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 9 (Cal. 1995) ("To properly analyze the trigger of coverage issues presented in this case, it is necessary to first clearly distinguish between third party liability insurance . . . and coverage under a first party property insurance policy. . . .").

19. *Id.*

20. *Id.*

allegedly caused to the property. In this case, it is the developer's or contractor's insurance which must indemnify the homeowner.²¹

The California Supreme Court stressed the importance of making a distinction between first and third party policies in *Garvey v. State Farm Fire & Casualty Co.*²² In *Garvey*, the court differentiated between first and third party policies with regard to the type of injury insured against.²³ *Garvey* also examined the public policy considerations in a concurring opinion.²⁴ The next year, in *Prudential-LMI Commercial Insurance v. Superior Court*, the court found that differences between first and third party policies would also affect the analysis of the appropriate trigger of coverage.²⁵

In the past ten years, the courts have disagreed on this issue. A number have declined to make a distinction between the two types of policies,²⁶ while others have found the differences dispositive.²⁷ This issue has finally been addressed and resolved in *Montrose*.²⁸

B. Duty to Defend

Once a defendant becomes aware that a third party claim is being threatened or filed against him, he must inform his insurance carriers, so that they may tender a defense.²⁹ The insurer's duty to defend is broader than

21. MILLER, *supra* note 9, § 6.3.

22. *Garvey v. State Farm Fire & Casualty Co.*, 770 P.2d 704 (Cal. 1989).

23. *Id.* at 710. "[T]he right to coverage in the third party liability insurance context draws on traditional tort concepts of fault, proximate cause and duty. This liability analysis differs substantially from the coverage analysis in the property insurance context, which draws on the relationship between perils that are either covered or excluded in the contract." *Id.*

24. *Id.* at 716 (Kaufman, J., concurring). "[I]t may be that the reasonable expectations of the insureds will be different under property damage and liability insurance policies . . . there is a public policy consideration involved in . . . third party injury and the potential burden on the public fisc in the absence of compensation." *Id.*

25. *Prudential-LMI Commercial Ins. v. Superior Court*, 798 P.2d 1230, 1243 (Cal. 1990).

26. See *Home Ins. Co. v. Landmark Ins. Co.*, 253 Cal. Rptr. 277 (Ct. App. 1988); *Fireman's Fund Ins. Co. v. Aetna Casualty & Surety Co.*, 273 Cal. Rptr. 431 (Ct. App. 1990), *overruled by Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 23 (Cal. 1995); *Pines of La Jolla Homeowners Ass'n v. Industrial Indem. Co.*, 7 Cal. Rptr. 2d 53 (Ct. App. 1992), *overruled by Montrose*, 897 P.2d 1, 23.

27. See *California Union Ins. Co. v. Landmark Ins. Co.*, 193 Cal. Rptr. 461 (Ct. App. 1983); see also *Stonewall Ins. Co. v. City of Palos Verdes Estates*, 9 Cal. Rptr. 2d 663 (Ct. App.), *review granted*, 834 P.2d 1147 (Cal. 1992), *case transferred with directions* 904 P.2d 370 (Cal. 1995); *Zurich Ins. Co. v. Transamerica Ins. Co.*, 34 Cal. Rptr. 2d 913, 921 (Ct. App. 1994), *review granted*, 889 P.2d 539 (Cal.), *review dismissed and case remanded* 902 P.2d 1297 (Cal. 1995). After *Montrose* was decided, *Stonewall* and *Zurich* were remanded to be reconsidered in light of *Montrose*. Neither *Stonewall* nor *Zurich* are citable authority. They are used in this Note solely to illustrate the confusing history, and differences of opinion, surrounding the issues discussed in *Montrose*.

28. *Montrose*, 897 P.2d at 9.

29. MILLER, *supra* note 9, § 6.8. "However, the insurer's duty to defend is not necessarily coextensive with, and may be broader than, its duty to indemnify its insured for any loss that may ensue. This is primarily because the defense must be assumed at an early stage of the underlying litigation and, at that time, the nature of the particular claim and of the potential

the obligation to indemnify.³⁰ Therefore, insurer has the duty to defend even if it is ultimately found to be free from liability.³¹

The insurer's obligation to defend depends on the terms of the policy.³² If there are ambiguities in the contract language, they must be resolved to give effect to the insured's objectively reasonable expectation that a defense will be provided.³³ If the facts do not clearly indicate whether the policy has been triggered, then the insurer must tender a defense where there is the "bare potential or possibility" of liability.³⁴

C. The Definition of "Occurrence" in Standard Form CGL Policies

Montrose addressed CGL policies.³⁵ A CGL policy provides coverage for all types of legal liability arising from bodily injury or property damage resulting from an "occurrence."³⁶ The definition of the term "occurrence" is at the heart of *Montrose* because, as a contract, the policy's language determines when the coverage is triggered, and the extent of liability under the policy.³⁷

The standard form CGL policy language, developed by the insurance industry, was revised in 1973.³⁸ The 1973 revisions define "occurrence" as "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage, neither expected nor intended by the insured."³⁹ The definition of "property damage" was also changed in 1973 to mean "physical injury to or destruction of tangible property which occurs during the policy period . . ."⁴⁰ These phrases are interrelated, and the way in which they are interpreted will affect the availability of coverage.

damages may be unclear." *Id.*

30. *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034, 1050 (D.C. Cir. 1981); *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153, 1160 (Cal. 1993).

31. *Keene*, 667 F.2d at 1050; *Montrose*, 861 P.2d at 1157. *See also* *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 177 (1966).

32. *Keene*, 667 F.2d at 1050; *Montrose*, 861 P.2d at 1157; *Gray*, 419 P.2d at 168.

33. *Montrose Chem Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 11 (Cal. 1995); *Gray*, 419 P.2d at 172.

34. *Montrose*, 861 P.2d at 1160.

35. *Montrose*, 897 P.2d 1. "CGL" stands for Comprehensive General Liability.

36. *Anderson & Plunkett*, *supra* note 3, at 254.

37. *Id.* at 255.

38. *Id.* at 254-255. The insurance industry first developed the standard form CGL policy in 1940-1941. It has been revised numerous times since then, in 1943, 1947, 1955, 1966, and lastly in 1973. *Id.* at 454 n.19.

39. *Id.* at 254-255.

40. *Id.*

D. Trigger of Coverage Defined

The courts have adopted at least nine different approaches to determining when coverage is triggered.⁴¹ *Montrose*, however, only discusses four of the nine possibilities: the exposure trigger; the manifestation trigger; the continuous injury trigger; and the injury-in-fact trigger.⁴² The courts have generally limited the exposure trigger and the injury-in-fact trigger to asbestos or bodily injury cases.⁴³ In construction defect cases involving continuous injury, the conflict has typically been between applying either the manifestation trigger or the continuous injury trigger.⁴⁴

With a continuous injury, damage is often imperceptible for a period of time before it manifests itself. The manifestation of loss trigger focuses on the date on which appreciable injury first becomes apparent.⁴⁵ The insurance company insuring the property at that time becomes solely responsible for indemnification, no matter how many policies were in effect during the time the damage was occurring.⁴⁶ Therefore, application of the manifestation rule results in relatively narrow coverage.⁴⁷

Under the continuing injury trigger, property damage that is continuous or progressively deteriorating over several policy periods is potentially covered by all the policies on the risk⁴⁸ during those periods.⁴⁹ This could include the entire period from the first exposure to harm (or from the wrongful act), to the time the injury is discovered.⁵⁰ This provides far broader coverage than a manifestation trigger because all insurers who ever provided coverage could be held liable for damages.⁵¹

41. *Id.* at 257. These include: 1) continuous trigger; 2) injury-in-fact; 3) exposure; 4) manifestation; 5) discovery; 6) double anchor; 7) products liability trigger; 8) loss of use; and 9) cause. *Id.*

42. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 16 (Cal. 1995).

43. *Id.* at 16, 18 n.16.

44. *Gruol Constr. Co. v. Insurance Co. of North America*, 524 P.2d 427 (Wash. Ct. App. 1974); *Home Ins. Co. v. Landmark Ins. Co.*, 253 Cal. Rptr. 277 (Ct. App. 1988); *Fireman's Fund Ins. Co. v. Aetna Casualty & Surety Co.*, 273 Cal. Rptr. 431 (Ct. App. 1990), *overruled by Montrose*, 897 P.2d at 23; *Prudential-LMI Commercial Ins. v. Superior Court*, 798 P.2d 1230 (Cal. 1990); *Pines of La Jolla Homeowners Ass'n v. Industrial Indem. Co.*, 7 Cal. Rptr. 2d 53 (Ct. App. 1992), *overruled by Montrose*, 897 P.2d at 23; *Stonewall Ins. Co. v. City of Palos Verdes Estates*, 9 Cal. Rptr. 2d 663 (Ct. App.), *review granted*, 834 P.2d 1147 (Cal. 1992), *case transferred with directions* 904 P.2d 370 (Cal. 1995); *Zurich Ins. Co. v. Transamerica Ins. Co.*, 34 Cal. Rptr. 2d 913 (Ct. App. 1994), *review granted*, 889 P.2d 539 (Cal.), *review dismissed and case remanded* 902 P.2d 1297 (Cal. 1995); *Chu v. Canadian Indemnity Co.*, 274 Cal. Rptr. 20 (Ct. App. 1990).

45. *Anderson & Plunkett*, *supra* note 3, at 263.

46. *Montrose*, 897 P.2d at 16.

47. ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW § 65 (1987).

48. "On the risk" is a term of art referring to an insurance policy which is providing coverage. If an insurance company has issued a policy to an insured, the company is on the risk of that insured's potential liability.

49. *Montrose*, 897 P.2d at 17.

50. *Anderson & Plunkett*, *supra* note 3, at 259.

51. JERRY, *supra* note 47.

*E. Case History of Application of Policy
Triggers In Cases of Continuing Injury*

In California, the trigger of coverage in a liability policy occurs when the complaining third party was injured, rather than when the wrongful act was committed.⁵² However, this rule does not help to assign liability when the injury is of a continuing nature and the damage occurred over several policy periods. In that situation, prior to *Montrose*, a party could find support for applying either a manifestation or a continuous injury trigger.

*California Union Insurance Co. v. Landmark Insurance Co.*⁵³ is the first reported California case to rule on the trigger of coverage provided by successive third party CGL policies in the context of continuous injury. In *California Union*, the property damage was caused by a leaking pool, which was installed during the first insurer's policy period.⁵⁴ The leak manifested itself immediately after installation, and the damage was repaired.⁵⁵ Unknown to those involved, however, the true cause of the leak was not fixed, resulting in further damage.⁵⁶ The actual cause of the injury was not discovered until the second insurer's policy went into effect.⁵⁷

The Second District Court of Appeal held that both insurers on the risk were jointly and severally liable for the continuing damage.⁵⁸ The first insurer's coverage was triggered because the initial damage manifested itself during its policy.⁵⁹ The second insurer, whose policy period began after manifestation, was also liable for the continuous property damage occurring during its policy period.⁶⁰ The court stated that while the damage was already initiated when the second policy went into effect, further damage had indeed occurred during the policy, and therefore the policy was triggered.⁶¹

The Fourth District Court of Appeal questioned *California Union* in two later cases, *Home Insurance Co. v. Landmark Insurance Co.*⁶² and *Fireman's*

52. The first case to set down the rule was *Remmer v. Glen Falls Indemnity Co.*, 295 P.2d 19, 21 (Cal. Ct. App. 1956).

53. *California Union Ins. Co. v. Landmark Ins. Co.*, 193 Cal. Rptr. 461 (Ct. App. 1983).

54. *Id.* at 463.

55. *Id.*

56. *Id.*

57. *Id.*

58. *California Union*, 193 Cal. Rptr. at 471.

59. *Id.* at 469.

60. *Id.* at 470.

61. The court based its reasoning on three cases which are also cited by the court in *Montrose*: *Gruol Constr. Co. v. Insurance Co. of N. Am.*, 524 P.2d 427 (Wash. App. 1974); *Insurance Co. of N. Am. v. Forty-Eight Insulations*, 633 F.2d 1212 (6th Cir. 1980); and *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981). Although *Forty-Eight Insulations* and *Keene* were products liability cases, their policies were CGL policies, and the court found that "any distinction is more imaginary than real." *California Union*, 193 Cal. Rptr. at 472.

62. 253 Cal. Rptr. 277, 281-282 (Ct. App. 1988).

*Fund Insurance Co. v. Aetna Casualty & Surety Co.*⁶³ In both cases, the court faced similar construction defects in which the damage continued over two separate policy periods.⁶⁴ However, the Fourth District Court of Appeal found that the court's reasoning in *California Union* did not pertain to either case. It applied a manifestation trigger in both cases; the result being that only the first carrier was liable for the damage.⁶⁵

In each case, the court declined to follow *California Union* because it based its reasoning on cases in which the various carriers came on the risk prior to manifestation of the actual injury.⁶⁶ The court distinguished this situation from *Home* and *Fireman's Fund*, where the second carrier came onto the risk after manifestation of the damage.⁶⁷ In both cases, the court stated that it would violate their reading of the loss-in-progress rule⁶⁸ if they held an insurer liable for damage manifested under another insurer's policy.⁶⁹

In *Fireman's Fund*, the plaintiff sought to distinguish its third party policy from *Home*, which dealt with a first party policy.⁷⁰ This reasoning was derived from the *Garvey* opinion,⁷¹ which was decided by the California Supreme Court after *Home*.⁷² Notwithstanding *Garvey*, the Fourth District Court of Appeal refused to find any difference in the way the two types of policies were analyzed. First, it held that the policy language used in the first party policy in *Home* was "apparently identical" to the language used in the

63. 273 Cal. Rptr. 431, 433 (Ct. App. 1990) overruled by *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 23 (Cal. 1995).

64. In *Home*, concrete hotel balconies started chipping. The damage was first noticed when the first insurance policy was in effect. The damage spread to more balconies during the second policy period. *Home*, 253 Cal. Rptr. at 278-279. In *Fireman's Fund*, a construction company made repairs to the exterior walls of a hotel. The next year, the patched areas started cracking and falling off. The damage was identified during the first policy period, however, the actual cause of the damage (inappropriate patching material) was not discovered until the second policy was in effect. *Fireman's Fund*, 273 Cal. Rptr. at 432.

65. *Home*, 253 Cal. Rptr. at 280; *Fireman's Fund*, 273 Cal. Rptr. at 431-432.

66. *Home*, 253 Cal. Rptr. at 282. "We also have concern that California Union misapplied three pre-manifestation cases [*Gruol*, *Forty-Eight Insulations*, and *Keene*] to hold a post-manifestation carrier jointly and severally liable." *Id.* See also *Fireman's Fund*, 273 Cal. Rptr. at 432.

67. *Home*, 253 Cal. Rptr. at 282. See also *Fireman's Fund*, 273 Cal. Rptr. at 432-433.

68. See *infra* notes 92-102 and accompanying text. "The loss-in-progress rule provides that once a loss becomes 'known', it is no longer insurable and the insurer's potential liability ends."

69. *Home*, 253 Cal. Rptr. at 282. "To apportion damages and hold an insurer liable for damage manifested in another insurer's policy period also violates the loss-in-progress rule, i.e., that an insurance company may insure only against contingent or unknown risks. Liability will not be imposed under an all-property insurance policy where damages occur and are apparent before the date the policy takes effect." *Id.* See also *Fireman's Fund*, 273 Cal. Rptr. at 433.

70. *Fireman's Fund*, 273 Cal. Rptr. at 433.

71. See *supra* notes 22-25 and accompanying text. In *Garvey*, the court found that the causation analysis differed substantially in first and third party insurance policies. *Garvey v. State Farm Fire & Casualty Co.*, 770 P.2d 704, 710 (Cal. 1989).

72. *Fireman's Fund*, 273 Cal. Rptr. at 433.

third party policy.⁷³ Second, the court found that in cases like *Fireman's Fund* and *Home*, where the claimant was fully compensated for his losses, there was no need to focus on the reasonable expectations of the insured or on a causation analysis.⁷⁴

The California Supreme Court first addressed a construction defect case concerning continuous injury in *Prudential-LMI Commercial Insurance v. Superior Court*.⁷⁵ Faced with a disparity in court of appeal opinions regarding the appropriate trigger of coverage and whether first and third party policies should be treated differently, the supreme court defined a partial framework for analysis.

Prudential-LMI involved a first party policy and the supreme court applied a manifestation trigger.⁷⁶ However, the supreme court also stated that the triggers in first and third party cases should be approached differently.⁷⁷ The question of coverage in the third party liability context was expressly reserved.⁷⁸

Contrary to expectations, in 1992, the Fourth District Court of Appeal reaffirmed *Fireman's Fund*. In *Pines of La Jolla Homeowners Ass'n v. Industrial Indemnity Co.*,⁷⁹ the court once again held that the manifestation trigger applied to continuous injury covered under successive third party policies.⁸⁰ Although the supreme court had handed down *Prudential-LMI* in the interim, the court did not refer to *Prudential-LMI* in its opinion, and did not raise the issue of potential differences between first and third party policies.

That same year, the Second District Court of Appeal held in *Montrose*⁸¹ and in *Stonewall Insurance Co. v. City of Palos Verdes Estates*⁸² that a continuous injury trigger applies to third party liability cases involving continuous damage.⁸³ The Second District Court of Appeal relied heavily

73. *Id.* at 434.

74. *Id.* at 434-444.

75. *Prudential-LMI Commercial Ins. v. Superior Court*, 798 P.2d 1230 (Cal. 1990).

76. *Id.* at 1247.

77. *Id.* at 1246. The court quotes several "commentators" regarding the need for differential treatment of first and third party policies. However, it does not actually point to any specific reasons behind the distinction.

78. *Id.*

79. *Pines of La Jolla Homeowners Ass'n v. Industrial Indem. Co.*, 7 Cal. Rptr. 2d 53 (Ct. App. 1992), *overruled by* *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 23 (Cal. 1995).

80. *Id.* at 57.

81. The Second District Court of Appeal heard *Montrose* at the appellate level.

82. *Stonewall Ins. Co. v. City of Palos Verdes Estates*, 9 Cal. Rptr. 2d 663 (Ct. App.), *review granted* 834 P.2d 1147 (Cal. 1992), *case transferred with directions* 904 P.2d 370 (Cal. 1995).

83. *Id.* at 672.

on its previous opinion in *California Union*⁸⁴ and on the California Supreme Court's lead in *Prudential-LMI*⁸⁵ in coming to its decision.

Thus, as of 1992, the California appellate courts continued to be in disagreement regarding the appropriate trigger of coverage for continuous injury cases. The supreme court resolved the issue in the context of first party insurance in *Prudential-LMI* by applying a manifestation trigger. However, its statement that third party cases should be handled differently did not provide a clear enough framework for the appellate courts. The Fourth District Court of Appeal continued to apply a manifestation trigger to third party cases, while the Second District Court of Appeal applied a continuous trigger.

Finally, in the last third party, continuous injury case heard by the appellate courts prior to *Montrose*, the Fourth District Court of Appeal repudiated its approach in *Fireman's Fund* and *Pines of La Jolla*. In *Zurich Insurance Co. v. Transamerica Insurance Co.*,⁸⁶ the court concluded that a continuous injury trigger should be used in the context of a third party case involving continuous or progressively deteriorating damage.⁸⁷

The *Zurich* court reasoned that there are different discovery requirements in first and third party policies which make different triggers appropriate for each.⁸⁸ The court also stated that the manifestation trigger is not particularly applicable when one analyzes the definition of "occurrence" in third party liability policies.⁸⁹ Finally, the court reasoned that in a multi-unit project,

84. *Id.* at 671. The court cites *California Union* and quotes:

(1) "[I]n a 'one occurrence' case involving continuous, progressive, and deteriorating damage, the carrier in whose policy period the damage first becomes apparent remains on the risk until damage is finally and totally complete notwithstanding a policy provision which purports to limit coverage solely to accidents/occurrences within the time parameters of the stated policy term"; and (2) an insurance carrier coming on the risk after such damage becomes apparent is also liable for indemnification of the insured where the "damage causing force" already in motion causes further damage.

Id. (citations omitted).

85. *Id.* at 672.

We conclude that *Prudential-LMI*'s analytical framework requires that in third-party/liability insurance involving continuous and repeated exposure to a continuing series of loss causing events of the same character a "continuous trigger" of coverage applies; all carriers on the risk from inception of harm to the time the loss is no longer contingent are liable to the insured.

Id.

86. *Zurich Ins. Co. v. Transamerica Ins. Co.*, 34 Cal. Rptr. 2d 913 (Ct. App. 1994), *review granted*, 889 P.2d 539 (Cal.), *review dismissed and case remanded* 902 P.2d 1297 (Cal. 1995).

87. *Id.* at 915.

88. *Id.* at 920.

89. *Id.* at 921.

“the entire contingency insured against by an insurance policy cannot be said to have materialized when one particular defect is noted at one unit.”⁹⁰

F. Loss-in-Progress

While the trigger theories indicate when coverage is to begin, it is the loss-in-progress, or “known loss,” rule which dictates when it will end. The loss-in-progress rule is codified in California Insurance Code sections 22 and 250, which define insurance and limit insurability to “contingent or unknown” events.⁹¹ The loss-in-progress rule provides that once a loss becomes “known,” it is no longer insurable, and the insurer’s potential liability ends. However, the phrase “contingent or unknown” is not a self defining term,⁹² and the courts have interpreted it with conflicting results.⁹³

When applying the loss-in-progress rule to first party continuous injury cases, the courts agree that an injury ceases to be “contingent” when it first manifests itself.⁹⁴ The results have been different, however, when the loss-in-progress rule has been applied to third party continuous injury cases. Prior to *Zurich*, the Fourth District Court of Appeal had held that section 22 applied to both first and third party cases.⁹⁵ It also stated that “[i]t is the damage which must be ‘contingent or unknown’ and not the liability of the insured or the cause of the damage.”⁹⁶

In *Montrose* and *Stonewall*, the Second District Court of Appeal disagreed with the Fourth District’s interpretation of sections 22 and 250. The court pointed out that the statutory language is worded in the disjunctive and that it is the *liability* of the insured that must be contingent or unknown, not the *damage* or the loss.⁹⁷ The court explained that if at the time the

90. *Id.*

91. CAL. INS. CODE § 22 (West 1993) (“Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event.”); CAL. INS. CODE § 250 (West 1993) (“[A]ny continuous or unknown event, whether past or future, which may damnify a person having an insurable interest, or create a liability against him, may be insured against . . .”).

92. *Stonewall Ins. Co. v. City of Palos Verdes Estates*, 9 Cal. Rptr. 2d 663, 677 (Ct. App. 1992), review granted 834 P.2d 1147 (Cal. 1992), *cause transferred with directions* 34 Cal. App. 4th 1855 (Oct. 1995).

93. Compare *Fireman’s Fund Ins. Co. v. Aetna Casualty & Surety Co.*, 273 Cal. Rptr. 431, 434 (Ct. App. 1990), *overruled in* *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 23 (Cal. 1995). (“It is the damage which must be ‘contingent or unknown’ and not the liability of the insured or the cause of the damage”) with *Stonewall*, 9 Cal. Rptr. 2d at 677-678 and *Zurich Ins. Co. v. Transamerica Ins. Co.*, 34 Cal. Rptr. 2d 913, 919-921 (Ct. App. 1994) review granted, 889 P.2d 539 (Cal.), review dismissed and case remanded 902 P.2d 1297 (Cal. 1995) (holding that it is the liability or risk which must be contingent or unknown, not the damage).

94. E.g., *Prudential-LMI Commercial Ins. v. Superior Court*, 798 P.2d 1230, 1246-1247 (Cal. 1990).

95. *Home Ins. Co. v. Landmark Ins. Co.*, 253 Cal. Rptr. 277, 282 n.4 (Ct. App. 1988); *Fireman’s Fund*, 273 Cal. Rptr. at 434.

96. *Fireman’s Fund*, 273 Cal. Rptr. at 434 n.5.

97. *Stonewall*, 9 Cal. Rptr. 2d at 677.

policy was issued the liability of the insured was unknown, then the risk was insurable.⁹⁸ This is the case even if the injury were inevitable,⁹⁹ such as with a latent¹⁰⁰ soils problem.

Two years after the Second District Court of Appeal handed down *Montrose* and *Stonewall*, the Fourth District Court of Appeal backtracked on its stand regarding the application of the loss-in-progress rule in third party continuous injury cases. It admitted in *Zurich* that theirs was a “rather narrow definition of contingency,” and “[a]n equally correct interpretation” would be that applied by the Second District Court of Appeal.¹⁰¹

III. *MONTROSE CHEMICAL CORP. OF CALIFORNIA v. ADMIRAL INSURANCE CO.*

A. Facts of the Case

Montrose was a defunct chemical company that manufactured the pesticide DDT from 1947 to 1982.¹⁰² Between 1960 and 1986, Montrose was insured under CGL policies from seven different carriers.¹⁰³ Admiral Insurance Company had issued four separate CGL policies to Montrose between 1982 and 1986.¹⁰⁴ Admiral’s CGL policies incorporated the standard industry language and provided for indemnity for bodily injury or property damage caused by an “occurrence.”¹⁰⁵

The lawsuit was initiated by Montrose in order to determine which of the seven insurers were obligated to defend the company in five separate actions brought against it. These five underlying lawsuits involved Montrose’s disposal of hazardous waste at two sites in California, Stringfellow and Levin Metals.¹⁰⁶ All five actions alleged property damage due to contamination

98. *Id.*

99. *Id.*

100. CAL. CIV. PROC. CODE § 337.15(b) (West 1982) (“[L]atent deficiency’ means a deficiency which is not apparent by reasonable inspection.”).

101. *Zurich Ins. Co. v. Transamerica Ins. Co.*, 34 Cal. Rptr. 2d 913, 920 (Ct. App. 1994), review granted, 889 P.2d 539 (1995), review dismissed and case remanded 902 P.2d 1297 (Cal. 1995).

102. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 4 (Cal. 1995).

103. *Id.* at 4 n.4. The seven carriers include: Insurance Company of North America, American Motorists Insurance Company, The Travelers Indemnity Company, National Union Fire Insurance Company, Canadian Universal Insurance Company, Centaur Insurance Company and Admiral Insurance Company.

104. *Id.*

105. *Id.*

106. *Id.*

which had continued throughout the periods in which Admiral's policies were in effect.¹⁰⁷

Montrose requested its seven insurance carriers, including Admiral, to defend it in this matter.¹⁰⁸ All of the carriers, except Admiral, agreed to provide a defense subject to a reservation of rights.¹⁰⁹

In 1989, Admiral filed a motion for summary judgment requesting the trial court find that Admiral had no duty to defend or indemnify Montrose.¹¹⁰ Admiral contended that the "occurrence" of property damage at the Levin Metals site had been triggered prior to its policy periods when the damage had been discovered.¹¹¹ Admiral also claimed that at the Stringfellow site the contamination was an uninsurable "loss-in-progress" prior to the issuance of the first Admiral policy in October of 1982.¹¹² This loss-in-progress claim was based on an August 1982 letter in which the EPA informed Montrose that it considered Montrose potentially responsible for contribution of clean-up costs at the Stringfellow site.¹¹³

The trial court granted Admiral's motion on both grounds.¹¹⁴ Montrose appealed, and the Second District Court of Appeal reversed.¹¹⁵ Admiral then petitioned for, and was granted, review by the California Supreme Court.¹¹⁶

107. *Id.* at 4-6. The actions underlying Montrose include: 1) United States of America, et al. v. J.B. Stringfellow, Jr., et al. (The basis for the claim was strict liability under CERCLA for generating the toxic waste shipped to the Stringfellow site); 2) Newman, et. al. v. J.B. Stringfellow, Jr., et al. (Numerous plaintiffs seek damages from Montrose and other defendants alleged to have resulted from the release of contaminants from the Stringfellow site); 3) Parr-Richmond Terminal Co., et al. v. Levin Metals Corp., et al.; 4) Levin Metals Corp., et al. v. Parr-Richmond Terminal Co., et al.; 5) Levin Metals Corp., et al. v. Parr-Richmond Terminal Co., et al. Cases 3, 4 & 5 are all integrated. They are based on a CERCLA claim. Montrose's liability arises from the fact that it shipped chemicals to the site which were used by an independent company in formulating other chemical products. *Id.*

108. *Id.* at 6.

109. *Id.* at 6-7. When an insurer issues a reservation of rights notice, it is informing the insured that it will provide a defense while retaining the right to later claim noncoverage under the policy. JOHN F. DOBBYN, *INSURANCE LAW IN A NUTSHELL* 268 (3d ed. 1996).

110. *Montrose*, 897 P.2d at 7.

111. *Id.* at 7.

112. *Id.*

113. *Id.* at 5. On August 23, 1982, six weeks before Admiral's first policy with Montrose went into effect, Montrose was notified by the EPA that it considered Montrose a potentially responsible party (PRP) for response costs at the Stringfellow site. *Id.*

114. *Id.* at 7.

115. *Id.*

116. *Id.* at 7-8.

B. The California Supreme Court's Analysis

1. Trigger of Coverage

By the time *Montrose* reached the supreme court, there was great conflict in the lower courts regarding the coverage analysis the application of the manifestation and continuous injury triggers in various continuous injury construction defect cases. The California Supreme Court needed to address and settle this issue.

In *Montrose*, the supreme court held that all third party policies in effect during a period of continuous or progressively deteriorating property damage were potentially liable for indemnification.¹¹⁷ Those insurers therefore had the duty to defend, even if the policy expired prior to manifestation of the injury.

In determining what trigger to apply in a case of third party liability involving continuous or progressively deteriorating property damage, the supreme court analyzed several factors. These include: the differences between first and third party policies,¹¹⁸ the policy language,¹¹⁹ and practical and public policy considerations.¹²⁰

a. First and Third Party Policies

First, the supreme court distinguished third party liability insurance from first party property insurance.¹²¹ The court reasoned that property insurance is a contract by which the insured is covered for certain enumerated "perils."¹²² The cause of the loss in this context is usually a fortuitous event such as an explosion, fire, or wind.¹²³ By contrast, liability coverage is concerned with "traditional tort concepts of fault, proximate cause and duty."¹²⁴

The supreme court found that another important distinction between first and third party policies is the parties' expectations.¹²⁵ First party insureds usually purchase sufficient insurance to cover their maximum potential losses.¹²⁶ Third party insureds, on the other hand, can only "guess about its potential exposure to third parties."¹²⁷

117. *Id.* at 27.

118. *Id.* at 9.

119. *Id.* at 11.

120. *Id.* at 24.

121. *Id.* at 9.

122. *Id.*

123. *Id.*

124. *Id.* at 9.

125. *Id.* at 10.

126. *Id.*

127. *Id.*

Other distinctions between the two types of policies include the requirements in a first party policy that the loss be “discovered” within the policy period,¹²⁸ and that the insurer be notified within a certain period after “the inception of the loss.”¹²⁹ These two requirements are not imposed in third party liability policies.¹³⁰

b. Admiral’s Policy Language

After addressing the factors to be considered in determining the appropriate trigger of coverage, the court turned to Admiral’s policy language. The supreme court concluded, after reviewing the standard industry CGL language in Admiral’s policies, that the policy “clearly and explicitly provides that the occurrence of bodily injury or property damage during the policy period is the operative event that triggers coverage.”¹³¹

The supreme court also conducted an extensive review of the drafting history of the policy language.¹³² It found that when the drafters of the standard “occurrence” language added the phrase “injurious exposure to conditions” to the original terminology, they contemplated the policy providing coverage for all damage from continuous injury which occurred during the policy period.¹³³

c. Practical and Public Policy Considerations

In explaining why the continuous injury trigger should be applied to third party continuous injury claims, the supreme court also looked at practical and policy considerations.¹³⁴ Admiral raised the practical concern of how a

128. *Id.*

129. *Id.*

130. *Id.* at 10.

131. *Id.* at 13. The supreme court quotes Admiral’s policy as follows:

Admiral contracted with Montrose to “pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of . . . property damage to which this insurance applies, caused by an occurrence [P]roperty damage to which this insurance applies” is defined in Admiral’s policies as “physical injury to or destruction of tangible property which occurs during the policy period”

Furthermore, “occurrence” is defined in Admiral’s policies as “an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.”

Id. at 13.

132. *Id.* at 14.

133. *Id.* at 15.

134. *Id.* at 24.

continuous injury trigger would affect insurance industry reserves.¹³⁵ The court assured Admiral that reserves would not be negatively affected by a continuous injury trigger¹³⁶ because the courts “generally apply equitable considerations to spread the cost among the several policies and insurers.”¹³⁷ However, the court did not detail how apportionment of costs would be determined.

Perhaps the most convincing practical consideration the court raised is the distinction between an occurrence based policy,¹³⁸ such as Admiral’s, and a claims-made policy.¹³⁹ In a continuous injury situation, damages may not become apparent until many years after the existing occurrence policy has expired. However, the insurer whose policy was in effect when the injury occurred is still liable for the damage.¹⁴⁰ This is a disadvantage for the insurer because it has no way of knowing whether it still may carry liability for expired policies.¹⁴¹ This period of lingering liability is known as the “tail.”¹⁴²

A claims-made policy, on the other hand, limits coverage to the single policy in effect when the insured has a claim made against him, regardless of when the injury occurred.¹⁴³ This is an advantage for the insurer for it can be certain that when the policy expires, so does its liability.¹⁴⁴ There is no “tail.” Because of this restriction, the carrier can more easily establish the amount of its reserves. It also has less exposure, and can charge less for the policy.¹⁴⁵

In *Montrose*, the supreme court reasoned if a manifestation trigger were applied to an occurrence based policy, it would effectively transform a broader and more expensive policy into a claims-made policy.¹⁴⁶ This is because with a manifestation trigger, the insurer is only liable for injuries which actually appear within the policy period, effectively disposing of the “tail” problem.

135. *Id.* at 25. The reserves are the funds an insurance company must keep on hand to enable it to cover its liability in any given year. This figure is not equal to the total possible liability on its outstanding policies. Rather, it is the amount the insurer predicts that it will actually be liable for, in any given year, based on experience tables. DOBBYN, *supra* note 110, at 71-72.

136. *Montrose*, 897 P.2d at 25.

137. *Id.*

138. An occurrence policy provides coverage if the damage or injury occurs during the policy period, regardless of when the claim was filed with the insurance company. JERRY, *supra* note 47, § 62a.

139. *Montrose*, 897 P.2d at 26.

140. JERRY, *supra* note 47, § 62a.

141. *Id.*

142. *Id.* (“[The tail is] the lapse of time between the date of the act or neglect and the time the claim is made.”).

143. *Id.*

144. *Id.*

145. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 26 (Cal. 1995).

146. *Id.* at 27.

2. The Loss-in-Progress Rule

Montrose's second significant holding concerned the loss-in-progress rule. The Court held that even if the policy went into effect after the manifestation of the injury, the insurer remains on the risk and retains the duty to defend until the insured's liability is certain.¹⁴⁷ The supreme court found that, in the context of third party coverage involving continuous injury, *liability* (not damage) which is contingent at the time the policy is issued is insurable.¹⁴⁸ This is in accord with the Second District's position on the loss-in-progress rule. As Justice Baxter notes in his concurring opinion in *Montrose*, "a literal application of this theory would allow the purchase of liability insurance for a completed tort up to the moment a final damage judgment is imposed upon the tortfeasor."¹⁴⁹

IV. QUESTIONS LEFT UNANSWERED

While *Montrose* put to rest two hotly debated insurance issues, there are several remaining questions which must be answered before coverage for continuous construction defect injuries can be determined. These issues include: 1) how the defense is handled, 2) the types of construction defects which fall into the "continuous" or "progressively deteriorating" category, 3) the total amount of coverage the insured can collect, and 4) how to apportion the defense costs and indemnity among the triggered policies. The remainder of this Note will focus on fashioning a satisfactory method of handling these outstanding issues, based on hints given in *Montrose* and on other case law.

A. Is the Injury Continuous?

Not all construction defect claims will have the same trigger. The type of trigger applied will depend upon whether the defect is defined as "continuous."¹⁵⁰ Of the many defective items being contested in a typical construction defect case, only a few will come under the category of "continuous" or "progressively deteriorating."¹⁵¹

With many construction defects, the damage and the manifestation will occur simultaneously, such as a chipped bathtub or an exploding heater. With

147. *Id.* at 29.

148. *Id.* at 29. The court cites to the following cases to illustrate its conclusions: Keene Corp. v. Insurance Co. of N. Am., 667 F.2d 1034, 1041 (D.C. Cir. 1981); Aetna Casualty & Surety Co. v. Condict, 417 F. Supp. 63, 73 (S.D. Miss. 1976); City of Johnstown, N.Y. v. Bankers Standard Ins., 877 F.2d 1146 (2d Cir. 1989); Sentinel Ins. Co. v. First Ins. Co., 875 P.2d 894, 920 (Haw. 1994).

149. *Montrose Chem. Corp.*, 897 P.2d at 31 (Baxter, J., concurring).

150. Interview with Alan Johnston, Partner, Duke, Gerstel, Shearer & Bregante, in San Diego, Cal. (Sept. 1995).

151. *Id.*

this type of injury, a manifestation trigger would be appropriate, and only one policy would be triggered.

However, with other types of construction defects, the injury is continuous from the date of installation to the date of manifestation (or actually, to the date of repair). The most obvious examples would be spalling concrete, dry rot, or faulty soil compaction. With these types of defects, the initial negligence of the builder creates a defective condition which is not immediately apparent, but which causes injury over a period of time, ultimately resulting in observable damage. The continuous injury trigger would apply to these defects, and all the policies in effect during the period of damage would be triggered.

Many other types of damage could also fall into the "continuous or progressively deteriorating" category.¹⁵² The category of damage, and therefore the trigger to be applied, will ultimately be left to the experts to determine.¹⁵³ The experts will not only need to ascertain the type of damage, but they will also have to calculate the period in which the damage occurred.¹⁵⁴ In many cases, continuous damage will be able to be traced to the time of installation. However, in some instances damage may not begin until some time after installation, and then will continue from that point on.¹⁵⁵ If this is the case, fewer policies will be triggered.

Now that different triggers may be applied to different types of damage, another layer has been added to the litigation process. This will result in a battle of experts. There will continue to be the usual experts¹⁵⁶ debating whether a defect exists. Now, however, there will also be experts from the various insurance companies arguing over the category of a particular defect.

B. Duty to Defend

In *Montrose*, the court found that every policy on the risk during the period of continuous injury may have the duty to defend.¹⁵⁷ The court rejected joint and several liability,¹⁵⁸ which means that the insured cannot

152. Damage such as: stains which worsen over time; windows which spring more and more leaks over the years; and bathroom tiles which loosen and periodically fall off, could also be considered "continuous."

153. Interview with Alan Johnston, Partner, Duke, Gerstel, Shearer & Bregante, in San Diego, Cal. (Sept. 1995).

154. *Id.*

155. An example could be roof tiles which are not nailed properly. They may be satisfactory for a few years, but become dislodged after a particularly bad storm. From that point on, they may be responsible for leaks which cause a dry rot condition in an attic space for a number of years until ultimately discovered and repaired.

156. Representing the home owners and the developers.

157. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 4 (Cal. 1995).

158. *Id.* at 21 n.19.

pick and choose who he wants to defend him, but that all insurers must defend in total.¹⁵⁹

Montrose did not address how the defense process will operate in practice. Once a claim is filed against a policyholder, he must inform all the insurers who are potentially liable. There will probably be disagreement among the parties as each interprets *Montrose* in his favor. Insurer's may claim that they need not tender a defense until the insured can establish that the injury occurred within their policy periods. Insureds will argue that it is the carrier's responsibility to determine whether their policy has been triggered.

Insurers, however, should accept their duty to defend, without waiting for a court ruling. As stated above, an insurer must tender a defense whenever there is the "bare potential or possibility" of liability.¹⁶⁰ If an insurer refuses a defense, and it is later determined that they are liable, its "limits are opened" and it becomes responsible for all costs in the action.¹⁶¹

While *Montrose* did not address how defense costs would be allocated when multiple policies are triggered, past cases have discussed the issue. Unfortunately, the courts do not agree on a solution. As with allocation of liability, some courts hold that defense costs should be apportioned according to the amount of contribution to the judgment against the insured.¹⁶² Other courts have held that defense costs should be prorated on the basis of the amount of coverage afforded.¹⁶³

Montrose does not address how a policyholder should proceed. What can the insured do to move his case along and obtain the defense he paid for? Who has the responsibility to iron things out? In *Keene Corp. v. Insurance Co. of North America*,¹⁶⁴ the court held that the policyholder could select one insurer to defend and indemnify him up front while the tort suit was being heard.¹⁶⁵ After liability was established at trial, the various insurers could allocate indemnity and seek contribution among themselves, without bothering the victim or the insured.¹⁶⁶ The court found this approach would promote judicial efficiency, and would stop indemnity battles between insurers from interfering with the main suit.¹⁶⁷

159. Interview with Robert Shoecraft, Partner, Duke, Gerstel, Shearer & Bregante, in San Diego, Cal. (Sept. 1995).

160. *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153, 1160 (Cal. 1993).

161. *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 178-179 (Cal. 1966).

162. See *Signal Companies v. Harbor Ins. Co.*, 612 P.2d 889, 895 (Cal. 1980); see also *Olympic Ins. Co. v. Employers Surplus Lines Ins. Co.*, 178 Cal. Rptr. 908, 913 (Ct. App. 1981).

163. See *Employers Reinsurance Corp. v. Phoenix Ins. Co.*, 230 Cal. Rptr. 792, 798 (Ct. App. 1986).

164. *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981).

165. *Id.* at 1051.

166. *Id.*

167. *Id.* at 1051 n.38.

In the interest of clarity and judicial efficiency, the California courts should adopt *Keene* and require that one carrier handle the defense of a case. The insured's attorney should take charge of organizing the carriers at the beginning; he should not rely on them to take responsibility for coordinating themselves and cooperating with each other. After the responsible insurers have been identified, they should have the opportunity to reach an agreement amongst themselves to determine which one will provide a defense. Only if they cannot come to an agreement within a reasonable period of time will the insured be allowed to choose a particular insurer to defend him.

After trial, the carriers can meet and apportion liability and defense costs. This may result in further litigation, but the victim and the insured will no longer be involved, leaving the dispute up to those contractually obligated to deal with it.

C. Setting the Liability Limit: Stacking

1. Case History

If damage is determined to be "continuous," and a number of policies have been triggered, the question arises of how much the insured can collect. If the amount of liability incurred is within the limits of one year's coverage, the insured can simply apportion indemnity between the various triggered policies. However, if the liability incurred is greater than the highest single policy limit of those policies triggered, the insured will want to combine two or more policies, termed "stacking," in order to obtain full coverage. The question becomes whether stacking of policies should be allowed, or whether the court should impose a limit on how much the insured can collect.

Stacking is not a method of allocation between multiple policies.¹⁶⁸ It is a way by which the *limit of coverage* may be determined when multiple policies are triggered. Regardless of whether stacking is allowed, once the amount of liability is determined, the various insurers will have to allocate the costs of indemnity among themselves.

Outside of California, the majority of states hold that when multiple successive policies are triggered in a case of continuous injury, their limits may not be stacked.¹⁶⁹ The California Supreme Court has not yet ruled on

168. *But see* Uniroyal, Inc. v. Home Ins. Co., 707 F. Supp. 1368 (E.D.N.Y. 1988) (erroneously listing stacking and joint and several liability as methods of allocation, although ultimately rejecting both).

169. John K. DiMugno, *Montrose v. Admiral Insurance Co.: The California Supreme Court's Attempt to Clean Up the Coverage Mess*, INS. LITIG. REP. 308, at 314-15 (1995). "[Stacking] divorces the coverage from the injuries triggering the coverage; it simply lumps all the injuries into one large pool. . . . Finally, even with the same insurer on both policies, stacking in this manner makes the aggregate limits and the separately negotiated premiums for each policy illusory by expanding coverage to the sum of both policies." *Id.* (quoting Uniroyal, Inc. v. Home Ins. Co., 707 F. Supp. 1368, 1391 (E.D.N.Y. 1988)). The article goes on to state, "Louisiana and Minnesota appear to be the only jurisdictions that permits (sic) stacking in the context of cumulative injury tort cases." *Id.* at 315.

this issue.¹⁷⁰ However, this question must be answered before *Montrose* can have any real effect.

Those searching *Montrose* for hints on how to approach the stacking issue may look to footnote nineteen. There, the court rejected the tort principle of joint and several liability, in favor of the application of contract law principles “to the express terms and limitations of the various policies of insurance on the risk.”¹⁷¹ If contract law principles are applied to the stacking question, however, conflicting interpretations can still be made regarding the “one occurrence” clause in the policy.¹⁷² Therefore, the language in footnote nineteen does not offer any concrete guidance.

Insureds may look to *Montrose's* approval of a Washington State Appellate case, *Gruol Construction Co. v. Insurance Co. of North America*,¹⁷³ as supporting stacking. *Montrose* interprets the *Gruol* opinion as stating that “an insurer would become liable at any point in the process for the entire loss up to the policy limits, even though the continuing injury or progressively deteriorating damage may extend over several policy periods.”¹⁷⁴

This statements appears to suggest that the court may allow insureds to recover over one policy's limit. However, *Montrose's* interpretation of *Gruol* is based on *Gruol's* trigger analysis and on its adoption of joint and several liability (which *Montrose* rejects as a tort concept), and not on a discussion of stacking. The stacking issues does note arise in *Gruol*, and therefore *Montrose's* approval of the case cannot be used as an argument in favor of stacking. Thus, neither policyholders nor insurers may rely on the language in *Montrose* to further their respective assertions regarding the stacking issue.

Although the stacking question was not taken up in *Montrose*, there are two continuous injury cases recently remanded by the California Supreme Court to be reconsidered in light of *Montrose*, which address this issue. It remains to be seen whether the appellate courts will alter their approaches to

170. *Id.* at 313.

171. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 21 n.19 (Cal. 1995). This is in line with *Keene Corp. v. Ins. Co. of N. Am.*, as well as other case law. See *Armstrong World Industries v. Aetna Casualty & Surety Co.*, 26 Cal. Rptr. 2d 35, 60 (Ct. App. 1993), review granted, 886 P.2d 1311 (Cal. 1994), vacated and remanded, 904 P.2d 370 (Cal. 1995) (“[I]n *Keene*, the court distinguished the doctrine of joint and several tort liability, applicable to the rights of the victim, from the contractual liability of the insurers to *Keene*. . . .”) After *Montrose* was decided, *Armstrong* was remanded to be reconsidered in light of *Montrose*. Therefore, *Armstrong* is no longer citable authority. It is used in this Note solely to illustrate the different approaches taken by the lower courts prior to *Montrose*. See also *Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1225 (6th Cir. 1980) (“[I]n allocating the cost of indemnification under the exposure theory [similar to a continuous injury theory], only contract law is involved [not tort law]. Each insurer is liable for its pro rata share. The insurer's liability is not ‘joint and several’, it is individual and proportionate.”).

172. Does “one occurrence” mean one occurrence in total (no stacking), or one occurrence per year (stacking allowed)? See discussion of *Stonewall*, *infra* notes 178-182 and accompanying text.

173. *Gruol Constr. Co. v. Insurance Co. of N. Am.*, 524 P.2d 427 (Wash. App. 1974).

174. *Montrose*, 897 P.2d at 19.

stacking on remand. Since *Montrose* did not address the stacking issue, the lower courts cannot look to the supreme court for guidance. In *Armstrong World Industries v. Aetna Casualty & Surety Co.*, the trial court rejected stacking.¹⁷⁵ The court stated that the insured was not entitled to get "more than it bargained for."¹⁷⁶ The insureds did not challenge the ruling on appeal.¹⁷⁷

In contrast, the appellate court in *Stonewall* allowed stacking.¹⁷⁸ *Stonewall* involved a situation where there were three policies issued in three consecutive years, each with a limit of \$300,000 per year.¹⁷⁹ The court found that all the relevant policies included the standard CGL language which stated that all damage arising from a continuous and repeated exposure is deemed a single occurrence.¹⁸⁰ Did this mean that the insured could collect only up to \$300,000 because the injury is considered a "single occurrence" in total? Or does this mean that the insured could collect \$900,000 because the injury caused a "single occurrence" per year? The court found this language to be ambiguous and therefore read it in favor of the insured, allowing him to collect the stacked limit of \$900,000.¹⁸¹

Both the *Montrose* and *Stonewall* opinions cited *Keene* with approval, although neither case referenced *Keene's* stance on stacking.¹⁸² With *Keene's* approach, the victim would be compensated up to one policy's limits (which would presumably be set by the highest possible limit).¹⁸³ While *Keene* did state that "every policy is liable up to its limits,"¹⁸⁴ this was meant to ensure security for the insured in case, for some reason, all other

175. *Armstrong*, 26 Cal. Rptr. 2d at 60.

176. DiMugno, *supra* note 169, at 313-314. "[While] every triggered policy has an independent obligation to respond in full to a claim . . . that does not entitle an insured to get more than it bargained for . . . The policy holder cannot reasonably expect more simply because asbestos-related claims trigger more than one policy . . ." *Id.* See *Armstrong*, 26 Cal. Rptr. 2d at 60. "[T]he trial court's decision ensures that the policyholder is indemnified by one insurer for the full extent of the loss up to the policy's limits, but apportions liability among all insurers whose policies were triggered by the asbestos-bodily injury. We find nothing erroneous in that decision." *Id.*

177. DiMugno, *supra* note 169, at 314.

178. *Stonewall Ins. Co. v. Palos Verdes Estates*, 9 Cal. Rptr. 2d 663 (Ct. App.), *review granted*, 834 P.2d 1147 (Cal. 1992), *case transferred with directions*, 904 P.2d 370 (Cal. 1995).

179. *Id.* at 685.

180. *Id.* at 685-686.

181. *Id.*

182. *Montrose* relied on *Keene* in its trigger analysis. Both *California Union* and *Stonewall* erroneously relied on *Keene* as applying joint and several liability when multiple policies are triggered. However, as the *Armstrong* court points out, *Keene* has been misinterpreted; it does not hold that insurers are to be held jointly and severally liable: "[I]n *Keene*, the court distinguished the doctrine of joint and several tort liability, applicable to the rights of the victim, from the contractual liability of the insurers to *Keene*, [the insured]." *Armstrong*, 26 Cal. Rptr. at 60.

183. *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034, 1049-1050 (D.C. Cir. 1981).

184. *Id.* at 1050.

triggered policies could not pay.¹⁸⁵ *Keene* still established a single policy limit on the total amount a claimant could collect.

The stacking issue may be the most important unanswered question following *Montrose*. If stacking is approved, insured's could recover far more for damages than they could have previously. On the other hand, insurers would stand to lose vast amounts of money. Although each side has valid legal arguments, the answer may well turn on public policy factors.

2. Public Policy

a. Arguments in Support of Stacking

There are numerous public policy considerations which the courts must address when deciding whether to allow stacking. It has already been shown that applying contract principles to the standard CGL policy language does not establish whether stacking was bargained for by the policyholder. *Montrose* found, however, that the language in the standard CGL policy can bring on a reasonable expectation in the insured that coverage is afforded under all the policies.¹⁸⁶ Also, the courts have long held that public policy favors finding coverage when reasonably possible.¹⁸⁷ Additionally, if the policy language is ambiguous, it is weighed in favor of the insured.¹⁸⁸

Montrose also showed that the insurance industry knew and approved of a continuous trigger when it was drafting its policy language.¹⁸⁹ If this is the case, carriers should have been putting aside sufficient reserves to cover all the risks to which the policy language exposed them. Therefore, carriers cannot now claim that stacking will deplete their reserves.¹⁹⁰

While stacking will increase costs for the insurance companies, the goal of the tort system is to have insurers absorb the costs of indemnity, and then distribute the cost through society by charging the necessary premiums. In the context of construction defect litigation, increased premiums would likely cause developers to raise the price of homes. This could ultimately benefit homeowners by spreading the risk from the individual with a defective home to society at large.

b. Arguments Against Stacking

First, one might agree that the CGL policy language gave the insured the reasonable expectation that he would be protected by all the policies in effect

185. *Id.*

186. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 15 (Cal. 1995).

187. *Id.* at 12.

188. *Id.*

189. See *supra* notes 133-135 and accompanying text.

190. *Montrose*, 897 P.2d at 12.

during the time period of the injury. However, this only means that the insured expected that all the policies would be triggered. It does not mean that he reasonably expected that he would be indemnified for an amount equaling the total coverage of all the policies added together.

Second, while the drafting history of the CGL policy may show that the insurance industry favored a continuous trigger, it did so because it wanted to spread risk among a number of companies, among other reasons.¹⁹¹ No where did the drafters state that the industry favors the stacking of policies.

Third, while one of the goals of the tort system is to spread the costs of liability to society at large through insurance policies, this would not be the result if stacking was applied to construction defect cases. The high costs of construction defect litigation have already caused American insurance companies to either raise their rates beyond what many developers can pay, or to pull out of the developer liability insurance market in California.¹⁹² If policies are stacked, this situation will only become worse.

This predicament is particularly severe with condominiums, which are the primary subjects of construction defect litigation.¹⁹³ Because of this, condominium builders must have liability insurance.

Complicating the issue is the fact that condominium purchasers are often first time home buyers or people seeking affordable housing. California already has among the highest priced housing in the country, with low or medium income families often priced out of the market altogether. Builders credit both insurance costs and the unavailability of insurance, for their inability to construct affordable homes.¹⁹⁴ The most affected by rising

191. *Id.* at 26. Among the reasons relied on for not incorporating a manifestation trigger into the standard definition were several stated equitable concerns: "the difficulty of applying such limitations or requirements in cases of continuing damage or injury over the course of successive policy periods, the uncertainty of who would bear the burden of a discovery requirement (i.e., the insured or third party claimants), the arbitrariness, from the carrier's perspective, of telescoping all damage in a continuing injury case into a single policy period, and the fear that policy-holders could be disadvantaged by such an approach." *Id.*

192. Construction Magazine, "Builders Scramble for Insurance," June 1995; Thor K. Biberian, *Defect Lawsuits Could Signal End of Attached Product*, SAN DIEGO DAILY TRANSCRIPT, Nov. 6, 1995, at B1; Van Housen, *supra* note 11 (stating that "[p]remiums paid by condo builders for liability insurance have increased tenfold since 1980. . . while the number of insurance carriers who offered such coverage a decade ago topped 40, they can now be counted on one hand"); Dwight Hansen, *Commentary on Insurance*, L.A. TIMES, Apr. 17, 1994, at 11 (Hansen, a lobbyist for the building industry, states "[n]ot a single state-admitted insurance carrier is covering liability for condo or multifamily construction right now. . . . The only liability insurance available is from higher-risk, higher-premium carriers located out of state").

193. See Van Housen, *supra* note 11; Biberian, *supra* note 192; Ricardo Sandoval, *When the Roof Falls In*, 12-SEP CAL. LAW. 45 (1992) ("[T]he question is not if there will be a claim, but when will the claim come and how big will it be?").

194. Construction Magazine, *supra* note 192; Biberian, *supra* note 192; Andrea Adelson, *Post-Growth O.C. Is Ripe for Building Defect Cases*, L.A. TIMES, May 30, 1995, at 1 (stating that the affordable housing shortage is a byproduct of construction defect litigation); Hansen, *supra* note 195 ("This epidemic of construction defect lawsuits is killing off the supply of affordable housing in Orange County and is spreading throughout the state Since they can't get insurance to do multifamily, condominium or planned-unit developments, many builders are changing their business plans and won't build these projects anymore, particularly those involving

insurance costs are also those least able to absorb them. By allowing stacking, the courts would be making it even more difficult for developers to provide reasonably priced housing. This would run counter to the aims of the strict liability/tort system. The costs of indemnifying builders cannot be spread throughout society through higher housing prices; the market cannot support more expensive homes.

In addition, by allowing stacking, the courts would be sending the wrong message to builders. There is no incentive for builders to select qualified subcontractors, or to ensure that quality materials are being installed, if they know that they have a huge pool of insurance to cover even the most costly defects. Money which would go to pay greater insurance costs under a stacking system, would be better spent in higher quality construction.

Thus, relevant law and policy suggests the best long-range solution would be to prohibit stacking. In construction defect cases involving continuous or progressively deteriorating injury, the insured should be restricted to collecting the highest single limit of those policies triggered.

D. Allocation of Indemnity

After determining the nature of the damage, which policies are triggered, and the limit of the amount of coverage, the court must allocate the liability among the triggered policies. When allocating, the court must first check the language of the policies regarding the allocation of liability among insurers.¹⁹⁵ However, such provisions are not always included, and when they are, they sometimes conflict.¹⁹⁶ Courts must then step in and apportion the liability as they see fit.

Montrose states that indemnity should be apportioned along contract principles,¹⁹⁷ and that the courts should apply equitable considerations.¹⁹⁸ Both statements are quite vague. The court only directly addresses the allocation issue in its statement that “[t]he task may require allocation of contribution among all the insurers on the risk in proportion to their respective policies’ liability limits (such as deductibles and ceilings) or the time periods covered under each such policy.”¹⁹⁹ Again, this issue must be decided before *Montrose* can be practically implemented.

homeowners associations.”).

195. *Keene Corp. v. Insurance Co. of N. Am.*, 677 F.2d 1034, 1050 n.35 (D.C. Cir. 1981). The court refers to provisions which allocate liability according to “Contribution by Equal Shares,” under which all insurers share liability equally, and according to “Contribution by Limits,” under which insurers contribute in proportion to their policy limits.

196. *Armstrong World Industries v. Aetna Casualty & Surety Co.*, 26 Cal. Rptr. 2d 35, 58 (1993), review granted, 886 P.2d 1311 (Cal. 1994), vacated and remanded, 904 P.2d 370 (Cal. 1995).

197. *Montrose Chem. Corp. v. Admiral Ins. Co.*, 897 P.2d 1, 21 n.19 (Cal. 1995). 2d at 344 n.19.

198. *Id.* at 26.

199. *Id.* at 10-11.

The supreme court expressly declined "to formulate a definitive rule applicable in every case" where multiple insurers cover the same risk.²⁰⁰ It may be possible, however, to fashion a workable rule which would apply specifically to construction defect cases involving continuous injury. Case law has defined at least four methods of allocation:²⁰¹

- 1) based on the proportion of injuries which actually occurred during the policy period;²⁰²
- 2) based on the "time on the risk";²⁰³
- 3) based on each policy's limits;²⁰⁴
- 4) based on the policy limits multiplied by the years of coverage formula.²⁰⁵

The least workable approach in construction defect cases involves basing allocation on the actual injury incurred during the policy period.²⁰⁶ Defects are often not discovered until destructive testing²⁰⁷ takes place; no one has witnessed the progression of the injury. Even if the defect is visible, there is rarely any qualitative evidence showing the extent of the injury in any given period. For example, it would be virtually impossible for experts to determine how much dry rot occurred in year four, as opposed to year five. This would entail pure guesswork, and would needlessly prolong and confuse an already complicated procedure.

The other three methods do not involve conjecture; they are based on formulas. To illustrate how each method works, consider the example of a construction defect involving faulty soils compaction. At trial, the injury is found to have begun at the time of grading, and to have been continuous and progressively deteriorating during a five year period, at the end of which a landslide occurs. Over the five years, the builder purchased coverage from

200. *Signal Co.'s v. Harbor Ins. Co.*, 612 P.2d 889, 895 (Cal. 1980). "We expressly decline to formulate a definitive rule applicable in every case in light of varying equitable considerations which may arise, and which affect the insured and the primary and excess carriers, and which depend upon the particular policies of insurance, the nature of the claim made, and the relation of the insured to the insurers." *Id.*

201. Other approaches include apportionment based on: 1) the premiums paid (*Insurance Co. of Texas v. Employers Liab. Assurance Corp.*, 163 F. Supp. 143, 147, 151 (S. D. Cal. 1958)); 2) in equal shares (*Reliance Ins. Co. v. Saint Paul Surplus Lines Ins.*, 753 F.2d 1288, 1292 (4th Cir. 1985)); 3) using "maximum loss" method (*Mission Ins. Co. v. Allendale Mutual Ins. Co.*, 626 P.2d 505 (Wash. 1981).

202. *See Uniroyal, Inc. v. Home Ins. Co.*, 707 F. Supp. 1368 (E.D.N.Y. 1988).

203. *See Insurance Co. of N. Am. v. Forty-Eight Insulations*, 633 F.2d 1212 (6th Cir. 1980).

204. *See Argonaut Ins. Co. v. Transport Indem. Co.*, 492 P.2d 673 (Cal. 1972); *see also Employers Reinsurance Corp. v. Phoenix Ins. Co.*, 230 Cal. Rptr. 792 (Ct. App. 1986); *see also CNA Casualty v. Seaboard Sur. Co.*, 222 Cal. Rptr. 276 (Ct. App. 1986).

205. *See Armstrong World Industries v. Aetna Casualty & Sur. Co.*, 26 Cal. Rptr. 2d 35 (Ct. App. 1993), *review granted*, 886 P.2d 1311 (Cal. 1994), *vacated and remanded*, 904 P.2d 370 (Cal. 1995).

206. Interview with Alan Johnston, Partner, Duke, Gerstel, Shearer & Bregante, in San Diego, Cal. (Sept. 1995).

207. Destructive testing is the phase of discovery wherein specific areas of a building or site are systematically taken apart. This allows the parties to determine how the building was actually built, what materials were used or left out, and what mistakes have been made.

three different companies, A, B and C. A issued the developer three separate policies for three successive years, each with a \$100,000 limit. B provided insurance for one year, but with a \$400,000 limit. C came on the risk last, with a one year policy with a \$100,000 limit. The damages total \$400,000.

If the "time on the risk" method is used, A (with three years on the risk) would have to contribute \$240,000. B and C (with one year on the risk) would each have to pay \$80,000. The inequities of this system are apparent when one considers that B and C have the same liability, but B collected much higher premiums for a larger policy.

If liability is allocated in proportion to the policy limits, the result is much different. A and C would each owe \$66,667, while B would owe \$266,667. This system is no fairer than the last. Why should A and C have the same amount of liability when A was collecting premiums for three years, and C was only on the risk for one?

The last method, which apportions liability according to a formula which multiplies the policy limit by the time on the risk is the most equitable. Using this method, A would be responsible for \$150,000 (\$300,000 of the \$800,000 total coverage over the period = 3/8), B for \$200,000 (\$400,000 of the \$800,000 total = 1/2), and C for \$50,000 (\$100,000 of the \$800,000 total = 1/8). It should be clear that this is by far the fairest method of allocation.

This method was first used by the court in *Armstrong*, who found that it was not only the most equitable method, but also that it was consistent with the policy language.²⁰⁸ If this formula is adopted in construction defect cases, it would lend clarity and certainty to the situation, reduce the number and length of lawsuits, and speed up settlements.

E. Other Issues to be Considered

All of the allocation methods mentioned above are far simpler than any real life situation. In practice, most insurance policies include deductibles and self-insured retentions (SIRs), which complicate the amount the carriers must contribute.²⁰⁹

208. *Armstrong*, 26 Cal. Rptr. at 57.

[T]his court finds that the most equitable method of allocation is proration on the basis of policy limits, multiplied by years of coverage. This method is consistent with policy language in that it takes policy limits into consideration. Typically, a pro rata 'other insurance' clause provides for proration according to 'the applicable limit of liability.' This method also reflects the fact that higher premiums are generally paid for higher 'per person' or 'per occurrence' limits. Since some policies are in effect for more than one year, and injury occurs every year . . . , multiplying the policy limits by years of coverage results in a more equitable allocation than proration based on policy limits alone.

Id.

209. DiMugno, *supra* note 169, at 316.

Developers also typically carry excess or umbrella policies for coverage beyond what their primary policy will pay.²¹⁰ Excess coverage does not kick in until the underlying policy is exhausted.²¹¹ When multiple policies are triggered, this leads to the question of whether there needs to be horizontal or vertical exhaustion before various policies will be triggered.²¹²

Yet another factor which muddies the situation is the possibility that the builder may have had no coverage for a period of time.²¹³ If there is a gap in coverage, is the insured required to cover that period himself, or should the other policies fill the gap, in accordance with the loss-in-progress rule?

Nearly all these scenarios will be involved with any large construction defect claim. The combination of the various factors will greatly affect the outcome of a particular case. The courts will have to decide each situation on a case by case basis. This does not mean, however, that the courts should abandon all attempts to set down guidelines for the key issues which always arise. Practicing attorneys must have a starting point for knowing how to proceed with continuous injury cases. The court, at a minimum, must establish workable rules concerning defense, stacking, and basic allocation.

CONCLUSION

Montrose will have several effects on construction defect litigation. At the outset, *Montrose* may increase overall litigation costs. Not all defects encountered in a construction defect suit will fall into the "continuous injury" category. Now experts must not only determine the cause and the extent of damage, but must determine whether the damage was continuous. Costs will also rise simply because there will be more insurance companies involved, each arguing over the portion of the damage for which they should be held liable.

Another reason litigation costs may increase is because *Montrose* does not address many insurance issues which are essential to resolving construction defect disputes. While *Montrose* extends the potential for liability to numerous carriers in construction defect cases, the opinion offers no guidance as to how to handle the many implications which it precipitates. What are the limits which a policyholder can collect? How should the indemnity be allocated? What about excess coverage, SIR's, and gaps in coverage? Each case will present very different combinations of types of policies, their language, and exclusions. Until these questions are answered, construction defect litigation will become mired in confusion, as attorneys spend time and money arguing for one interpretation or another. If *Montrose* is to have any

210. Interview with Alan Johnston, Partner, Duke, Gerstel, Shearer & Bregante, in San Diego, Cal. (Sept. 1995).

211. *Stonewall Ins. Co. v. City of Palos Verdes Estates*, 9 Cal. Rptr. 2d at 684.

212. DiMugno, *supra* note 169, at 317.

213. *Id.*

positive effect, the California Supreme Court must decide these outstanding questions, and allow continuous injury cases to be resolved in an orderly fashion.

Perhaps the most important issue which *Montrose* raises is the question of stacking. If insureds can collect from all the triggered policies up to each policy's limits, they will receive quite a windfall. In most situations, no matter how extensive the damage, there will be coverage. Of course, this would not be welcome news for the insurance industry, who would be faced with far more liability than they had planned for. This, in turn, could result in the insurance industry not issuing policies to developers for multi-unit projects. If builders couldn't get insurance for their product, very few homes would be built, and those that were built would be very expensive. Following this scenario to its conclusion, the consumer would actually be harmed, rather than benefitted, by opening up the limits of insurance coverage.

The legal system should do what it can to encourage builders to build quality homes. If the amount of coverage is limited, and the developer's own resources are on the line in case of defective construction, reason dictates that he will take greater care in building the home. This is not to say that the homeowner would be guaranteed a top quality product, but he would get a better built home than if the builder had unlimited indemnity. If stacking is prohibited, there may not be a substantial improvement in home construction, but at least the level of quality would be held to the status quo. If stacking is allowed, and human nature being what it is, there would be little incentive for a developer or contractor to take extra care—the insurance company would pay for his mistakes.

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