New Jersey Supreme Court Requires Exhaustion of All Other Applicable Insurance Before N.J. Property-Liability Guaranty Association Pays Statutory Benefits For An Insolvent Insurer's Long-Tail Claims

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On September 24, 2013, in *Farmers Mutual Fire Ins. Co. of Salem v. NJPLIGA*, ** N.J. ***, 2013 N.J. LEXIS 902, (2013), the New Jersey Supreme Court ruled that all other applicable insurance must be exhausted before the New Jersey Property-Liability Insurance Guaranty Association ("PLIGA") is required to pay statutory benefits on behalf of an insolvent insurer for claims involving continuous indivisible injury or property damage occurring over a period of years as a result of exposure to injurious conditions (i.e. long-tail claims). The Court's opinion gives strong support to policyholders who will argue that their solvent insurers must pick up the insolvent insurer's share of such claims.

The New Jersey Property-Liability Insurance Guaranty Association ("PLIGA") and the PLIGA Act, *N.J.S.A.* 17:30A-1 *et. seq*., were designed to provide limited protection for losses that an insolvent insurer is unable to pay. In order to obtain statutory benefits from PLIGA for policy periods otherwise covered by an insolvent insurer, a claimant must first "exhaust" all of its rights against solvent insurers. Historically, the policyholder was responsible to pay for insolvent periods not covered by PLIGA based on Supreme Court precedent governing allocation of long-tail claims. *Benjamin Moore & Co. v. Aetna Cas. & Sur. Co.*, 179 *N.J.* 87, 99 (N.J. 2004) ("[T]he insured also is responsible for years in which coverage is exhausted or its insurer bankrupt."); *Spaulding Composites Co., Inc. v. Aetna Casualty & Surety Co.*, 176 *N.J.* 25, 36 (2003) ("[T]he insured is required to pay its "aliquot" share of both defense and indemnification on account of years in which . . . its coverage was exhausted or bankrupt."). In *Sayer v. Insurance Company of North America*, 305 *N.J. Super*. 209 (App. Div. 1997), the Appellate Division held that the New Jersey Surplus Lines Insurance Guaranty Fund was required to step into an insolvent Surplus Lines insurer's shoes for purposes of long-tail allocations (up to the Fund's statutory limit). In 2004, in an apparent response to the Appellate Division's decision in *Sayer*, the Legislature amended both the Surplus Lines Insurance Guaranty Fund Act and the PLIGA Act to affect all claims arising out of insolvencies occurring after December 22, 2004. Significantly, the definition of "exhaust" was amended to state that:

"Exhaust" means with respect to other insurance, the application of a credit for the maximum limit under the policy, except that in any case in which continuous indivisible injury or property damage occurs over a period of years as a result of exposure to injurious conditions, exhaustion shall be deemed to have occurred only after a credit for the maximum limits under all other coverages, primary and excess,if applicable,issued in all other years has been applied.

[*N.J.S.A.* 17:30A-5.]

In *Farmers*, the Court addressed the impact of the 2004 amendment on PLIGA's role in the long-tail allocation scheme. There, environmental contamination was discovered on properties insured at different times by Farmers Mutual and Newark Insurance Company ("Newark"). Farmers Mutual insured each property for one year under separate policies with $500,000 liability limits. Each property was also insured under policies issued by Newark covering multi-year periods and each providing $300,000 annual liability limits. Farmers Mutual paid $138,123.52 to cover the total amount of remediation costs for both properties. After Newark became insolvent, Farmers sought reimbursement from PLIGA for Newark's share of the remediation costs with respect to each property. Relying on the PLIGA Act's 2004 amendment to the definition of "exhaust," PLIGA argued that the limits of the Farmers Mutual policies must be exhausted before any costs could be allocated to Newark's insolvent policy periods. Because the limits of the Farmers Mutual policies were sufficient to cover all of the environmental remediation costs, PLIGA argued that the Farmers Mutual policy limits were not "exhausted" within the meaning of the 2004 amendment. Farmers Mutual argued that the 2004 amendment adding the definition of "exhaust" was not intended to overrule precedent holding the policyholder responsible for insolvent periods. Relying on the "if applicable" language in the amendment, Farmers argued that since Newark was the sole insurer of the property for all but one year of the continuous-trigger period, the Farmers Mutual policy was not "applicable" and therefore was not required to be exhausted before PLIGA would reimburse Farmers for Newark's share of the remediation costs. In the alternative, Farmers argued that applying the statute as advocated by PLIGA to Farmers' pre-2004 policies would constitute unconstitutional *ex post facto* legislation. Farmers was successful in the trial court, but the Appellate Division reversed in an unpublished decision.

On appeal to the New Jersey Supreme Court, Coughlin Midlige & Garland submitted an *amicus* brief to the Court on behalf of Zurich American Insurance Company, which urged the Court to not disturb New Jersey precedent holding the policyholder responsible for insolvent periods.

Zurich argued that the 2004 Amendment was limited to setting the criteria for recovering statutory benefits from PLIGA, and was not intended to address the respective responsibilities of solvent insurers and insureds for insolvent periods. Zurich thus argued that the Court could rule in favor of PLIGA on the issue before it, namely whether PLIGA was required to pay statutory benefits, without changing settled New Jersey allocation law.

The New Jersey Supreme Court affirmed the Appellate Division's ruling against Farmers. In so doing, the Court viewed the 2004 Amendment as overturning its prior holdings that the policyholder should be responsible for insolvent periods, at least with respect to claims involving the PLIGA Act.   The Court held that PLIGA was not required to contribute towards the claim until all solvent coverage for all other years had been exhausted. As Farmers had not paid its total policy limits on all of its policies, it was not entitled to recover from PLIGA. The Court also rejected Farmers' *ex post facto* argument and, Zurich's argument that the 2004 Amendment could be given full effect without abandoning proration to the insured for insolvent periods. Although the Court affirmed the continued application of the principles underlying *Owens-Illinois*, it noted that the application of those principles is not static, but constantly evolving to adapt to new circumstances.

This decision represents a shift in New Jersey law, as it implicitly suggests that solvent insurers are responsible for long-tail losses otherwise allocable to an insolvent insurer in cases where PLIGA stands in the shoes of the insolvent insurer. Although the solvent insurer's exposure will still be limited to its policy limits, insureds will undoubtedly use this decision to argue that insurers should be required to contribute additional funds to fund the share otherwise allocable to the insolvent insurer. Although the Court did not expressly state that solvent insurers are required to take up the insolvent insurer's share, the Court did hold that the insured should not bear that burden, and that PLIGA is not be required to contribute until all other insurers are exhausted.

Because the 2004 statutory amendment that forms the basis of the Court's decision only applies to insurers that became insolvent after December 22, 2004, the impact of the decision may have significant limitations. However, the Court's decision leaves many questions unanswered, such as how to allocate where there is an insolvent insurer sitting either below or above solvent insurers, or where the insolvent's limits exceed the $300,000 limits of PLIGA's statutory benefit. These and other questions will need to be resolved in subsequent litigation. The decision is also significant to the extent that it may call into question the continued viability of cost share agreements applying an *Owens-Illinois* allocation and where the insured is contributing towards an insolvent insurer's share.

Should you have any questions or comments regarding this matter, please feel free to contact Coughlin Midlige & Garland LLP.