

# NOTES

## INCONSISTENT APPORTIONMENT CLAUSES IN INSURANCE CONTRACTS\*

FREQUENTLY property is insured under two policies, and when the property is destroyed the problem of apportionment of the loss between the insurers arises.<sup>1</sup> A paramount goal in this apportionment of liability between severally liable insurance companies should be the reduction of litigation. Apportionment clauses themselves were adopted primarily to prevent the circuity of action inherent in the system of contribution which preceded them.<sup>2</sup> But the variance in methods of apportionment tends to prevent the realization of an ideal desired by both the insured and the insurer alike—swift, automatic, non-litigious indemnification.<sup>3</sup>

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\* *Bergstrom Paper Co. v. Continental Insurance Co.*, 75 F.Supp. 424 (E.D. Wis. 1948). Appeal taken, Aug. 8, 1948 (7th Cir.).

1. The problem of apportionment arises in all kinds of property insurance and other fields as well. Ehrenzweig and Ehrenzweig, *Apportionment of Losses Between "Blanket" and "Specific" Insurance Policies*, 43 COL. L. REV. 825, 826 (1943); Note, *Contribution Between Insurers on Partially Concurrent Obligations*, 40 HARV. L. REV. 878 (1927).

One author has explained the occurrence of overlapping insurance as "due to the limitations which individual insurers place on the amount which they will write on given risks, and partially to the fact that in the purchase of fire insurance to cover varying values and varying situations, contracts covering the same property are written at different times. It is often due to an attempt to work out a convenient arrangement of expiration dates, or to take advantage of economies in the application of rates." Blanchard, *Apportionment of Loss in Fire Insurance*, 15 JOURNAL OF AMERICAN INSURANCE No. 5, 11 (1938). Among other important reasons are the desire of business men to patronize more than one insurance agent, and the failure of agents, in the absence of the considerations mentioned by Blanchard, to coordinate coverage by different companies.

2. The principle of contribution, which is traceable back to the Athenians and Rhodians, originated in "the rules . . . which fixed the reciprocal obligations of the owners of the cargo of a vessel to contribute towards the reparation of sacrifices made for the common safety in a storm." BELL, *CONTRIBUTION IN FIRE INSURANCE* 2 (1935).

The earliest records of the apportionment clause go back to the first half of the eighteenth century. *Id.* at 36. Its function was succinctly described by an English court: "[W]here there are several policies, and where there, in point of fact, is a double insurance, then in order to do away with the old practice of the insured recovering the whole from one of the insurance offices, and then the one from whom it was recovered being put to obtain contribution from the others, this clause was put in to say that the insured should, in the first instance, proceed against the several insurance companies for the aliquot parts for which they would be liable in consequence of that condition." *North British and Merchantile Insurance Co. v. London, Liverpool and Globe Insurance Co.*, 5 Ch. D. 569, 588 (1877).

3. Continued although unsuccessful attempts to bring order into the field of non-concurrent apportionment suggest that the ideal has at least been recognized. "[Non-concurrent apportionment] has commanded the attention of the courts as well as the best legal and lay minds in the fire insurance business for nearly a century, and although many rules have been devised for the apportionment of losses where policies are non-concurrent,

Underlying all methods of apportionment where the sum of the face limits of all applicable policies exceeds the amount of the loss is the rule that the insured must be fully indemnified.<sup>4</sup> Where either applicable policy alone would cover the loss, adherence to the rule of full indemnity usually presents no difficulty, because the great majority of contracts have so-called "pro rata" apportionment clauses, which operate to allot liability for the loss in proportion to the face limits of the policies.

But the question which arises when the apportionment clauses have inconsistent terms had never, until recently, been considered by the courts. In such a case, the sum of the fractions of the loss assumed by each company may not equal the whole of the loss suffered, and if the apportionment clauses are honored, the insured may not be fully indemnified.

In *Bergstrom v. Continental Insurance Co.*<sup>5</sup> the question was broached for the first time.<sup>6</sup> The Bergstrom Company had suffered a loss of \$75,194.19,<sup>7</sup> which the jury found was due to an explosion of certain insured pipe fittings. The loss was completely covered by an explosion policy carried with the Hartford Steam Boiler Inspection and Insurance Company for \$100,000.00, and by a fire and explosion policy carried with the Continental Insurance Company for \$400,000.00. But the apportionment clauses in the two policies were inconsistent. While Continental's was the typical pro rata clause,<sup>8</sup> Hartford's clause specified a liability limited to a fraction of the loss computed by dividing the amount of the loss, or the face amount of Hartford's policy, whichever amount was the smaller, by the sum of that amount and the face limits of all other applicable policies.<sup>9</sup> Had these two clauses been invoked,

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no rule of universal or even general application has been found and the prospect of discovering the philosopher's stone is as remote as ever." Bament, *Apportionment of Losses Under Non-Concurrent Policies* in *THE FIRE INSURANCE CONTRACT* 539 (1922). "Perhaps no question has led to a greater confusion in the courts. . . ." *Buse v. National Ben Franklin Insurance Co.*, 96 Misc. 229, 239, 160 N.Y. Supp. 566, 572 (Sup. Ct. 1916). For other similar comments see REED, *ADJUSTMENT OF FIRE LOSSES* 255 (1929); 10 CORN. L. Q. 514 (1925).

4. See, e.g., *Employers Casualty Co. v. Ragley*, 197 S.W.2d 536, 539 (Tex. Civ. App. 1946).

The source of this rule is not clear. It may well stem from the time before apportionment clauses were used, when the insured could recover the whole loss from one insurer. See note 2 *supra*.

5. 75 F. Supp. 424 (E.D. Wis. 1948).

6. The problem was forecast by Donovan in "Other Insurance" *Clauses in Casualty Policies*, A.B.A. PROCEEDINGS OF THE SECTION OF INSURANCE LAW 170, 172 (1947). The author noted that insurers have so far compromised their disputes, but that if a case involving inconsistent apportionment clauses were ever litigated, it would be "debatable" whether the court would invoke both clauses.

7. See notes 10 and 13(b) *infra*.

8. The relevant portion of Continental's clause read: "This Company shall not be liable . . . for a greater proportion [of any loss] than the amount of insurance under this policy bears to the amount of all insurance. . . ." Brief for Continental in the District Court, p. 13.

9. The relevant portion of Hartford's clause read: "In the event of a property loss

Continental would have been liable for \$60,155.35, Hartford for only \$11,898.64, and the insured would not have been indemnified for the remaining \$3,140.19.<sup>10</sup>

Both companies admitted the validity of the full indemnity rule.<sup>11</sup> Hartford, at least by implication, offered to pay the whole amount of the gap, so long as Continental would be held liable to the full extent of its own clause,<sup>12</sup>

to which both this insurance and other insurance carried by the Assured apply, herein referred to as 'joint loss', (a) the Company shall be liable only for the proportion of the said joint loss that the amount which would have been payable under this policy on account of said loss had no other insurance existed, bears to the combined total of the said amount and the whole amount of such other valid and collectible insurance; . . . ." Brief for Hartford in the Court of Appeals, p. 3.

10. The computation is as follows:

(a) Hartford's apportionment:

Amount which would have been payable under Hartford's policy had no other insurance existed (\$75,194.19*)	
<hr/>	X \$75,194.19 = \$11,898.65
\$75,194.19 plus whole amount of Continental's policy (\$400,000.00)	

(b) Continental's apportionment:

Amount of insurance under Continental's policy (\$400,000.00)	
<hr/>	X \$75,194.19 = \$60,155.35
\$400,000.00 plus amount of Hartford's policy (\$100,000.00)	
	Total: <hr/> \$72,054.00

\* An item of \$1814.40, for which a third insurer was liable, is excluded from these calculations for the sake of simplicity. See note 13(b) *infra*.

11. Hartford, however, did not admit its validity in the original argument. *Bergstrom v. Continental Insurance Co.*, 75 F. Supp. 424, 428 (E.D. Wis. 1948). But on reargument of the apportionment question, after which the court denied a motion to reconsider, Hartford did admit the validity of the rule. Communication to the *YALE LAW JOURNAL* from Mr. F.W. Stevenson, Counsel for Hartford, Dec. 8, 1948, in the Yale Law Library. Since the judgment of the court in the *Bergstrom* case was not handed down until after the reargument, Hartford's concession of the point upon the reargument would seem to be crucial in this regard.

12. This solution of course amounts to a pro rata apportionment. However, Hartford's primary argument went even further. Hartford contended not only that Continental should be held to its own apportionment clause, but that Continental should also share liability for the gap, as follows:

(a) Hartford's share:

Hartford's share under the first apportionment (\$11,898.65)	
<hr/>	X \$3,140.19 = \$ 518.55
Total Indemnity under the first apportionment (\$72,154.00)	

(b) Continental's share:

Continental's share under the first apportionment (\$60,155.35)	
<hr/>	X \$3,140.19 = \$2621.64
Total indemnity under the first apportionment (\$72,054.00)	
	Total: <hr/> \$3140.19

while Continental insisted that the inconsistency of the clauses somehow required equal division of the whole loss.<sup>13</sup> The Court upheld Continental's highly dubious position, giving as its only reason the full indemnity rule.<sup>14</sup>

The unusual circumstances of the *Bergstrom* case do not justify the court's failure to apply the generally accepted rules and doctrine, and thereby to contribute to the development of uniform application of apportionment rules which alone can promise swift indemnification for any loss doubly insured. There was no directly applicable precedent in the *Bergstrom* case of either legal doctrine or business practice. But since the great bulk of apportionment problems are solved by bargaining and arbitration, the court might well, in searching for guidance, have turned initially to the rules there developed.

The National Board of Fire Underwriters (NBFU) has drawn up the only explicit statement of business practice in apportionment,<sup>15</sup> to which

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See Brief for Hartford in the Circuit Court, p. 9, and Communication from Mr. F.W. Stevenson, note 11 *supra*. This apportionment has no parallel in the case law, or apparently in any business practice.

13. Brief for Continental in the District Court, p. 10.

Two grounds were advanced:

(a) Continental argued first that the apportionment clauses should not apply because the two policies covered different "risks," one being a "fire" policy and the other an "accident" policy. Brief for Continental in the District Court, pp. 14-15. It is clear that double insurance does not exist when policies do not protect the insured item against the "same risk." 5 COUCH, INSURANCE LAW § 1039 (1st ed. 1929). However, the term "same risk" does not refer to some mere nominal difference in the property covered, but to some real difference in the *kind* of coverage, although the cases fail to indicate the required degree of difference. See cases cited in 6 APPLEMAN, INSURANCE LAW § 3907 (1st ed. 1942). It certainly would seem logical that coverage is double when the company whose policy is at issue would be liable if no other policy were applicable; but again the cases are not clear. *Ibid.* Continental made the question moot, however, by admitting liability as a matter of fact. [Continental conceded liability initially, and the only issue presented to the jury, which it answered affirmatively, was whether Hartford was liable. *Bergstrom v. Continental Insurance Co.*, 75 F. Supp. 424, 425-6 (E.D. Wis. 1948).] Once admitting liability Continental could not rely on the "same risk" rule to avoid any specific method of apportionment, for the rule only governs liability as such. *Ibid.*

(b) Continental's other argument rested on the fact that there was another policy issued by the Fidelity and Casualty Company covering only part of the damage to the extent of \$1814.40. Continental argued that if the liability covered by that policy were prorated between the three companies, Fidelity and Casualty would be liable for only \$9.58, and that it should not be left with such "Lilliputian" liability. Brief for Continental in the District Court, p. 17. It is doubtful whether the precedent for such an argument is anything but dicta; and even if the precedent is reliable, where the real question in a case is the relative liability of two policies of substantial amounts, the effect of any solution of that question upon the inevitably small liability of a company not even a party to the suit would hardly seem determinative.

14. *Bergstrom v. Continental Insurance Co.*, 75 F. Supp. 424, 428 (E.D. Wis. 1948).

15. Recommendations of the National Board of Fire Underwriters, Non-Concurrent Apportionments (1942). The pamphlet states: "With a view to eliminating the many misunderstandings and disputes arising from apportionments . . . [four rules were adopted in 1934] to serve as a basis for apportionment in all cases. At the time it was generally recognized that none of these rules was perfect. It was believed, however,

most fire insurance companies, including Continental,<sup>10</sup> have subscribed. The NBFU formulation prescribes two different rules where the coverage is similar to that of the Hartford and Continental contracts.

One is the limit of liability rule,<sup>17</sup> under which each company's share is in proportion to the amount it would pay were no other policy applicable. When the face limit of each policy is greater than the loss the rule results in an equal apportionment.<sup>18</sup> But beyond the fact that the rule is but rarely used in the cases for any purpose,<sup>19</sup> the NBFU authorizes its use only where there is a "limiting" clause<sup>20</sup> which precludes full indemnification even where there is no other applicable insurance.<sup>21</sup> Since neither Hartford's nor Continental's policy had such a clause, the rule is not apposite in the *Bergstrom* case.

The other, and more general, NBFU rule derives from *Page v. Sun Insurance Office*,<sup>22</sup> which has been followed in the courts<sup>23</sup> as well as in business practice.<sup>24</sup> The facts in the *Page* case and the *Bergstrom* case are almost

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that if adhered to consistently in all cases of apportionment involving non-concurrent policies the result over a period of time would offset any inequalities growing out of specific apportionments which were not wholly satisfactory to the particular companies. . . ." *Id.* at 1. The pamphlet then goes on to state that the 1934 rules have been revised.

16. Communication to the YALE LAW JOURNAL from Mr. W.B. Sherwood, General Adjuter of the NBFU, Nov. 18, 1948, in the Yale Law Library.

17. "When any or all policies are subject to coinsurance, reduced rate contribution or reduced rate average clauses: The limit of liability rule shall be used. . . ." NBFU Recommendations, *supra* note 15, at 3. The same rule is suggested in Clough, *Apportionment of Compound Non-Concurrent Insurance* in THE FIRE INSURANCE CONTRACT 554, 566 (1922).

18. It should be noted that an equal apportionment does not result when a special "limiting" clause is present.

19. Among the few instances of its use are: *National Security Co. v. Massachusetts Bonding Co.* (S.D.N.Y. 1926) (not officially reported), 40 Harv. L. Rev. 878, 881, n. 17; *Burnett v. Millsaps*, 59 Miss. 333 (1881); *Cherry v. Wilson*, 78 N.C. 164 (1878). The English courts have frequently used the limit of liability rule. *E.g.* *American Security Co. v. Wrightson*, 27 T.L.R. 91 (K.B. 1910).

20. See note 17, *supra*.

21. Under these clauses unless the insured has insurance up to a certain percentage of the value of the property insured he will be treated as a coinsurer for the deficit. *E.g.*, if under a 90% coinsurance clause insured carried insurance only up to 45% of the value of the property insured, in case of a loss he would be reimbursed only for one half of the loss.

One author opposes the use of the limit of liability rule even in the case of coinsurance or average clauses. He suggests that there should be an apportionment between the severally liable companies based on the face limits of their policies, and that only if the liability of the company whose policy has a "limiting" clause is greater under the apportionment than under its clause limit should the clause limit control that company's liability. Ehrenzweig, *Apportionment of Losses under "Non-Concurrent" Fire Policies*, 42 BEST'S INSURANCE NEWS No. 8, 71, 80 (1941).

22. 74 Fed. 203 (8th Cir. 1896).

23. See, *e.g.*, *Schmaelzle v. London & L. Fire Insurance Co.*, 75 Conn. 397, 404, 53 Atl. 863, 865-6 (1903).

24. NBFU Recommendations, *supra* note 15, at 2.

parallel: the coverage of the policies was similar, and in each case only one policy had a pro rata clause. However the other policy in the *Page* case, instead of having an inconsistent apportionment clause, had none at all. Nevertheless the loss was divided on a pro rata basis. And so in the principal case the court might well have looked to the spirit of the *Page* case, and have supplied the Hartford policy with a pro rata clause.

The fact that the *Page* rule is itself based on a doctrine which could equitably standardize all insurance apportionment further supports its use in the *Bergstrom* case. Known as the "sum insured" doctrine,<sup>25</sup> it provides that since each insurer has received premiums for the risk up to the face limit of its policy, the whole amount of each policy should be "the absolute and invariable measure of [its] 'covering capacity' . . ."<sup>26</sup> It might be argued that the *Bergstrom* decision will tend to increase uniformity in apportionment by inducing those boiler insurance companies which use the Hartford clause to adopt the pro rata clause. But as between the companies, which had assumed widely different risks, the decision was inequitable. Furthermore, in ignoring both the "sum insured" doctrine and the NBFU rules the decision represents a retrogression from the goal of uniformly prompt payment to the insured based on agreement rather than litigation.<sup>27</sup>

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25. Ehrenzweig, *supra* note 21, at 71-73; Ehrenzweig and Ehrenzweig, *supra* note 1, at 831-4. The doctrine has been tersely stated: "[T]hat which covers the whole covers every part that constitutes the whole." *Page v. Sun Insurance Co.*, 74 Fed. 203, 204 (8th Cir. 1896).

26. Ehrenzweig, *supra* note 21, at 80 (italics omitted). He continues: "[The 'sum insured'] is an essential part of the contract, while a 'limit of liability' is increased only by a casual event. The insurers measure their risks by premiums calculated with regard to the sums insured. The calculation may take into consideration a 'limiting clause' [i.e. coinsurance or average clause]. But how in all the world can it take into account the 'limit of liability' of a future loss case? And yet these 'limits,' although in no way connected with the contractual consideration (premium), are made to decide on the apportionment of the due indemnity." *Ibid.*

27. Considerable conflict presently exists, especially in cases where there is a loss covered completely by one policy and partially by several others. See eight of the rules listed in REED, *op. cit. supra* note 3, at 256-75; also Robb in RICHARDS ON INSURANCE 466 *et seq.*, n. 78 (4th ed. 1932). In such cases particularly, the "sum insured" doctrine is helpful in choosing between the numerous alternative methods of apportionment, either under the Kinne rule (NBFU Recommendations, *supra* note 15, at 2) or the presently obsolete rule preferred by Ehrenzweig, *supra* note 21, at 74. For Ehrenzweig's criticism of the Kinne rule, which does not strictly conform to the "sum insured" doctrine, see Ehrenzweig, *Apportionment of Losses under "Non-Concurrent Fire Policies,"* 42 BEST'S INSURANCE NEWS No. 9, 63, 64 (1942).