ESSAYS

THE RISE AND FALL OF COMMERCIAL LIABILITY INSURANCE

Kenneth S. Abraham*

The idea that businesses can insure against liability is so axiomatic that it has very nearly become a form of legal reasoning itself. This "insurability axiom," as I shall call it, is an important—and occasionally dispositive—ingredient in debates about the proper scope of tort liability for personal injury. Indeed, in products liability the idea was present and highly influential at the creation of the modern regime. Over time, insurability has come to figure prominently in other fields as well.

It is a great advantage of axioms that their truth need not be continually re-examined. But sometimes the foundations of an axiom have seriously weakened even while the structure it supports still appears to be stable. Today, as in the past, the first line of coverage that businesses in this country use to insure against liability is Comprehensive General Liability, or "CGL," insurance. Yet the availability and character of CGL insurance have changed dra-

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* Class of 1962 Professor of Law and Albert C. Tate, Jr. Research Professor, University of Virginia School of Law.


4 Until 1986, this form of insurance was known as "Comprehensive General Liability" (also "CGL") insurance. The reasons for the change are discussed below. See infra text accompanying notes 18–19.
matically over time. Given these changes, the truth of the axiom that businesses can insure against liability is far from unchallengeable. In fact, some of the most important developments in CGL insurance over the last two decades have involved the placement of limitations on the scope of coverage provided by this form of insurance. Special-purpose forms of insurance that exist alongside CGL coverage have not completely filled the resulting gaps in insurance protection. The practical effect of this development, therefore, has been to limit the insurability of important forms of business liability.

This evolution—one might even say transformation—of CGL insurance is the product of very disparate legal and economic forces. That transformation is far from complete. To understand where commercial liability insurance is heading, it is necessary to appreciate where it has been and what has caused it to evolve.

This Essay tells the story of CGL insurance, from its origins late in the nineteenth century to its contemporary predicament. Unfortunately, the lessons of this story are more cautionary than hopeful. The legal system gave rise to the need for CGL insurance, but at times has affected it negatively; the insurance market has continually adjusted to legal intervention, though not always in the manner that might have been desired; and because forces far more powerful than legal doctrine now threaten CGL insurance, the potential for law to have a positive influence on the evolution of this form of coverage is open to serious question.

I. THE RISE OF CGL INSURANCE

Until the second half of the nineteenth century, liability insurance would have been considered against public policy. Because (then, as now) the imposition of liability was designed in part to deter tortious behavior, insurance against liability would have been thought to excessively encourage what we now call “moral hazard”: the tendency of a party who is insured to exercise less care than would be exercised in the absence of insurance.6

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6 As the next paragraph in the text indicates, liability insurance as we now know it
The situation was roughly the same in England until the enactment of the Employers' Liability Act of 1880, which adopted a form of workers' compensation and made it lawful to insure against the costs of this new form of liability. Following this lead, an English company, the Employers' Liability Assurance Corporation, established a branch in Boston in 1886 and sold its first liability insurance policy in this country in that year. Although it would be twenty-five more years before workers' compensation laws were enacted in the United States, American employers at this time did face potential tort liability to their employees for injuries suffered on the job. In addition, common carriers as well as other businesses faced potential liability for tortious injury to members of the public—that is, non-employees.

The first form of coverage insuring against these liabilities was known as "Employers' Liability Insurance." In its early stages coverage of liability to members of the public was added by endorsement. The insurance was general in the sense that, subject to a limited set of exclusions, it covered all liability for bodily injury arising out of the assured's activities. Coverage against liability for property damage was eventually added. The policies not only covered liability, but the costs of defense as well. Employers' Li-

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7 Employers' Liability Act, 1880, 43 & 44 Vict., c. 42 (Eng.).
10 Kulp, supra note 8, at 23.
11 Id. at 23–24.
ability Insurance apparently thrived, not only economically but also legally. By the turn of the century there was a burgeoning body of case law interpreting the language of the policies and applying it to claims disputes.  

The same forces that generated the demand for businesses to insure against tort liability to their employees, however, eventually led, in the second and third decades of the twentieth century, to the enactment of workers’ compensation laws limiting or abolishing this form of liability. With the advent of workers’ compensation, employers’ potential liability to their own employees declined and, eventually in most states, was all but eliminated. As a consequence, half of the raison d’être for Employers’ Liability Insurance, and all of the reason for its name, disappeared. What remained of value in Employers’ Liability Insurance, however, was in fact of increasing significance and value to businesses: coverage against liability to members of the public. This coverage protected businesses against conventional tort liability, which, of course, would turn out to expand to an extraordinary degree during most of the century. This residual insurance was not only preserved; it became the centerpiece of coverage. Accordingly, the policy’s title was changed to reflect the new scope of coverage: It became “Public Liability Insurance.”

From roughly 1915 to 1940, Public Liability Insurance policies were refined to reflect the predominant form of liability risk, or “hazard,” faced by the policyholder. For example, individual policies separately covering contractors, manufacturers, and owners, landlords, and tenants were developed. Particular hazards posed within each category also were commonly insured separately. Thus, a policyholder might have to purchase individual policies separately “scheduling” or covering elevator liability, products liability, premises liability, and any other hazards posed by its operations or activities.

This approach was cumbersome for both policyholders and insurers. It was a bit like the purchase of telephone service and equipment today: Telephones themselves, other hardware (phone

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13 See id. at 604–08.
14 Kulp, supra note 8, at 23.
jacks, automatic answering devices), local service, long-distance service from the home, and remote long-distance service each are sold separately, even when purchased from the same vendor. In the case of phone service that arrangement may make sense. But businesses during the first half of the twentieth century faced many of the same legal risks, even though the probability of experiencing liability varied. The obvious solution was to provide a general-purpose liability insurance policy that could be used by any business, to vary the premiums charged to take account of the risk level posed by the policyholder, and to encourage the purchase of special-purpose coverage where it was needed, by excluding identifiable special or unusual risks from coverage provided by the general liability insurance.

This change was accomplished in 1941, with the introduction of the Comprehensive General Liability, or “CGL,” insurance policy. The policy was prepared by the “rating bureaus” that not only controlled the development of standard-form coverage at the time, but engaged in cartel-like behavior, such as attempting to fix premium rates, as well. The latter behavior was effectively outlawed five years later, but primary responsibility for the development and modification of standard-form coverage remained in the bureaus, as it remains in their successor organization even today.

The CGL policy has been extremely durable; it has undergone major revision only five times in the intervening years. At the time of the last major revision in 1986, the name (but not the initials) of the policy was changed to “Commercial General Liability,” in what can only be assumed was an effort to eliminate the disadvantage that insurers faced in litigation over whether there was coverage under a “comprehensive” policy. Even the major revisions have not radically altered the overall form of the CGL policy. The basic terms of today’s policy remain remarkably similar to the original 1941 policy. What has changed is that the policy is now subject to a long series of exclusions that were not included in

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17 The single successor to the rating bureaus is the Insurance Services Office, Inc., which prepares form policies for the property-casualty insurance industry. Abraham, supra note 6, at 32-34.
the original version. Nevertheless, the CGL policy is the basic liability insurance policy still purchased by businesses in the United States, accounting for tens of billions of dollars in annual premiums for "primary" CGL insurance alone. As we shall see, however, part of the reason for the durability of the form and apparent substance of the CGL policy is that its role in protecting the ordinary business from civil liability, and the coverage that it provides in practice, have actually been shrinking.

II. The Road to the CGL Crisis

The four decades that followed promulgation of the first CGL policy were a period of growth and stability. The policy became a component part of the post-war American industrial expansion. Just as the insurability axiom provides, American businesses could and did insure against the risk of liability. Sometimes the seeds of a problem, however, are sown many years before the problem actually materializes. In the case of what would eventually become the CGL insurance "crisis" of the mid-1980s, some of these seeds were sown by the efforts of the insurance industry in the 1960s to expand the coverage afforded by the CGL policy, as well as by the industry's botched effort in the 1970s to contract that coverage through use of a "pollution exclusion." With the vulnerabilities created by these revisions of the CGL policy in place, the toxic tort and environmental cleanup liability explosions of the later 1970s and 1980s struck the industry with devastating force. Each of the foundations of the later crisis are worth chronicing, for they reveal the way that economic and legal conditions combined to create an important chapter of insurance history.

A. From "Accident" to "Occurrence"

Early CGL policies insured against any liability for damages incurred because of bodily injury or property damage. This broad grant of coverage was the vehicle through which the CGL policy provided "general" liability coverage, not limited by the nature of the policyholder's business. The insuring language in the early policies did incorporate one important limitation on the general

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coverage afforded by the policy: The harm in question had to be
caused by “accident.” The principal function of this limitation on
coverage was to combat moral hazard—as noted above, the ten-
dency of those who are insured to exercise less care than they
would exercise if they were not insured. The “accident” limitation
ensured that there would be no coverage of liability for non-
accidental injury or damage, that is, harm that the policyholder ex-
pected or intended.

A lurking question that emerged over the years, however, was
whether the “accident” limitation implied temporal restrictions as
well. By the 1950s, a division between policyholders and insurers
over the meaning of that term emerged in litigation. Insurers took
the position that the term “accident” had a temporal component
and, therefore, did not comprehend coverage of liability resulting
from long-term exposure to injurious conditions.20 In contrast, poli-
cyholders contended that the sole function of the term “accident”
was to combat moral hazard, and that the term therefore contained
no temporal component. In effect, the issue was whether an injury-
causing event had to go “boom” in order to constitute an accident
within the meaning of the CGL policy language.

There probably was not enough case law by the end of the 1950s
to reflect a clear trend in favor of insurers or policyholders on this
issue. But to a large extent the insurance market took the issue out
of the hands of the courts beginning in the early 1960s. Around this
time certain Lloyds and London market CGL insurers21 saw a busi-
ness opportunity in the division between policyholders and insurers
on the meaning of an insured “accident.” These insurers began to
market CGL policies in the United States containing an endorse-
ment affording coverage of liability for damage caused not by
“accident” but by “an occurrence,” which they defined to include
any accidental injurious exposure, regardless of duration. The
American market began to respond in kind by offering occurrence
endorsements of its own, thus to a large extent rendering the dis-

1955).
21The so-called London market is comprised of unincorporated syndicates
operating out of Lloyds of London and incorporated “London market insurers” who
often participated together in the insuring enterprise by taking a “line” on (that is,
insuring a part of) CGL and other policies issued at the time.
pute over the meaning of the term "accident" moot. To put a punctuation mark at the end of this affair, in 1966 the standard-form CGL policy was revised to cover liability for injury or damage arising out of an "occurrence" rather than an "accident." Ever since, the standard-form CGL policy has been known as an "occurrence" policy.\textsuperscript{22}

This shift from "accident" to "occurrence" coverage would almost certainly be recognized today even by insurers as a largely salutary development. Nevertheless, because the shift would eventually confirm that CGL policies potentially cover slow-to-develop toxic tort and environmental liabilities, the move to occurrence-based coverage helped to prepare the way for the crisis that would develop nearly twenty years later.

\textbf{B. The Development of the Qualified Pollution Exclusion}

Almost immediately after promulgation of the 1966 CGL "occurrence" policy, insurers seem to have begun harboring doubts about the wisdom of what they had done. Consider the new risks that insurers had confirmed were now covered under the revised CGL policy. The policy defined an "occurrence" in pertinent part as "an accident, including injurious exposure to conditions, which results . . . in bodily injury or property damage."\textsuperscript{23} Given the insurers' prior position as to the meaning of the term "accident" in the older CGL policies, the lion's share of the additional insurance provided by the shift from "accident" to "occurrence" coverage was almost necessarily insurance against liability for injury or damage caused by pollution. Indeed, although it is possible to conceive of a few forms of harm caused by "injurious exposure to conditions" that are not the result of pollution (repetitive stress injury and radiation damage, for example), most bodily injury and property damage caused by continuous exposure to harmful conditions are related to pollution. Thus, the definition of an "occurrence"

\textsuperscript{22} There are two reasons for the name: to distinguish the new, occurrence-based CGL policy from the older, accident-based policy; and to distinguish it from "claims-made" policies, which also cover liability caused by an "occurrence" but embody a different "trigger" of coverage. For discussion of this difference, see Hartford Fire Ins. Co. v. California, 509 U.S. 764 (1993); Sol Kroll, The Professional Liability Policy "Claims Made," 13 Forum 842 (1978).

\textsuperscript{23} Abraham, supra note 18, at 299.
now clearly afforded policyholders coverage against liability for pollution.

Yet in the years immediately following the 1966 revision of the CGL policy, the first highly publicized major environmental disasters—the Santa Barbara oil spill and the grounding of the Amoco Cadiz—brought home to insurers the extent of their newly-acknowledged exposure. Earth Day, a series of simultaneous nationwide demonstrations held in April 1970, further dramatized the extent of public support for environmental protection and, therefore, the potential for the imposition of environmental liability in scope and magnitude not previously experienced.

Insurers' dawning realization that the recent shift of the CGL policy from an "accident" to an "occurrence" basis left them exposed to enormous potential environmental liability led them quickly to attach "pollution exclusion" endorsements to their policies. These endorsements began to appear in 1969 and were common shortly thereafter. Interestingly, the endorsements did not attempt to exclude coverage of all liability for pollution-related damage. Rather, coverage was typically excluded unless the "discharge, dispersal, release or escape" of pollutants causing such damage was "sudden and accidental."24 In 1973 the substance of these endorsements was incorporated into the standard-form CGL policy itself, as what became known as the "qualified" pollution exclusion.

Significantly, at the time that pollution exclusion clauses were first submitted to state insurance regulators for approval, the rating bureaus responsible for the submissions prepared cover letters explaining the new provision. Many of these letters stated that the purpose of the exclusion was merely to "clarify" the scope of pre-existing coverage because, in most instances, the exclusion would produce "no change" in coverage under CGL policies.25 At the very least, these letters understated the scope of the change that the insurers sought to accomplish with the pollution exclusion. For this reason the representations in the letters would ultimately plague

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24This was the language that eventually found its way into the pollution exclusion incorporated in the 1973 revision of the CGL policy. Individual insurers, however, sometimes employed slightly different language.

insurers’ efforts to apply the exclusion when policyholders later began their fight to obtain coverage of liability for gradually occurring pollution under CGL policies containing pollution exclusions.

C. The Liability Explosion and Its Interaction with CGL Policies

The years between 1975 and 1985 witnessed an enormous expansion in potential civil liabilities. The first significant mass products liability actions were filed in the 1970s. By the early 1980s, cases involving asbestos, the Dalkon Shield, and DES were a staple of judicial dockets. These cases involved thousands or tens of thousands of claimants and hundreds of millions or even billions of dollars of potential liability. Neither the defendants in these lawsuits nor their CGL insurers could know at the time whether these new mass tort claims would continue to escalate in frequency and scope or would eventually reach the steady state that hindsight can now identify as their true level.

Then, in 1980, what turned out to be an even more devastating liability bombshell exploded: Congress enacted into law the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), or "Superfund" Act. As it was soon interpreted, CERCLA imposed retroactive, strict, joint and several liability for the cost of cleaning up hazardous waste deposit sites on any past or present owner or operator of a site, and on any offsite party who generated any hazardous material deposited at a site. Originally conceived as a program costing several billion dollars, within a decade estimates of the total cost of Superfund cleanup (as well as cleanup under analogous state liability regimes) exceeded

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26 There has been considerable debate in the literature over whether the actual incidence of liability expanded during these years. For an extensive catalogue of this literature, see Marc Galanter, An Oil Strike in Hell: Contemporary Legends About the Civil Justice System, 40 Ariz. L. Rev. 717, 721 n.14 (1998). Whatever the correct view, in my opinion there can be little question that the scope of potential liability expanded during this period, for the reasons noted in the text.


At that time, the total surplus (in effect, net worth) of the American property/casualty insurance industry was roughly twenty-five percent of this figure.

The rise of these new liabilities placed the industry in a triply-exposed position: 1) the "trigger," or event that activates coverage under CGL policies, was interpreted so as to make these policies especially vulnerable to claims involving long-tail liabilities; 2) the pollution exclusion was not interpreted in the manner expected by the insurance industry, thus frequently rendering it an ineffective barrier to claims for coverage of pollution liability; and 3) these vulnerabilities combined with the periodic underwriting "cycle" to which the industry has been subjected over the years so as to exacerbate the industry's financial exposure.

1. The Long-tail "Trigger"

The "trigger of coverage," or event that activates insurance under CGL policies, has always been the occurrence of bodily injury or property damage during the policy period. This trigger results in coverage of liabilities with a "long tail"—that is, coverage under a policy that was in effect at the time of injury or damage, even though a claim alleging liability for this injury or damage is not filed against the policyholder until many years later. Long-tail liabilities are precisely what were involved in the new mass tort and CERCLA regimes. Plaintiffs in the former sought damages arising out of long-latent but previously-existing harms such as lung disease (asbestos), cancer (DES), and reproductive-system injury (the Dalkon Shield). Similarly, CERCLA liability was (and is) typically imposed where hazardous waste has, without anyone's knowledge, contaminated underground water over a period of years. Upon proof of trigger and the other prerequisites to coverage, CGL policies sold decades before mass tort and CERCLA liabilities were imposed could therefore be held responsible for insurance of these

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30 See, e.g., A.M. Best Co., Best's Aggregates and Averages: Property-Casualty 2 (1991) (stating that total industry "policyholders' surplus" in 1990 was $138 billion).
liabilities. Not only were these liabilities potentially enormous, but because the liabilities were in large measure completely unexpected, CGL insurers had never collected premiums commensurate with this enormous potential coverage responsibility.

In addition to the trigger of coverage, a number of courts ruled that every policy that was in effect during a year or years when indivisible injury or damage for which the policyholder was liable occurred was potentially responsible for coverage, and that the policyholder could select the policy or policies that would bear this responsibility. As a consequence, every insurer that had ever insured a policyholder might be held to cover liability arising out of long-latent injury or damage, under legal doctrines or statutory liability regimes that had not even existed at the time the policies were issued. Thus, a policy covering liability for property damage that was issued in 1955 could be held liable for damage that occurred during that year, in a lawsuit brought in 1982 seeking to impose liability on the policyholder for the cost of cleaning up all pollution occurring in all the years between 1955 and 1982.

Policyholders facing these liabilities of course quickly turned to their CGL insurers for coverage. When the insurers declined to pay the claims, complex and prolonged litigation ensued. Although it was some years before any of these claims came to trial, legal and policy interpretation rulings by the courts during the first half of the 1980s made it clear that insurers’ putative defenses would not automatically or always prevail. Perhaps the most celebrated set of these rulings concerned the pollution exclusion.

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33 See, e.g., id. at 1050.
35 See generally Kenneth S. Abraham, Environmental Liability and the Limits of Insurance, 88 Colum. L. Rev. 942, 960–70 (1988) (discussing how early 1980s judicial constructions of CGL policies made it more difficult for insurers to write such policies).
2. The Meaning of the "Sudden And Accidental" Pollution Exclusion

The key phrase in the qualified pollution exclusion incorporated into CGL policies in the early 1970s was the exception to the exclusion for damage caused by pollution discharges that were "sudden and accidental." That is, coverage was not excluded in cases involving liability for bodily injury or property damage resulting from "sudden and accidental" discharges. Although the long-tail nature of mass tort and CERCLA liability meant that pre-pollution-exclusion policies were often implicated in CGL claims, the pollution exclusion was a major line of defense invoked by insurers in claims against policies issued after 1970.

As coverage litigation proceeded, however, it became apparent that in many jurisdictions the exclusion would not bar coverage of liability for damage caused by the gradual discharge of pollutants. In one of the great examples of persistence and ingenuity in the history of civil litigation, attorneys for CGL policyholders often successfully argued that the word "sudden" in the exception to the pollution exclusion did not have a temporal component. Rather, they contended, the word was ambiguous because it might mean either "abrupt" or "unexpected," and under familiar principles of interpretation should be construed against the drafter (the insurer) in favor of coverage. In a number of cases the insurance industry's decade-old letter to state regulators representing that the addition of the exclusion to CGL policies typically worked "no change" in the scope of coverage also figured prominently. Some state supreme courts ultimately developed the doctrine of "regulatory estoppel" to preclude insurers from asserting that the exclusion meant something other than what had been represented to the regulators.

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37 See supra text accompanying note 25.
To be sure, insurers eventually won roughly as many judicial victories on this issue as policyholders, but the very fact that policyholders had sometimes succeeded in convincing courts that "sudden" could mean "gradual" apparently convinced many insurers that they could no longer hope to draw a reliably enforceable line between covered and non-covered pollution liability. It would have to be all or nothing, and covering all pollution liability was apparently out of the question. In the meantime, however, each insurer had a portfolio of several decades' worth of CGL policies that were potentially on the risk for its policyholders' CERCLA liabilities.

3. Exacerbation by the Underwriting Cycle

For much of the twentieth century the property/casualty insurance industry had been subject to cycles involving years of level premiums followed by sharp premium increases. Because of the long tail on CGL liabilities, a substantial portion of insurers' return in this line of coverage is produced by investment income earned during the years when premiums are invested prior to payout. As insurers clamored for premium dollars to invest at the double-digit rates of return that prevailed in the late 1970s, a CGL price war broke out and the "underwriting cycle" turned hard for insurers. Premiums were steady and profits declined. These poor financial results were experienced at the same time that CGL insurers' underlying potential cost base was being radically expanded by the rise of the new civil liabilities and expansive judicial interpretations of CGL policy language: All the ingredients for what became the CGL "crisis" of the mid-1980s were, therefore, finally in place.

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*b* For an account of the background of the industry's decision to attempt to exclude all pollution coverage from the CGL policy, see Hartford Fire Ins. Co. v. California, 509 U.S. 764, 770–78 (1993).

III. THE CRISIS AND ITS AFTERMATH

The industry's problems came to a head in the insurance "crisis" of 1985–86. Premiums for many CGL policyholders skyrocketed, sometimes doubling or tripling. For a time, in some states, certain classes of policyholders (day-care centers and municipalities, for example) found that they could not purchase coverage at any price. In the years leading up to the crisis, the industry had been engaged in the periodic process of revising the standard-form CGL policy. Almost simultaneously with the advent of the crisis, the new CGL form, containing an "absolute" pollution exclusion, was promulgated. In a period of months, pure availability problems began to abate, but concern about pricing instability and the prospect that premiums would continue to skyrocket in the future was widespread. 42

The causes of the "crisis" were complex and to this day are still disputed. 43 There can be little doubt, however, that changes in civil liability, existing and threatened, together with the perceived unpredictability of results in coverage disputes, were major contributors. A number of other unusual factors probably converged to make matters worse. 44 But whatever the respective contributions of its various causes, the effects of the crisis have been lasting. CGL insurance has not been the same since.

A. Tort Reform

In the rush to place blame for the crisis, the tort system received a substantial share of finger pointing. Task forces were formed to study the causes of the crisis and propose solutions. Plaintiffs' at-

42 See Abraham, supra note 41; Priest, supra note 1, at 1572–73.
44 For a particularly compelling argument that the pendency of the Tax Reform Act of 1986 affected insurers’ loss-reserving practices, which in turn influenced premium levels, see Kyle D. Logue, Toward a Tax-Based Explanation of the Liability Insurance Crisis, 82 Va. L. Rev. 895 (1996).
torneys blamed the insurance industry, but many in the defense community blamed a tort system that was said to be out of control. Businesses, insurers, and others affected by both expanding tort liability and the insurance crisis—manufacturers’ groups, physicians, and municipalities, primarily—descended on state legislatures to lobby for tort reform.

The result of this lobbying was the enactment of the first tort reform statutes of general application ever adopted, in dozens of states. The most prominent reforms affected the measure of damages rather than liability standards: ceilings on recoverable pain and suffering or punitive damages, modifications of the collateral source rule, and limitations on the scope of joint and several liability. The actual impact of these statutes on the frequency and severity of tort liability and on CGL premiums has never been entirely clear. But in my view, the enactment of tort reform statutes had two other discernible, even if not tangible, effects. First, the willingness of the state legislatures to take action in response to the urgings of the “defense community” had a reassuring psychological impact on both insurers and policyholders. Second, legislative action also served as a political shot across the judicial bow, bringing the period of expansion in tort law and increasingly pro-policyholder interpretation of CGL policies to an end. The law in these areas as it then stood has since tended to crystallize, without further expansion or retrenchment.

In retrospect, it appears that the stabilization of premiums that ensued in the late 1980s may have been due at least as much to the effects of the Tax Reform Act of 1986 as to state tort reforms. Interestingly, however, although the enactment of tort reforms may have calmed the overall panic among insurers and policyholders during those years, it did not return matters to the status quo ante. Paradoxically, instead of bringing policyholders and insurers back together in the joint enterprise of managing liability risk, the en-

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45 See, e.g., Peter W. Huber, Liability: The Legal Revolution and its Consequences 9 (1988) (referring to the “ceaseless expansion” of the tort system).
48 See Logue, supra note 44, at 897.
acement of tort reform tended to drive them apart. With the reassurance provided by the new tort reforms, many policyholders now felt more confident managing a higher proportion of their liabilities without the aid of conventional commercial liability insurance. This new policyholder independence had a lasting effect on CGL insurers.

B. The Rise of the “Alternative Market”

Ironically, although insurers and commercial policyholders were united in seeking tort reform, the crisis also created a split between these two camps that has never been repaired. Concern about the future stability of pricing and the reliability of coverage was a natural side effect of the crisis. During the crisis, commercial policyholders had often found it advantageous to employ alternative methods of managing liability risk. When the crisis subsided, these alternatives became permanent fixtures in the arsenal of risk-management tools employed by policyholders. First, policyholders began to increase the size of the self-insured retentions (“SIRs”), or deductibles, to which their CGL insurance was subject. A disproportionate share of the cost of coverage is incurred to process comparatively small claims, since certain unvarying administrative costs (for example, the expense of opening a file, assigning an investigator, completing necessary paperwork, etc.) must be incurred whether the claim turns out to involve a large or small sum. By increasing their SIRs, policyholders were able to capture greater savings on these disproportionate costs. Moreover, under excess policies providing that the costs of defending against claims within the SIR were payable by the policyholder, immediate premium savings (though not necessarily long-term savings) would be even larger. Indeed, as SIRs increased to six and even seven figures, a policyholder’s SIR began to function more like a primary CGL policy, with the first layer of “primary” commercial coverage actually functioning more like excess coverage.

A second set of alternatives to conventional commercial insurance that policyholders also employed with increasing frequency actually constituted risk-transferring substitutes to commercial

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*See Priest, supra note 1, at 1570.

*Id. at 1571.
coverage. Policyholders formed captive insurers, risk-retention groups, and other pooling arrangements to provide themselves coverage. These devices often enabled policyholders to deal directly with the reinsurance market through these closely controlled risk-transferee enterprises, thus allowing access to risk diversification services without the need for conventional CGL insurance as an intermediary. The business lost in this way by the commercial market to the alternative market never returned. Policyholders learned in the crisis that they need not rely entirely on the commercial insurance market, understood thereafter that they did not have to subject themselves as completely to the risk that premiums would skyrocket again in the future, and came to regard commercial insurers with greater distrust than in the past. As a consequence, this alternative market has garnered an increasing percentage of insurance premium dollars in the ensuing years.\(^\text{23}\)

This development has proven to be highly significant in ways that would not have been obvious when it began. As noted above, commercial policyholders purchase CGL coverage in primary and successive “layers” of excess insurance. Because the alternative market tends to cover lower as distinguished from higher layers of risk, the commercial market still supplies a large portion of excess coverage. The effect of this division of coverage responsibility is that comparatively small losses are self-insured “internally” by the policyholder, whereas comparatively large losses are covered by the “external,” commercial market. Increasingly, therefore, it is big claims that are made against commercial insurers, and big claims that are litigated.

Even more importantly, the rise of the alternative market has helped to undermine long-term relationships between policyholders and commercial insurers. Whereas it was once common for policies to be annually renewed almost automatically, policyholders now shop for coverage, and are constantly considering alternatives to commercial coverage, and commercial insurers know it. In the past, a long history of good relations between a policyholder and its insurer, as well as the desirability of preserving good relations

\(^{21}\) Id. at 1570.

for the future, meant that at least some doubtful or disputable claims were negotiated to settlement. That practice is now changing. Because this year’s policyholder may not renew its policy next year anyway, insurers have much less incentive to settle close claims in order to preserve business relations. Policyholders now speak facetiously about an implied “big claim” exclusion in CGL policies, referring to the perceived tendency of commercial insurers to deny any substantial claim by asserting what policyholders regard as questionable policy defenses. What was once a cooperative relationship has thus evolved into an adversarial one.

C. The New Economics of Insurance

Like the financial services industry generally, the insurance industry is overcapitalized. Premiums in CGL insurance have been adequate for a number of years. With coverage underpriced, insurers seeking to maintain market share are likely to write whatever business they can and later to engage in what might be called “point-of-claim underwriting”—denial of the claims necessary to make operations profitable. Inevitably, the larger the claim, the greater the impact of its denial on the insurer’s bottom line. This state of affairs creates a vicious cycle in which claims are denied, litigation ensues, and policyholders find the purchase of future CGL coverage less and less attractive because of the prospect that it will not provide protection against sizable claims. As less coverage is purchased, the denial of sizable claims becomes even more essential to profitability, and the cycle is reinforced.

In addition, the civil liability wars of the past twenty-five years have created a virtually self-perpetuating, blue-chip plaintiffs’ bar. Large recoveries result in large contingent fees, which result in war chests that are available to finance the next major suit or class action. Because big liabilities continue, big insurance claims continue. Moreover, asbestos and environmental cleanup coverage litigation has spawned a generation of experienced mega-coverage lawyers in some of the most respected law firms in the country. These lawyers have a sizable specialty-specific capital investment in their

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53 A.M. Best Co., Managing the Enterprise, A Special Supplement to Best’s Rev. and Best Week 3 (Jan. 2000).
54 Id. at 20–21.
insurance coverage expertise to protect and amortize. To accomplish this they need to litigate coverage claims.

Finally, whatever might be said in favor of alternative dispute resolution mechanisms in other fields, the principal such mechanism that has sometimes been used in insurance—mandatory, binding arbitration—has never gained a substantial foothold in the CGL insurance field. One reason is that, because of the multi-year trigger of coverage that typically figures in mega-coverage litigation, there are dozens of insurer defendants and the streamlined, short-and-sweet hearings characteristic of arbitration are infeasible. Another reason is that policyholders do not trust that arbitration will generate results as favorable as will litigation.\(^5\) If big claims could be expeditiously and equitably resolved through arbitration, insurers' incentive and ability to deny such claims would be reduced, and an atmosphere of greater cooperation might well be engendered. In the absence of such a possibility, however, the big claim exclusion has both room and reason to operate.

**IV. THE FUTURE OF CGL INSURANCE**

The era of the big-claim exclusion cannot last. Insurers cannot expect to continue selling coverage that policyholders eventually come to perceive as being merely a ticket to expensive litigation when a major liability is incurred. Policyholders will not be willing to pay substantial sums for such coverage. Consequently, the current predicament is not an equilibrium. The logic of this situation strongly suggests that CGL insurance must move in one of two directions: toward even less or toward more coverage.

**A. Continued Product Fragmentation**

Certainly the current trend—and the direction in which CGL coverage has been heading for decades—is toward ever more nar-

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\(^5\) The absence of a jury undoubtedly is part of the reason for this distrust. In addition, arbitration clauses sometimes require that arbitrators have experience in the insurance industry. Policyholders probably suspect that individuals with this sort of experience will be biased in favor of insurers. Finally, some arbitration clauses require that arbitrations comply with the terms of foreign statutes (such as the English Arbitration Act of 1996) or that the actual arbitration proceeding be held abroad.
row CGL coverage. The original "comprehensive" general liability insurance policy contained only five exclusions. Over time the exclusions have proliferated. Today there are a minimum of fifteen exclusions in the standard-form CGL policy, occupying nearly four pages of fine print. Often these policies also contain "manuscript," or customized endorsements embodying additional exclusions. Thus, the introduction of the qualified and then the absolute pollution exclusions were only the most prominent examples of this process. What was once broad general liability insurance has now become much narrower general liability insurance. Depending on their liability exposures, policyholders must now purchase different forms of special-purpose coverage to fill the gaps created by the exclusions from coverage. It is no surprise, then, that the adjective in the title of the policy for its first forty-five years—"comprehensive"—was changed to "commercial" in 1986. This change was an emblem of the narrowing of coverage that had already been occurring.

Of course, the more extensive the exclusions from CGL coverage, the greater the opportunities—legitimate and otherwise—for insurers to identify bases for denying claims. The proliferation of exclusions expands the bases for denial not only directly but indirectly as well. The more extensive the exclusions from CGL coverage, the greater the policyholder demand for gap-filling forms of coverage. For example, to the extent that the "sistership" exclusion in CGL policies can be read to preclude coverage of liability for the cost of recalling products from the market, the greater the demand for targeted "recall" insurance. A policyholder's decision to purchase recall insurance may be made out of an excess of caution, or because the recall policy provides coverage that is broader than what is arguably not excluded under a CGL policy. Nevertheless, a CGL insurer faced with a claim for coverage of certain of

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36 These exclusions precluded liability assumed under contract; liability arising out of aircraft, watercraft, or motor vehicle operation; statutory liability to employees; damage to property owned or occupied by the insured; and water damage liability. Malecki, et al., supra note 15, at 239.

37 Abraham, supra note 6, at 395–98.


39 This exclusion precludes coverage of the cost of recalling certain products. For an example, see exclusion "m" in Abraham, supra note 6, at 398.
the costs of recall can cite its policyholder's purchase of recall insurance in support of the argument that the policyholder understood that the CGL policy provided no recall coverage at all.\(^6\) In any event, even where coverage under the two policies does overlap, the principle of indemnity will prevent the insured from recovering more than the amount of its loss.\(^4\) There is therefore a further disincentive to claim coverage under the CGL policy. For these reasons, the narrowing of coverage has a potentially escalating effect that tends to narrow coverage even further.

These are merely examples of a general trend toward narrowing CGL coverage that could eventually produce an equilibrium. Policyholders would recognize that CGL coverage is "general" only; that it covers only those liabilities that every business can expect to incur: slips and falls on business property, personal injury to third parties caused by employees not driving, flying, or operating watercraft, and the like. Any form of liability not risked by each and every CGL policyholder, however, would have to be the subject of separate coverage, either purchased separately or as an add-on to CGL policies: products liability, product recall liability, pollution liability, defamation liability, intellectual property liability, directors and officers liability, professional liability. Already some of these forms of liability are treated in exactly this manner. The full logic of narrowing suggests that eventually all particular liabilities would be excluded from coverage under CGL policies and would have to be the subject of special-purpose coverage.

This may well be the most efficient division of labor among forms of coverage. But it should not be supposed that the availability of special-purpose coverage can be the twenty-first century's method of fulfilling the insurability axiom. On the contrary, existing special-purpose policies are themselves replete with coverage-limiting exclusions designed to combat moral hazard and adverse selection by actual and potential policyholders.\(^6\) Most of these

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\(^4\) See, e.g., McNeilab, Inc. v. N. River Ins. Co., 645 F. Supp. 525, 528 (D.N.J. 1986), aff'd, 831 F.2d 287 (3d Cir. 1987) (denying insurance coverage for costs of Tylenol recall under a CGL policy, in part because insured had purchased, then let expire, a separate recall policy).

\(^6\) See Abraham, supra note 6, at 190.

\(^6\) For example, special-purpose policies recently have emerged to cover employment-related liabilities that are arguably excluded by CGL policies. See, e.g., Jeffrey P. Klenk, Emerging Coverage Issues in Employment Practices Insurance: The
forms of coverage have in short order replicated the evolution of the CGL policy; by no means do they fill all the gaps in the CGL policy's coverage of business liabilities.

It may be that coverage of certain forms of liability under any kind of policy would be suboptimal. It seems likely, however, that less overall coverage is generally available under the CGL and special-purpose policies than is optimal. The predicament of CGL insurance, therefore, cannot be solved simply by a wave of the hand in the direction of special-purpose coverage. Rather, the current condition of CGL insurance is emblematic of business liability insurance and, indeed, of all business insurance as a whole.

B. Breaking the Cycle?

The problem that now plagues CGL insurance is the inability of insurers and policyholders to cooperate in their mutual interests. No single policyholder has a sufficient incentive to refrain from making a big coverage claim whose very magnitude may give it settlement value, regardless of the strength of the claim. No single insurer has a sufficient incentive to pay a big claim in full, even when the bases for denying the claim are weak. Yet it would be in the interests of both insurers and policyholders in the aggregate if implausible big claims were not litigated, and valid big claims were paid without dispute. A method of solving this collective action problem—some might call it a two-person prisoner's dilemma—would be required for the CGL expansion scenario to materialize.

There are two possibilities, though I am not optimistic that either will occur. The first might come from within the insurance industry itself. To date, something of a race to the bottom has taken place among insurers. To end this race, a single leading insurer would have to make a credible pre-commitment to providing and paying valid claims under expansive CGL insurance. Premiums for such coverage probably would have to be substantially larger than current premiums, since the policy would not be subject to an

implied "big claim" exclusion and would contain fewer express limitations on coverage than the current CGL policy. This insurer pre-commitment would have to be met in turn by a willingness on the part of a sizable number of major policyholders to purchase expansive CGL insurance from this insurer over a period of years and to make only valid claims under their policies. Part of this response by policyholders could be achieved by the sale of multi-year rather than annual policies. At present, however, the continuing commitment and trust on both sides that would be required to make this arrangement work is unlikely. Defections by policyholders in the face of very large liabilities are possible, and the temptation for an insurer who had already received a large, multi-year premium to deny close claims would be substantial. Nor does mutualization offer a means of overcoming this difficulty since, in connection with any given policyholder's big claim, the other policyholders would be subject to the same incentives as the insurer in a stock company.\textsuperscript{43}

A second solution to the CGL collective action problem might come from the courts, through development of a strong, clear principle of interpretation in CGL coverage disputes. For example, in cases where policy language does not definitively resolve coverage disputes, courts might use the concept of commercial insurance as a risk-sharing arrangement among policyholders to create coverage norms. The question in each case would then be whether the majority of policyholders would have chosen to purchase coverage of the claim at issue for an actuarially fair premium. I have argued elsewhere that this principle actually operates now in some cases.\textsuperscript{44} The problems with this approach, however, are likely to render it ineffective. The outcome in individual cases would be far from

\textsuperscript{43} The story of ACE and X.L. is illustrative. To address the difficulty of obtaining satisfactory CGL coverage during the crisis of the mid-1980s, these two insurers were formed in Bermuda by American industrial corporations. Within a decade, however, coverage disputes between policyholders and these two companies replicated disputes in the conventional commercial market. Because the policies issued by these companies require that disputes be arbitrated, these disputes are not reflected in reported opinions. But the range of issues that arise under their policies is extensive. See Lorelie S. Masters, ACE and X.L.: A New 'Batch' of Coverage Issues, Coverage, Jan/Feb 1999, at 24–30.

predictable for a number of years, and the fact that insurance is state law that is itself subject to uncertain choice-of-law rules in CGL coverage disputes would make the development of uniform rules very difficult. The parties would continue to have incentives to litigate because of the potential advantages of forum and choice-of-law shopping. In short, a judicially-created solution to the CGL collective action problem is not on the horizon.

CONCLUSION

The CGL insurance policy has had a good run. Important for roughly half a century, it continues in existence now, but only as a shadow of its former self. Legal evolution and ever-greater levels of distrust between policyholders and insurers have combined to make the prospects for the policy's continued viability dim indeed. The rise and fall of the CGL policy is a case study in the ways that legal change may interact with commercial practice to render once-useful products increasingly obsolete.