INSURANCE COVERAGE FOR ENVIRONMENTAL CLAIMS

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I. INTRODUCTION

A. Companies Have Experienced an Exponential Increase in Potential Environmental Liability

The explosion of environmental laws in the 1980's has dramatically increased the liability exposure of businesses that use, handle, store, or discard chemicals, products containing chemicals, hazardous waste or petroleum products.

B. Liability Without Fault

The federal Comprehensive Environmental Response, Compensation Liability Act, 42 U.S.C. §9601 et seq. (popularly known as "Superfund" or "CERCLA"), the Resource Conservation Recovery Act ("RCRA"), 42 U.S.C. §6901 et seq., and most state "little Superfund" statutes impose liability for releases and threats of releases of hazardous substances and petroleum products upon a broad range of current and former "owners" or "operators" of facilities from which there is a release or threat of release of hazardous substances, transporters of hazardous substances, and persons or companies that arrange for the shipment of hazardous substances to facilities at which a release or threat of release of hazardous substances occurs.

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C. Liability for Cleanup Costs

Under these environmental statutes, a company may be liable for the costs of cleanup even where the environmental damage was not the company's fault or the company had no knowledge of the spill, leak or ensuing environmental damage. A responsible party can be held jointly and severally liable for the full cost of cleanup.

D. Liability is Joint and Several

Assessment and remediation of environmental damage is extraordinarily expensive. Superfund site cleanups cost millions and even billions of dollars.

E. Risk Transfer

Insurance protection has become extremely important, if not critical, to their business security.

II. EVALUATION OF COMPANY'S INSURANCE COVERAGE/POLICIES

A. Types of Policies

- Comprehensive General Liability ("CGL")
- Umbrella
- Excess Liability, or Excess Umbrella
- First Party Property Insurance
- Pollution Policies

B. Significant Policy Terms for Environmental Coverage

1. Policy Period

2. Policy Limits

   a. Indemnity limits

   b. Defense limits

   c. Deductibles, Self-Insured Retentions (SIRs) or Retrospective Rating Provisions

   d. Amount of underlying limits that must be "exhausted" before coverage is triggered (excess policies)

3. Insuring Agreement

   a. Indemnity. Liability policies issued after 1965 provide that the insurer will pay "all sums which the insured becomes legally obligated to pay because of bodily injury or property damage caused by an 'accident' or 'occurrence'."

   b. Personal injury coverage. In addition to coverage for bodily injury and property damage many liability policies provide coverage for "personal injury" which is defined to include, among other things, "wrongful entry" and "interference with the right of private occupancy." This language has been interpreted to include coverage for environmental claims. Personal injury can be very valuable because often it is not subject to a pollution exclusion.

c. Defense. Primary liability policies usually state that the insurer has the right and duty to defend any suit against the insured alleging bodily injury or property damage even if any of the allegations of the suit are groundless, false or fraudulent.

d. First Party Property Insuring Agreement.

(1) Named peril policies provide coverage for direct losses resulting from the perils identified in the policy.

(2) "All-risk" or "special multi-peril" policies cover any "direct physical loss" which is not explicitly excluded.

4. Pollution Limitations

a. No Pollution Exclusion. Policies issued before 1972 usually do not contain any pollution exclusion. However, other provisions may present coverage obstacles.

b. Limited Pollution Exclusion. Most CGL, umbrella and excess policies issued after 1972 include what is commonly referred to as the "limited pollution exclusion," or the "sudden and accidental" pollution exclusion:

> This policy shall not apply ... to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, solids, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water unless such discharge, dispersal, release or escape is sudden and accidental. (emphasis added)

(1) Courts interpreting the limited pollution exclusion have disagreed on the meaning of the terms "sudden," "sudden and accidental," and "accidental."

Some courts have held that to be sudden a release or escape of pollutants must have been abrupt, as well as unexpected. See, e.g., Lumbermens Mut. Cas. Co. v. Belleville Industries, Inc., 407 Mass. 675, 689 (1990).

Other courts have held that an escape of pollutants that is unexpected and unintended is "sudden and

accidental" and therefore covered. See, e.g., Broadwell Realty Services Inc. v. Fidelity and Cas. Co., 528 A.2d 76 (N.J. Super. App. Div. 1984); Claussen v. Aetna Cas. & Sur. Co., 259 Ga. 333, 380 S.E.2d 686 (Ga. 1989).

(2) In states where a release of pollutants must have been abrupt to be covered, courts focus on the following factors to determine whether a discharge was "sudden and accidental":

- the physical cause of the release
- the period of the time the release continues undetected and whether proper monitoring would have caused its detection more promptly
- the company's response to the detection or discovery of a release
- whether repeated releases took place under the same circumstances.

c. The "Absolute" Pollution Exclusion. Liability policies issued after 1985 generally include a broader pollution exclusion, colloquially referred to as the "absolute pollution exclusion." This

exclusion states that the policy will not cover claims for bodily injury or property damage caused by discharges of pollutants, regardless of the nature of the release.

(1) In limited circumstances, environmental claims may be covered by policies with an "absolute" pollution exclusion. In Re Hub Recycling Inc., 106 B.R. 372 (D.N.J. 1989) (finding that absolute pollution exclusion did not unambiguously preclude coverage for all recyclables).

d. Pollution Exclusions in First Party Policies.

(1) Many first party policies contain exclusions for loss caused by deterioration, contamination, or pollution.

(2) In Jussim v. Mass. Bay Ins. Co., ___ Mass. ___, No. Hd-6131 (April 15, 1993), the Massachusetts Supreme Judicial Court ruled that an insured homeowner could recover costs incurred because oil migrated onto his property from his neighbor's property under a first party property "all-risk" policy where the cause of the oil release was an oil delivery company's negligence. (The oil delivery company had not realized that the

basement tank of the neighbor's had been removed by the previous owner and poured 500 gallons of oil into the basement through a pipe.) The court reasoned that the policy was designed to provide coverage for losses caused by the negligence of others, so that the insurer was required to provide coverage, despite a pollution exclusion in the policy. The court said that where the excluded event is not the cause of the loss, but rather the result of a covered risk, the insured would be covered.

5. Limitations on Coverage in the Definition of an "Occurrence"

Most liability policies issued after 1965 cover "occurrences." "Occurrence" is defined as:

> an accident including continuous repeated exposure to conditions, which results, during the policy period, in personal injury or property damage neither expected nor intended from the standpoint of the insured. (emphasis added)

a. The majority of courts have held that injury or damage is neither "expected nor intended" unless the insured actually intended to cause damage or there was such a

high degree of certainty or "substantial probability" that the insured's conduct would cause damage that damage can be inferred.

b. Some states place the burden of proving that bodily injury or property damage was unexpected and unintended on the insured. Other states treat the unexpected and unintended requirement as a limitation on coverage and place upon the insurer the burden of showing that the insured expected or intended bodily injury or property damage.

6. Date of Occurrence - "Trigger of Coverage" Issues

Liability and first party property policies cover bodily injury or property damage during the policy period. Environmental claims frequently involve progressive injuries or damage that takes place or continues through multiple policy periods. Because injury or damage may not become known to the insured or a third party for many years, precise identification of the date or dates when injury or damage took place may be impossible. Courts have developed four major approaches to determining when injury or damage "occurs" for purposes of triggering an insured's obligation.

a. A few states have held that the time contaminants are exposed to soil or groundwater triggers the insurance policy in that period,

i.e., the "exposure" theory. See, e.g., Continental Ins. Co. v. Northeastern Pharmaceutical and Chemical Co., Inc., 842 sub. nom. F.2d 977 (8th Cir.), cert. denied 109 S. Ct. 66 (1988).

b. Other courts have held that insurers on the risk during the date or period in which the claimant or property was actually injured or contaminated are obligated to provide coverage. This is known as the "injury-in-fact" theory. See, e.g., Unigard Mutual Insurance Company v. McCarthy's Inc., No. 83-1441, slip op. at 12 (D. Idaho June 5, 1987).

c. A small minority of states hold that only the insurer on the risk at the time when the injury or damage became "reasonably capable of discovery" or was actually discovered by the third party claimant must cover the loss. This is referred to as the "manifestation" theory. See, e.g., Mraz v. Canadian Universal Ins. Co. Ltd., 804 F.2d 1325 (4th Cir. 1986) (construing Maryland law). But see Harford County, Md. v. Harford Mut. Ins. Co., et al., 610 A.2d 286, 294 (Md. Ct. of App. 1992) (rejecting manifestation trigger under Maryland law).

d. Still other states hold that a "continuous trigger" should be applied, and that all insurers which issued policies to an insured between the date of

first exposure and the date that the insured learned of the injury must provide coverage. See, e.g., Owens-Illinois v. United Ins. Co., No. A-4411-89T2, (N.J. App. Div. April 29, 1993); Keene Corp. v. Insurance Company of North America, 667 F.2d 1034 (D.C. Cir. 1981), cert. denied, 455 U.S. 1007 (1982) (adopting continuous trigger for asbestos injuries).

e. In most cases, a continuous trigger is most advantageous to policyholders.

7. Obligation to Defend any "Suit"

a. Most CGL, and some umbrella and excess, policies state the insurer has the right and duty to defend the insured against any "suit" alleging bodily injury or property damage.

b. Insurers often contend that PRPs, NORs, or other notices of responsibility from governmental agencies do not constitute a "suit." Although courts have disagreed as to whether a PRP notice constitutes a "suit" for which the insurer must provide defense, the majority of decisions favor the insured on this issue. See, e.g., Coakley v. Maine Bonding & Cas. Co., 618 A.2d 777 (N.H. 1992).

8. Owned Property Exclusions.

a. The standard "owned-property" exclusion found in most CGL,

umbrella, and excess policies precludes coverage for property damage to

- Property owned, occupied by or rented to the insured;
- Property used by the insured;

or

- Property in the care, custody or control of the insured or as to which the insured is for any purpose exercising physical control.

b. The "owned property" exclusion was designed to exclude losses covered by a first party property policy.

c. Many courts have held that the "owned property" exclusion is inapplicable where a governmental agency is directing the insured to expend cleanup costs to remediate groundwater or to prevent or mitigate pollution that is causing, or may cause, damage to third parties. See, e.g., United States Aviex Co. v. Travelers Ins. Co., 125 Mich. App. 579, 336 N.W.2d 838 (1983); Intel Corp. v. Hartford Accident & Indem. Co., 952 F.2d 1551 (9th Cir. 1991).

d. Some courts interpreting the "owned-property exclusion" have ruled that coverage cannot exist under a policy unless present or past injury to the property of a third party is proved. See,

e.g., New Jersey v. Signo Trading International, Inc., 612 A.2d 932 (N.J. 1992).

III. CHOICE OF LAW AND CHOICE OF FORUM

A. Policy construction and interpretation is a matter of state law. Since different states have widely divergent interpretations of everything from the pollution exclusion to the meaning and time of an occurrence, the choice of forum and choice of law issues can have a dramatic impact on a company's ability to recover under its insurance policies.

B. In deciding where to file an insurance coverage action, the company or its outside counsel must first examine the case law on the relevant policy provisions and that state's approach to selecting which state's law will govern the insurer's obligations.

C. Factors affecting choice of law issues include:

- Location of sites giving rise to environmental liability
- The location of the insured's headquarters and/or primary operations
- The state where the insurance policies were negotiated, premiums paid, etc.
- The state's interest in having its law applied to the dispute.