

Insurance Coverage for Environmental Liabilities

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Abstract: Mr. Anspach is pleased to have this opportunity to speak with members of CHMM regarding insurance coverage for environmental liabilities. He will be discussing certain developing issues involved in disputes between policyholders and their insurers. These issues include:

- how to defend against an assertion of late notice by the insurers,
- whether the so-called "absolute pollution exclusion" is absolute,
- whether the insurers have a duty to pay for the costs of the remedial investigation in the context of their duty to defend,
- what is the scope of the insurers' duty to defend where there are both covered and non-covered claims against the insured, and
- does the insured have the right to choose from a number of veting insurers which insurer will defend it.

Introduction – Current Developments¹

I. How to defend against an assertion of late notice by the insurers.

- A. Submit a timely claim "as soon as practicable" after knowledge of the occurrence.
- B. If timely notice was not submitted, then,
 - i. Traditional Approach: Timely notice is a condition precedent to insurer's liability. *Industrial Coatings Group, Inc. v. American Motorists Insurance Company*, 276 Ill.App.3d 799, 658 N.E.2d 1338 (1st Dist. 1995).
 - ii. Modern Approach: Eschews technical forfeitures of insurance coverage unless the insurer has been materially prejudiced by virtue of late notification. *American Mutual Liability Insurance Company v. Beatrice Companies, Inc.*, 924 F.Supp. 861 (N.D. Ill. 1996).

II. Whether the so-called "absolute pollution" exclusion is absolute.

- A. Standard pollution exclusion, operative from about 1973 to about 1986 purports to exclude all pollution claims except where sudden and accidental.
 - i. Exception given temporal meaning, *i.e.*, abrupt and short-lived.
 - ii. Exception means unintended and unexpected. *Outboard Marine Corporation v. Liberty Mutual Insurance Company*, 154 Ill.2d 90, 607 N.E. 2d 1204 (1992).
- B. Absolute pollution exclusion, applicable since 1986 to all bodily injury and property damage, purports to exclude all pollution claims.
 - i. Some states, *e.g.*, Illinois, find that absolute pollution exclusion does not apply to "personal injury," which includes "wrongful entry," *i.e.*, trespass. *Millers Mutual Insurance Association of Illinois v. Graham Oil Company*, 282 Ill.App.3d 129, 668 N.E.2d 223 (2nd Dist. 1996).

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- ii. Some states e.g., Indiana, find that absolute pollution does not apply to petroleum contamination at a gasoline station. *American States Insurance Company v. Kiger*, 662 N.E.2d 945 (1996).

III. Whether the insurers have a duty to pay for the costs of a remedial investigation within the context of their duty to defend.

- A. California approach: Site investigation expenses, which include expenses for determining the existence, nature, extent, and effect of a discharge of a hazardous substance at a site, may constitute defense costs which the insurer must incur in fulfilling its duty to defend. *Aerojet-General Corporation v. Transport Indemnity Company*, 948 P.2d 909, 70 Cal.Rptr.2d 118 (Cal 1997), *modified*, 1998 WL 104692 (Cal.) (modification did not affect judgment).
- B. Michigan approach: the duty to defend “generally requires the insurer to conduct an investigation sufficient to mount an adequate defense”, and that this includes environmental investigation costs. The court reaffirmed the *Gelman Sciences, Inc. v. Fireman’s Fund Insurance*, 183 Mich.App. 445, 455 N.W.2d 328 (1990) decision that “costs expended during an RI/FS that go toward remediation, or making a potentially injured party whole,” are indemnification costs. Costs expended to determine liability constitute defense costs. The court also added another twist to the difference between defense and indemnification costs as it recognized that costs “normally incurred” in “doing business” do not constitute defense costs. *American Bumper and Manufacturing Co. v. Hartford Fire Insurance Co.*, 452 Mich. 440, 550 N.W.2d 475 (Mich. 1996).
- C. Minnesota Approach. In *Domtar, Inc. v. Niagara Fire Insurance Company (“Domtar”)*, the Supreme Court of Minnesota found that in order to establish its right to defense costs, an insured must first meet its burden of establishing that the costs were reasonable and necessary to its defense of the action. If the insured meets this burden, it can receive as defense costs those expenses reasonably necessary to defeat liability or to minimize the scope or magnitude of such liability. As in *Aerojet*, the *Domtar* court found that, just because defense costs may also serve a dual purpose of being response costs, does not render them indemnity costs.
- D. New Jersey Approach. In *General Accident Insurance Co. of America v. State Department of Environmental Protection*, 143 N.J. 462, 464-67, 672 A.2d 1154, 1156-57 (NJ 1996), the court held that mandated costs should have a presumption as being indemnity costs. It found that the policyholder bears the burden of demonstrating that the insurer derived an unjust benefit from allocating the cost as a duty to indemnify where the cost would have been incurred under the duty to defend. The court announced four factors to be applied in determining whether the cost falls under the duty to defend or the duty to indemnify:
 - 1) the relative risk that the PRP bore if it did not produce the RI/FS;
 - 2) the extent to which the details of the RI/FS may have been mandated by the environmental agencies;
 - 3) the extent to which the RI/FS studies provide a means by which the insurance company or the policyholder would be relieved of or be able to mitigate potential claims for damages; and
 - 4) the cost of producing the RI/FS in relation to the policy limits provided.

The court noted that in most circumstances, the RI/FS does usually serve to discharge the obligation of the PRP and may also discharge the duty of the insurance company. As each party has had an obligation discharged, the Court suggested that in fairness the costs should be allocated between indemnity and defense. It also noted that in most circumstances there usually is an actual or threatened use of the legal process.

IV. Does the insured have the right to choose from a number of covering insurers which insurer will defend and indemnify it?

In Illinois, it has been held that when two policies potentially apply to a loss, the insured can elect which of its insurers will defend and indemnify the claim by tendering its defense to the one insurer and not the other and thereby foreclose the settling insurer from obtaining contribution from the nonsettling insurer. *Institute of London Underwriters v. Hartford Fire Insurance Company*, 234 Ill.App.3d 70, 599 N.E.2d 1311 (5th Dist. 1992). The right of election becomes a powerful tool in the hands of the insured, because it places all responsibility on one carrier, preventing it from spreading its potential liability amongst multiple carriers. The threat of election provides each insurer on a claim with multiple insurers with an incentive to settle claims.