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Environmental Insurance

When Can Policyholders Get Covered For Performing 'Voluntary' Cleanup?

By Richard M. Kuntz

WHAT CONSTITUTES sufficient government coercion (or threat of coercion) for a party that has performed a cleanup to be entitled to coverage by its insurer? An Illinois appeals court panel, in a case of first impression in the state, recently tackled that issue. In *Lapham-Hickey Steel Corp. v. National Surety Corp.*, 633 N.E. 2d 199 (Ill. App., 1st Dist., 6th Div., March 31, released April 29), the Illinois appellate court issued a ruling that suggests that parties contemplating environmental response actions will have the best chance of obtaining insurance coverage if they wait until formal action is brought against them by the government or a private party. The court denied the coverage bid of a policyholder that had performed a "voluntary" cleanup, finding no indication in the record that the insured was subject to a probable and imminent threat of government action or that the government action in the case was adversarial or coercive.

Coverage disputes, such as the one in *Lapham-Hickey*, develop when the insured's environmental obligations are not presented in the traditional arena of a lawsuit or government mandate. Most problematic are situations in which a party:

- undertakes to investigate and remediate a site simply upon notification by a governmental agency that the party is potentially responsible for the problem (a PRP letter under the Superfund statute or similar state authority); or
- initiates its own response activities before any formal action by the government, and effects a "voluntary" cleanup, often under the direction of and with final approval from the state environmental regulator, which may or may not have a gun to the head of the party.

In *Lapham-Hickey*, the insured acquired a site in Minnesota in 1985 without knowledge of any contamination. Shortly thereafter, a prospective purchaser conducted an investigation of the site and discovered contamination. Thereafter, the insured was notified that both U.S. EPA and the

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Coverage Applies, Even Absent Cleanup Order

AN INSURED is entitled to coverage for the costs of cleaning up hazardous waste even though the government had not yet ordered the remediation, the Washington Supreme Court said. *Weyerhaeuser Co. v. Aetna Casualty & Surety Co.*, No. 61000-2, 1994 Wash. Lexis 325 (May 19). The policies covered "all sums" that the insured was obligated to pay "by reason of the liability imposed upon [it] by law..." The court found that the cleanup was required by law, despite the insurers' argument that the remediation was voluntary and not imposed by law. The insurers further argued that there must be a "third party" who acts in an "adversarial" manner to the insured and that there must be some "coerciveness" in order for there to be coverage.

However, the court said that "[t]here is nothing in the insurance policy language which requires a 'claim' or an overt threat of legal action and, therefore, the insurers' argument that a claim is a prerequisite to coverage seems to us to be an effort to add to the language of the policies." The court also noted that forcing a policyholder to await formal threat of legal action contradicts policy requirements that insureds "promptly mitigate further environmental damage." The opposing mandates "[create] an unresolvable conflict and [result] in destroying the contractual right to liability coverage" in many cases involving pollution damages, the court noted.

In its ruling, the court cited similar cases from California, Maryland, New Jersey, New York, Wisconsin and Wyoming. ■

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Minnesota Pollution Control Agency had "opened files regarding the site." The state agency then sent the insured a proposed consent order designating the insured as a "responsible person" under the Minnesota environmental statute.

The insured disputed this designation, and, following negotiations, the parties agreed that a "no action" letter would be issued. This letter indicated that the state agency had not made a determination as to whether the insured was a responsible party, but that the state agency staff did not believe that the insured was a responsible party. Therefore, the staff would not recommend any enforcement action. To obtain this no-action letter, the insured agreed to conduct a complete environmental investigation of the site, which confirmed the existence of contamination.

The state was not heard from further, but in 1987, U.S. EPA, in the language of the court, "issued a site inspection report, concluding that the site was contaminated," which appeared to indicate that EPA had initiated the CERCLA process.

Richard M. Kuntz *practices environmental law with The Law Offices of James T.J. Keating, P.C. in Chicago. Telephone: (312) 939-8282.*

However, that site inspection report was the last communication the insured received from EPA.

Since the insured's CGL policy contained the standard language that the insurer "shall have the right and duty to defend any *suit* against the insured" (emphasis in original), the court focused on whether there was a "functional equivalent" of a suit in this situation. The closest Illinois case was *U.S. Fidelity and Guaranty v. Specialty Coatings Co.*, 180 Ill. App. 3d 378 (1989), in which the insured had received a PRP letter. The court, however, looked primarily to language in a federal case, *Ryan v. Royal Insurance Co. of America*, 936 F.2d 731, 735 (1st Cir. 1990), which held that the functional equivalent of a suit requires some showing of "probable and imminent governmental action, as a condition precedent to coverage."

The *Lapham-Hickey* court found that the record did not contain any indication that the insured was subject to a probable and imminent threat of government action, or that the government action in the case was adversarial or coercive. It rejected the contention that mere ownership of contaminated property, coupled with government knowledge, is sufficient to trigger a duty to defend. The court did not, however, specify just what level of government coercion would trigger the duty to defend, although the decision can be read to concur that the receipt of a PRP letter, as in *Specialty Coatings*, would trigger the duty, as decisions in some other jurisdictions confronting the question have held. (See *Ray Industries Inc. v. Liberty Mutual Insurance Co.*, 974 F.2d 754 (6th Cir. 1992) for a closely reasoned contrary view applying Michigan law, but not following Michigan lower-court precedent on the issue.)

Absent from the court's reasoning is any consideration of the ultimate legal compulsion under which a party remediates a site. If the statutes indeed require such remedial action, regardless of the procedural posture of the agency enforcing the requirements, it would seem to contravene the public policy of the remedial statutes, which are clearly intended to encourage voluntary cleanup, to eliminate the possibility of insurance coverage for parties that remediate a site without the need for protracted government proceedings or litigation.

Lapham-Hickey could be interpreted by parties contemplating environmental response actions as a sign that they will have the best chance of obtaining insurance coverage if they wait until the government or a private party brings a formal action against them. Indeed, in language from *Specialty Coatings* not quoted by the *Lapham-Hickey* court: "The fortuitous choice to first seek voluntary compliance

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Insurance Litigation

New Door Wide Open for Pursuing Coverage Claims

By Robert D. Chesler

THE U.S. SUPREME Court's recent denial of a group of insurers' petition for certiorari in *Insurance Co. of North America v. Morton International Inc.*, 93-1797 (cert. denied, June 27), finally brings to an end Morton International's prolonged — and ultimately unsuccessful — quest for environmental cleanup coverage at a New Jersey site. More important, however, by refusing to review the New Jersey Supreme Court ruling at issue — a ruling that ultimately favors insureds — the U.S. Supreme Court essentially has left open for policy-holders nationwide a new avenue in pursuing their coverage claims.

The insurance coverage litigation stems from a claim brought in 1976 by the New Jersey State Department of Environmental Protection against Morton International over mercury contamination caused by Ventron Corp., Morton International's predecessor. See *State v. Ventron*, 94 N.J. 473 (1982). Morton International sued its general liability insurers for coverage in 1985. The facts seemed perfect for the insurers, since the insured was clearly unsympathetic. Indeed, the New Jersey trial, appellate and high courts all concurred that Ventron had been an intentional polluter.

The insurance litigation also raised several crucial insurance issues, including the definition of "damages," the scope of the duty to defend and the standard for intentional damage by an insured. The issue that got the most attention, however, and drove the insurers to petition the U.S. Supreme Court, was the New Jersey Supreme Court's treatment of the pollution exclusion clause. The insurance industry added this standardized clause to almost all general liability policies between 1973 and 1986, at which point it was replaced with a mere restrictive exclusion. The clause generally purported to exclude coverage for discharges of hazardous substances unless the discharges were "sudden and accidental."

"Sudden and accidental" became the most litigated phrase in America. Insurers argued that "sudden" had a temporal connotation, and that any pollution occurring over time was not covered. Policyholders argued that "sudden and accidental" was simply a restatement of the policy term "unintended and unexpected." In so doing, they relied, inter alia, on certain internal insurance industry documents from the early 1970s, generally referred to as the "drafting history."

N.J. Becomes 'Pro-Insured'

In 1976, a New Jersey trial court became the first court in America to address sudden and accidental, and found it to mean merely "unintended and unexpected." *Lansco Inc. v, Dept. of Env. Prot.*, 138 N.J. Super. 275 (Ch. Div. 1975), *aff'd*, 145 N.J. Super. 433 (App. Div. 1986), *cert. denied*, 73 N.J. 57 (1977). New Jersey trial and appellate courts repeatedly affirmed this holding for the next 15 years, and insurers pilloried New Jersey as a "pro-insured" state.

Morton International became an O.K. Corral face-off on the meaning of sudden and accidental. Case law developments during the past 15 years provided a divided jurisprudence nationwide. New Jersey became a favorite forum for insureds, but the New Jersey Supreme Court ruling in *Morton International Inc. v. General Accident Ins. Co.*, 629 A.2d 831 (1993), surprised everybody. (See *Hazardous Waste & Toxic Torts Law & Strategy*, August 1993 — previous name of this newsletter.)

First, the court reversed 17 years of

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Robert D. Chesler *is a director of Lowenstein, Sandler, Kohl, Fisher & Boylan, P.C., in Roseland, N.J., where his practice includes the representation of policyholders in environmental insurance coverage litigation. Telephone: (201) 992-8700.*

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instead of court action does not eliminate the specter of potential liability for cleanup costs and damages to be incurred by defendants." 535 N.E. 2d at 1079.

One day before the Sixth Division's ruling in *Lapham-Hickey*, the Third Division of the same appellate court (the First District) issued a contrary opinion in a case involving the same insured and another carrier, *Lapham-Hickey Steel Corp. v Protection Mutual Insurance Co.*, No. 1-92-3773 (March 30). The Sixth Division acknowledged that the Third Division had reached a contrary result, but stated simply that "We are not persuaded by the reasoning set forth in that opinion." 633 N.E. 2d at 202.

This is not the first time that different panels of the Illinois appellate court, First District, have reached contrasting results in an environmental coverage case in the same year. Compare *U.S. F&G v. Specialty Coatings Inc.*, 180 Ill App. 3d 378 (1st Dist. 1989) (finding pollution exclusion ambiguous) with *Outboard Marine Corp. (OMC) v. Liberty Mutual Insurance Co.*, 212 Ill. App. 3d 231 (1st Dist. 1989) (finding pollution exclusion unambiguous, holding reversed by Illinois Supreme Court in *OMC v. Liberty Mutual Insurance Co.*, 154 Ill. 2d 90 (1992)). Practitioners seeking guidance in the area of coverage for voluntary cleanups can only hope that the Illinois Supreme Court will similarly resolve the conflict in the *Lapham-Hickey* appellate court rulings. ■