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# Insurance Coverage of Environmental Disasters

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The purpose of this paper is to provide insureds with general information that will assist them in recognizing important facts and issues related to insurance coverage of environmental disasters. The primary areas addressed include (1) understanding the general types of potential insurance coverage; (2) recognizing environmental disasters; (3) deciding what to do once an environmental disaster is discovered to improve the possibility of insurance coverage and finally, (4) long term plans to improve coverage of potential future environmental disaster claims.

**Insurance Policies**

Insurance Coverage for Environmental Disaster Coverage is a complicated subject that must consider many different issues over many different timelines and many different jurisdictions with many different types of hazards. Understanding what an environmental disaster is and recognizing that one has occurred is the first thing an insured must do. Until the insured has recognized that an environmental disaster has occurred, it cannot ask the insurer for coverage and it cannot provide notice and coverage cannot be triggered. There are many different types of environmental disasters, a brief review of the history of the pollution exclusion in general liability policies provides some prospective as to how insurers look at environmental disasters and coverage.

Early standard general liability policies issues prior to 1966 contained insuring agreements that provided coverage for injury (caused by accident). The standard insurance service organization (ISO form) which is a general liability form used by most insurers was revised in 1966 to provide coverage for an "occurrence" with neither "expected" nor "intended" by the insured and specifically included continuous or repeated exposure to substantially the same conditions in its coverage. As a result of these changes, claims related to environmental damages increase dramatically. Insurers using the standard form added a mandatory endorsement in 1970 (ISO Form 00020173 1973) that excluded coverage using the following language:

> "Bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke vapors, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water."

The referenced ISO form was often used in conjunction with a carve-back in of coverage which provided: "this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental."

As you might expect, and as many of you may know, the 1970's and 1980's were a turbulent period for insureds and insurers who were engaged in coverage disputes under CGL policies for pollution related claims. Courts in the various jurisdictions reached different conclusions and were often at odds which made predicting coverage difficult.

The insurers, through the insurance service organization, created an absolute pollution exclusion in 1985 (See ISO form CG0021207), which excluded coverage for the following:

> "Bodily injury" or property damage" arising out of the actual, alleged, or threatened discharge, dispersal, release or escape of pollutants:
>
> > At or from any premises, site or location which is or was at any time owned, occupied, or rented or loaned to, an insured[.]
>
> "Pollutants" means solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed."

The absolute pollution exclusion lacked an exception for coverage for sudden or accidental problems and it did not provide coverage for allegations or threats of a polluting event and it also eliminated the requirement for a discharge into a foreign land, the atmosphere or water course or a body of water.

Not surprisingly, the absolute pollution exclusion was a source of significant litigation between insureds and insurers and lead to various interpretations by courts across the country. Some courts fell into a camp which accepted the insurance industry's broad interpretation of the exclusion. Another group affords limited exclusion to damages when an undefined claim involved harm to the broader environment. Another group of courts found that the exclusion was ambiguous or required to be interpreted based on history of the exclusion and looked at the presentations of the insurance industry to the various insurance commissioners in the various states *"Doer v. Mobil Oil Corporation*," 774 So.2d 119, 2000-0947, (La. 12/19/00). Knowing which state an environmental disaster is in and more importantly, what state law is going to apply to coverage, becomes very important and can be important in planning litigation as will be discussed below in some detail.

There are many types of insurance products today providing various types of coverage for environmental disasters. A review of all of the different products available is beyond the scope of this paper. Coverage ranges from limited coverage provided via endorsements to CGL policies to stand alone policy forms. Over the years, insureds have sought an expansion of coverage to avoid the gaps created by the pollution exclusions in CGL policies. In recent years there has been a significant increase in the number of carriers providing environmental coverage products compared to the limited market of even five or six years ago. Based on work with brokers over the last year or so, it appears that there are around 30 different insurers now offering some form of environmental coverage. Coverage available for environmental claims is more readily available currently on a claims made basis; although occurrence based insurance is also sometimes available.

The following is an example of an insuring agreement for claims made and reported coverage:

**1. COVERAGES**

**COVERAGE A – LEGAL LIABILITY**

The company will pay on behalf of the **Insured** all sums that the **Insured** shall become legally obligated to pay as **Loss** as a result of **Claims** for **Bodily Injury, Property Damage** or **Environmental Damage** resulting from **Pollution Conditions** caused by **Covered Operations**. **Claims** for **Bodily Injury, Property Damage** or **Environmental Damage** must be first made against the Insured during the **Policy Period** and reported to the Company as set forth in Subparagraph 2. Below.

For this Coverage to apply, all of the following conditions must be satisfied:

1. The **Covered Operations** which result in a **Claim** must commence on or after the Retroaction Date stated in item 5. Of the Declarations.

2. The **Insured** must report the **Claim** to the Company, in writing, as provided in Section **III. CLAIMS AND NOTICE PROVISIONS, A. INSURED'S DUTIES WHEN THERE IS A CLAIM OR EMERGENCY RESPONSE COSTS**, subparagraph 1., of this Policy, during the **Policy Period** or within sixty (60) days thereafter or within the Extended Reporting Period if applicable.

3. Such **Pollution Conditions** must be unexpected and unintended from the standpoint of the **Insured**.

**Excerpt from Specimen Policy: Contractors Pollution Liability Policy claims made and reported coverage form (2007).**

The coverage under this insuring agreement provides a relatively long notice period, i.e. during the policy period and for an additional 60 days thereafter with an extended reporting period. The notice provisions require that the insured provide notice within seven (7) days of the commencement of the pollution condition to capture emergency response costs.

Other policies that are available currently may also have limitations on the notice provisions. For example, the following endorsement limits both the length of the polluting event and requires written notice within thirty (30) days of the commencement of the event:

b. Coverage provided under this endorsement applies only if the original discharge, release, or escape of "pollutants" from a contained source:

(2) (a) Commences during the policy period;
(b) Is caused, either directly or indirectly, by a Named Peril; and
(c) Begins and ends completely within 7 days;

> **provided we are notified** in writing within 30 days of the commencement of the discharge, release or escape of "pollutants" from a contained state, regardless of when the insured becomes aware of the discharge, release or escape. (Emphasis added.)

The enforceability of the various notice provisions particularly with short timelines can vary from state to state and even within jurisdictions within a state. Thus, insureds must be aware of not only the type of coverage that they purchase among the wide variety of coverages now available, but they must pay particular attention to any notice provisions within purchased policies.

**Recognizing Environmental Disasters**

With the brief review of the history of the pollution exclusion and the general review of environmental coverage available today, a review of a few examples of the types of environmental disasters that may be subject to coverage disputes is instructive. Timelines related to environmental disasters are important. For the purposes of this paper, the types of disasters discussed, will be broken up generally into long term legacy type claims and sudden and accidental disasters.

Legacy type environmental disasters can cover long periods of time and it can be difficult for insureds to find insurance policies issued in the distant past. Many long term legacy cases have lead to the development of a branch of insurance coverage known as insurance archeology. Insurance archeologists have access to databases and warehouses containing insurance policies and information spanning more than 100 years. An insurance archeologist can be invaluable to an insured looking for coverage for predecessor companies if the insured has successor liability. Successor liability will be discussed further below.

Many long term legacy type environmental disasters involve the chemical industry and/or the oil and gas industry. Examples of obvious long term environmental legacy type disasters are landowner suits against oil companies for pollution to their property over long periods of time caused by oil and/or gas extraction. A related but less obvious type of environment long term disaster case can be found in landowner claims alleging land loss caused by saltwater intrusion. Oil and gas extraction in coastal wetland areas required the construction of canals. Plaintiffs have alleged the canals allowed saltwater intrusion into the freshwater marshes which allegedly killed the marshes resulting in land loss over long periods of time.

Chemical type legacy cases include landowner claims against processing and manufacturing plants such as creosote plants. In *Norfolk Southern Corporation v. California Union Insurance Company*, 859 So.2d 2001, 2002-2696 (La. App. 1st Cir. 9/26/03). The *Norfolk Southern* railroad sought a declaratory judgment for the coverage of damages by various London insurers. *Norfolk* was seeking reimbursement for costs expended by *Norfolk* in remediating various environment sites located throughout the United States. The sites at issue, beginning in 1910, involved wood treatment facilities using creosotes to make railroad ties. The creosote contaminated the worksite as well as property owned by adjoining landowners. The *Norfolk Southern* case involved many insurers over long periods of time. The *Norfolk* suit included various coverage issues including disputes as to the number of occurrences, the allegation of damages and the applicable law for the various policies and coverage claims.

**Sudden and Accidental Environmental Disasters**

In contrast to the long term legacy type environmental disasters, most insureds believe that it is easy to determine when a sudden and accidental environment disaster has occurred. The Deepwater Horizon oil spill in the Gulf of Mexico is prime example of what most insureds would consider a sudden and accidental disaster. On its face, the disaster would seem to have occurred when the drilling rig exploded. The explosive event certainly alerted the parties to report their claims. However, the fact that the oil leak continued for months, and the possibility that oil had been leaking from the well prior to the explosion, could raise issues about when the event occurred, how long it took place. These "Notice" facts could affect coverage.

Another sudden and accidental environmental pollution coverage issue that can be a trap for the insured is failure to realize that something that has been released is a pollutant. For example, I have been involved in litigation involving the release of brine (salt water) from a pipeline rupture and the release of carbon flakes from a manufacturing plant when the discharge was allegedly above regulatory limits. The insurers in those cases attempted to argue that salt and carbon are pollutants and are excluded under the general liability policy terms. The insurers went further and argued that the environmental coverage provided under their policies did not apply because notice of the sudden and accidental release of salt and carbon was not reported within the time limits required under the limited pollution coverage provided.

Insureds must be ever vigilant. To protect coverage provided by sudden and accidental pollution policies, insureds must have personnel in place with enough training to report what may appear to be minor problems, to risk managers and decision makers.

**What to do When Disaster Strikes**

Once an insured has recognized that an environmental disaster has occurred, and has at least begun the process of evaluating potential insurance coverage, the insured may be required to make a multitude of strategic decisions which may vary on a case by case basis.

One of the first decisions insureds may need to make, once it has recognized facts that may give rise to environmental disasters, is how, when and where to give notice. If, the event giving rise to the disaster has not triggered a claim as defined by the applicable policy(s), the insured must determine whether the policy requires or allows giving notice of potential claims. If the policy requires notice of potential claims, notice should be provided per the policy requirements. Care should be given at this point in providing facts that are either unclear, or not developed enough to determine the effect on coverage. If the policy allows but does not require notice of potential claims, the insured should analyze coverage limitations of current policies to determine whether it would be advisable to delay notice and possibly make a claim on later policies if and when a claim is actually made. If there is doubt, notice should probably be given sooner rather than later.

If a claim, as defined by the policy(s) is actually made, the insurer(s) should be noticed. A review of all applicable policies, their reporting periods and reporting periods within specific policy coverage sections should be conducted immediately to make sure that all deadlines are met. Notice requirements can be measured in days, i.e. less than a week. As always, a person with knowledge of the coverage provided

by the policy to be noticed as well as the facts of the specific occurrence should be involved in preparing the notice.

Discovery of a claim or potential claim often leads an insured to access how it should respond to a particular environmental disaster. If the insured has the financial ability to respond, and the response can mitigate damages, the insured should attempt to include its insurers in the mitigation response and work out payment agreements for the response. Unfortunately, circumstances do not always allow for input from the insurer where response times are very short.

There is a great deal of variation on whether insurance policies will cover mitigation costs. Mitigation coverage can be affected by a variety of factors such as controlling law, the type of damages or dangers to be mitigated and policy language. Mitigation may also be affected by policy provisions prohibiting voluntary payments. Most policies providing general liability insurance and environmental coverage contain a voluntary payment clause. The following is a typical voluntary payment clause:

> "No insured will, except at the insureds own costs, voluntarily make a payment, assuming any obligation, or incur any expense, other than for first aid, without our consent."

Additional considerations with regard to mitigation in the early stages of environmental disaster include consideration of state, federal and even local statutes, preservation regulations, public safety issues and evidentiary issues that relate to liability.

Evidentiary issues in the early stages of an environmental disaster should be referred to coverage counsel where possible. Preservation of evidence is required under state and federal rules. Spoliation of evidence can also be raised by potential plaintiffs and insurers. Effective management of a disaster can not only minimize and mitigate damages; it can also improve the possibility of insurance coverage.

**Choice of Law**

Environmental disaster coverage, like general liability coverage, can vary from state to state, and can vary between state and federal jurisdictions. An analysis of whether a declaratory judgment action on coverage should be filed, and if so, when and where may drastically affect coverage results.

Choice of law can be one of the most important factors in determining whether insurance coverage will be available for an environmental disaster. Different jurisdiction may have widely varying interpretations of key insurance terms. There are three general choice of law theories applied among the various states. Before 1970, most states applied the rule of *lex loci contractus* in contract disputes including insurance claims and coverage. The restatement (second) of conflict of law moved to a rule in favor of a flexible approach to determine which law governs construction of contracts. Many states following the second restatement give significant weight to the principle place of business of the insured. Most states have adopted the second restatement; however, the application of the second restatement to CGL policies has been quite varied. A significant number of states still apply the rule of *lex loci contractus*. Many states generally apply the law of the state where the environmental disaster occurs.

In addition to looking at the choice of law issues when deciding if, when and where to file a declaratory judgment action, insureds will often need to consider whether to file the action in state or federal court.

Some state courts, for a variety of reasons, tend to favor insureds in coverage actions to an extent not found in many federal courts. Thus, the choice of the state court over a federal court can often lead to an advantage for an insured seeking a coverage declaration. For an excellent review of choice of law in the insurance arena, please see Tort Trial & Insurance Practice Law General, Fall 2009, article entitled: "Choice of Law for CGL Insurance Policies: For the Uniform Rule" by Stephen M. Klepper.

Other considerations as to whether to file a declaratory judgment action or a coverage action in conjunction with the underlying plaintiffs suit for environmental damages should also be considered. These factors including but are not limited to how a dispute between the insured and insurer will affect the underlying case, whether the insurer is cooperative and acting in good faith, whether a defense is being provided or whether the insurer has denied a claim outright. The general rule is that insurance coverage litigation should take a back seat, where possible, to the defense of the underlying case. It is often in the insured and insurers best interest to avoid a coverage dispute during the defense of the underlying case.

**Long Term Plans to Maximize Coverage for Future Claims**

The old adage that an ounce of prevention is worth a pound of cure is certainly appropriate in the context of maximizing insurance coverage for environmental claims that may be brought in the future. Retention of knowledgeable brokers, insurance consultants, and/or coverage attorneys can assist the insured in assessing the types of risks that it is most likely to be exposed to, the types of coverage available to cover the risks and the various markets that may provide coverage. These same insurance professionals may also assist the insured in reviewing its current and past insurance program as well as its contractual insurance requirements for future and past contracts. Many insureds who are parties to long term contracts such as servitude agreements, drilling and production contracts, long term leases, and maintenance contracts may have agreed to insurance that varies from contract to contract (particularly if the insured has contracts from past mergers and acquisitions) and from time to time over the years.

Coverage required by many old contracts may not even be available. The failure to maintain insurance as required by long term contracts can lead to litigation and potential damages and/or termination of long term contracts. Audits of existing long term contracts by insurance professionals and a monitoring program of these contracts and insurance programs should be considered.

Insurance professionals can also assists insureds by reviewing pending contracts, particularly where the acquisition or merge of companies are involved or the insured is considering an asset purchase. Standard liability policies, and environmental policies, may contain what is known as an Anti-Assignment Clause with provisions which typically read as follows:

> "**Assignment.** Assignment of interest under this policy shall not bind the company [the insurer] until its consent is endorsed hereon."

Prior to 2003, the referenced Anti-Assignment Clause was rarely an issue because the courts and most insurance treaties interpreted the clause as only preventing an insured from transferring its rights to a third party prior to the date of the loss. Section 16.05 of *Appleman on Insurance* expresses the general consensus prior to 2003 as follows:

> "Under this rule, disregarding an express provision is justified because the insurer experiences no change in risk: 'once the insured-against loss has occurred, the policyholder essentially is transferring a cause of action rather than a particular risk profile.'"

In 2003, the insurance world, with respect to the Anti-Assignment Clause, shifted because of an opinion by the California Supreme Court, *Henkel Corp. v. Hartford Accident & Indemnity Co.*, 62 P.3d 69, 75 (Cal. 2003). In *Henkel* the company acquired a chemical product line from Amchem Products, Inc. and assumed all related liabilities. Eventually, *Henkel* was sued for those liabilities and sought coverage under Amchem's liability policies arguing that it had coverage by operation of law. The California courts rejected *Henkel's* position and further held that even if an assignment of rights had occurred via contract to *Henkel*, the assignment would be held invalid because the policies all contained Anti-Assignment Clauses and the insurers had not consented to the assignments.

There are currently three significant state court decisions that hold coverage rights did not follow liability as a matter of law where the liability was assumed by contract. *Pilkington N. Am., Inc.,* 861 N.E.2d at 131; *U.S. Filter*, 895 N.E.2d at 1177-78 and *Henkel,* 62 P.2d at 73-74. These cases differ somewhat on when a chose-in-action arises and can be transferred and coverage allowed despite an Anti-Assignment Clause.

The previously well settled law on assignment of insurance contracts is now unsettled and depending on the jurisdiction applicable what an acquiring company needs to ensure, or at least improve the probability that it will receive the benefit of the insurance program of an acquired company is in doubt. Generally, transfers of assets are the most likely types of transactions to result in a loss of coverage due to the Anti-Assignment Clause. Mergers and stock purchases are more likely in many jurisdictions to result in a transfer of insurance coverage to the surviving or emerged entity.

Companies involved in asset, stock, transfers or mergers should give consideration, where possible, to contacting insurers and seek consent to assignment. When doing this, it is likely the insurers will seek additional payments. The speed of modern transactions may not allow enough time to locate or determine who the relevant insurers are and often even when the insurers are identified; there is not sufficient time to work out an agreement with respect to assignment of insurance policies. The best practice, where possible, is generally to seek consent of insurers to any assignment that the parties wish to have the insurers bound by.

**Anti-Indemnity and Insurance Statute**

When drafting contracts and procuring insurance that may implicate activity in multiple states, the laws of the states should be considered. Several states have Anti-Indemnity Statutes in effect. For example, both Louisiana and Texas have Anti-Indemnity Statutes. Under certain conditions; the statutes prohibit indemnity and insurance of an indemnitor running in favor of an indemnitee.

**Conclusion**

Insurance coverage of environmental disasters is a complex area that requires vigilance on the part of the insured prior to and during any environmental disasters. As with most business endeavors, careful planning and analysis of contracts and acquisitions and the purchase of insurance going forward will

significantly enhance an insureds probability of having future environmental disasters covered by appropriate insurance.

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