Large Scale Loss: Perils and Pitfalls of Coverage?

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Early Days of Loss -- What will the impact be?

When a large catastrophic loss occurs, it is difficult in the early days to fully comprehend the true impact of the event. As losses continued to mount, there are often significant claims and issues that follow. When the environmental and economic losses are added in, much of which cannot even be calculated until much later, the numbers are often astronomical.

So what about the claims?

In instances of large scale loss, it is more than likely that claims for losses will extend beyond property and business interruption damages. There is likely to be an expanding wave of D&O suits that will follow. Professional liability, property loss, business interruption, clean up costs, bodily injury claims, will follow affecting all manner of third parties yet to be impacted.

As losses develop, claim resources will be needed to manage a host of potential losses. Coverage disputes will likely be on the rise as homeowners, towns and businesses seek to recover for losses occurring hundreds of miles from the impact area. Pollution exclusions will almost certainly be debated again in the courts as claims are presented and challenged. And, like many massive disasters, the industry will deal with potential fraudulent claims and those set on taking advantage of a bad situation.

So What about Coverage?

There are difficult issues posed by claims for insurance coverage for the costs of large environmental disasters, as can be seen from the many litigated cases spawned by such coverage claims. *See, e.g., Jefferson Block 24 Oil & Gas LLC v. Aspen Ins. UK Ltd.*, No. 08-4792 (E.D. La. Jan. 29, 2010) (ruling on coverage under an oil pollution act policy and addressing whether a facility was appropriately within the terms of coverage); *Aspen Ins. UK Ltd v. Dune Energy, Inc.*, No. 09-2906, 2010 WL 996550 (E.D. La. March 16, 2010) (ruling that a pollution exclusion barred coverage for an oil leak despite policyholder's argument that it had mere mineral lease rights to the land). Moreover, first party claims for damage and for business interruption have prompted serious litigation in recent years. For instance, in the BP Oil loss the existence and extent of an interruption in business was disputed where hotels and motels suffered decreased tourism business, but losses were offset by bookings made by environmental response teams working in the Gulf. See *730 Bienville Partners, Ltd. v. Assurance Co. of America*, No. 02-106F, 2002 WL 31996014 (E.D. La. Sept. 30, 2002) (ruling that New Orleans hotel that suffered loss of business following grounding of planes in wake of 9/11 could not recover on business interruption claim). Similarly, if business allegedly is affected by the concern that the coastline will be polluted, but a spill does not affect a particular area, limitations on coverage may apply. See *United Air Lines, Inc. v. Ins. Co. of State of Pa.*, 439 F.3d 128 (2d Cir. 2006) (ruling that airline could not recover for loss of business following 9/11 because loss was not caused by direct physical harm).

However, the issues under specialty environmental policies and first party policies may be dwarfed by the significance of potential third-party liability to others, and the coverage disputes that are likely to follow concerning coverage for such claims. The

claims, moreover, are likely to implicate many additional companies who may belatedly be added as defendants or who will be third-partied into the litigation for allegedly causing or contributing to the circumstance. These might be parts manufacturers and suppliers, contractors who installed or serviced providers, or companies with some other relationship to the operation. The multiplication of targeted defendants, as well as the broad range of possible plaintiffs, will ensure that liability claims arising from the catastrophe will be litigated for many years. Key general liability coverage issues are likely to include questions about the existence of property damage (as opposed to simple economic loss), the meaning of bodily injury (and whether claims for, inter alia, medical monitoring and fear of illness qualify as bodily injury), and whether pollution exclusions bar coverage for the third-party claims for injury or damage, as well as for any clean up expense. Questions such as whether coverage encompasses the costs of injunctive relief or payment for punitive damages also may be posed.

Because in the United States insurance coverage issues are governed by state law, there are different approaches to some of these key coverage issues depending on the applicable state's law. For example, in the BP Oil Spill there were significant differences in the law of Louisiana, Texas, Mississippi, Alabama and Florida on some of the issues of central importance in coverage for third-party harm allegedly caused by the Gulf Oil spill. With respect to the pollution exclusion, for example, Louisiana courts have sometimes limited the reach of newer pollution exclusions (*e.g.*, *Doerr v. Mobil Oil Corp.*, 774 So. 2d 119 (La. 2000)), whereas the rest of the gulf coast courts generally have enforced the straightforward meaning of pollution exclusions. See, e.g., *National Union Fire Insurance Co. v. CBI Industries, Inc.*, 907 S.W.2d 517 (Tex. 1995) (bodily

injuries arising out of release of hydrofluoric acid); *Abston Petroleum, Inc. v. Federated Mutual Insurance Co.*, 967 So. 2d 705 (Ala. 2007) (barring coverage for an above ground storage tank petroleum spill); *Deni Associates of Florida, Inc. v. State Farm Fire & Casualty Insurance Co.*, 711 So. 2d 1135 (Fla. 1998) (barring coverage for bodily injury arising out of ammonia spill and bodily injuries arising out of insecticide overspray claims); *Am. States Ins. Co. v. Nethery*, 79 F.3d 473 (5th Cir. 1996) (applying Mississippi law and barring claims alleging injury caused by paint fumes). Moreover, jurisdictions differ on their approach to choice of law issues and some may favor the application of their own law when injuries to claimants take place within the state, as opposed to the law of the place of contracting, *i.e.*, where the insurance contract was formed. Because the jurisdictions whose law is applied can be outcome-determinative, insurers and insureds facing coverage issues should evaluate whether initiating a coverage declaratory judgment action is prudent to preserve a choice of forum and obtain court guidance on disputed issues.

In addition to damages sought in litigation, many also may file claims under their own business interruption, contingent business interruption and similar policies. Generally, claimants are entitled to liability damages only if pollution touches their property. Business interruption claims might not have such a restriction and could arise further downstream. Business interruption policies typically appear within a commercial property policy, so such claims will depend on the definition of property.

1. Disputes Among Insurers

One aspect that many policyholders do not contemplate is that there will likely be disputes/disagreements among their several insurers. The interest of lower levels of coverage may vary from insurers higher on the tower of insurance. For example, an insurer that knows its policy limits will be paid is less likely to invest in much investigation/defense. However, insurers at a higher attachment point will not be of the same mindset. In addition, the policyholder may qualify as an additional insured on other parties' policies, but those parties' insurers may extend such coverage under reservation of rights. This may cause concern with the policyholder's primary insurer in terms of liability ultimately resting with it. Third-party insurers may seek to categorize certain losses as first-party losses and vice-versa.

Being keenly aware of the competing interests of varies types and levels of insurance will allow a policyholder to proactively these issues.

An example of some of these issues can be found in Great Northern Ins. Co. v. Greenwich Ins. Co., (3rd Cir. (Pa.) March 24, 2010). There, Atlas Resources owned and operated several natural gas wells. A February 2004 blowout at one of the wells resulted in insurers with the Chubb Group of Insurance Co. ("Chubb"), including Great Northern Insurance Company and the Federal Insurance Co., paying more than $1.6 million in cleanup costs and property damage. The insurers filed suit against Greenwich Insurance Company ("Greenwich"), which also insured Atlas Resources, demanding equitable contribution.

The United States District Court for the Western District of Pennsylvania granted judgment in Greenwich's favor, ruling that Chubb was not entitled to contribution under

Pennsylvania law unless it could show that the payments it made were made on behalf of Atlas Resources, as opposed to its parent company.

Plaintiff appealed, arguing that the lower court erred in disregarding Atlas Resources' drilling contract with Gene D. Yost & Sons Inc., which contained an assumption of liability clause requiring Atlas Resources to indemnify for claims arising from its drilling. Plaintiff argued that this clause proved Atlas Resources was liable for the damage caused by the blowout.

The Third Circuit disagreed, stating that this clause did not prove that the payments that plaintiff made were made on behalf of Atlas Resources. It merely provided a basis for Atlas Resources' liability. It remained possible, however, that plaintiff paid nothing on behalf of Atlas Resources. Accordingly, the contractual indemnification argument "gets us no further into the second element of an equitable contribution claim." Plaintiff also argued that the lower court's ruling essentially handed significant authority to claims adjusters by making it their job to allocate liability in insurance claims. The court rejected this argument as well, stating that "[a] claims adjuster's determination of respective liability, while certainly helpful, would not have been the only evidence that might have aided the district court." Evidence of the insureds' comparative negligence, a mutual insured's acknowledgement of shared liability, or even an effort to reduce general allegations to specific quantities might guide a court's analysis. The court held that a claim for equitable contribution calls upon the power of the court to design a remedy that is fair. Fairness cannot be fashioned from speculation.

2. Proper Allocation and Reimbursement of Costs

As discussed above, apportioning damages among insurers is a significant undertaking surrounding any large catastrophic loss. As significant is determining which costs are reimbursable to an insured.

The Coffeyville Resources Refining & Marketing, LLC. v. Liberty Surplus Ins. Corp. et. al., (D. Kansas, May 3, 2010) case is a good example of the issues that must be considered. The loss arose out of a flood of the Verdigris River on June 30, 2007. During the flood, a large amount of crude oil from policyholder's oil refinery was released into flood waters and was carried into Coffeyville, Kansas, resulting in widespread environmental damage to downstream homes and businesses. The policyholder alleged that as a result of this oil pollution release and resulting environmental contamination, it incurred more than $50,000,000 to investigate and remediate the contamination, and resolve claims arising from the spill.

The policyholder filed a coverage action, seeking coverage from four of its insurers for the remediation costs. Two of the insurers, Liberty Surplus Insurance Company ("Liberty") and Illinois Union, issued pollution legal liability policies to the refinery. The other two insurers, National Union and Westchester Fire Insurance Company issued general liability policies to the refinery. The refinery policyholder claimed the insurers breached their obligations to indemnify it under various liability insurance policies issued. Thereafter, the policyholder settled with Liberty, and as a result, coverage under the Liberty pollution policy was exhausted. The policyholder, however, continued the action against the remaining insurers asserting that the Illinois Union policy was immediately excess to the Liberty policy. Illinois Union denied this allegation and asserted that the National Union policy was primary excess.

After an extensive analysis and discussion, the court held The Illinois Union policy coverage was triggered by exhaustion of the Liberty policy and the $1 million SIR applicable to the Liberty policy. Thus, the Illinois Union policy was primary coverage with respect to the release from the refinery. As to property damage costs that were within the scope of coverage of both the Illinois Union and National Union policies, the National Union policy was excess, and was not triggered until all applicable coverage under the Illinois Union policy was exhausted. The further court held that the Illinois Union coverage for property damage claims, when considered with that policy's exclusion of clean-up costs, would lead a reasonable insured to believe that the exclusion applies only to clean-up costs that result solely from obligations under environmental laws. Thus, the exclusion did not limit or affect the policy's coverage for property damage settlements. To the extent restoration or repair costs for property were an allowable measure of property damages, the Illinois Union policy provided coverage for reasonable settlement of property damage claims based on such costs, even if such restoration costs overlap with "clean-up cost" obligations under environmental laws. The court noted that restoration costs are ordinarily an allowable measure of property damages if they do not exceed the pre-injury fair market value of the property. In the case of residential property, such costs are allowable as damages in excess of fair market value so long as they are not "wholly disproportionate" to the value of the property. Also, the court held that several cost categories identified by the policyholder fell within the scope of Illinois Union's coverage, including investigative and administrative expenses, alternate living expenses, automobile damage, damage to personal property, bodily injury claims, purchase of oil-impacted business and residential properties, business interruption

expenses, agricultural damage, and veterinary fees. There are genuine factual issues in the record, however, concerning the extent of such losses.

With respect to the refinery's claimed costs for categories such as demolition and removal of purchased structures ($ 6.9 million) and oil removal from or disposal of impacted property ($ 15.9 million), the court held that the refinery did not show, as a matter of law, that such costs were paid in settlement of claims for property damage, as distinct from payment of obligations under environmental laws. Thus, the policyholder bore the burden of showing more likely than not that payment of such costs actually resulted from settlement of its property damage liability to third-party property owners on their claims. The same was true with respect to expenses associated with those costs, such as laboratory sampling and litigation support costs. To the extent the policyholder shows the requisite connection to settlement of property damage claims, the costs fell within the (now) primary coverage of the Illinois Union policy. Also, the court held that the uncontroverted facts established that the release of crude oil from the refinery was "abrupt and neither expected nor intended by the Insured" within the meaning of the National Union policy.

Additional significant holdings from the court included:

- The treatment of governmentally-mandated "clean-up costs" under Endorsement 28 to the National Union policy was deemed ambiguous. The court determined that because the policy's coverage for "damages" could reasonably be construed to include all clean-up costs incurred by the policyholder due to an obligation to remedy harm to third-party property, the ambiguous allowance for coverage of "third party clean-up loss, cost or expense" in Endorsement 28 should be construed to provide coverage to the refinery for its cost of cleaning up third party property, even if its obligation to do so was based solely on a governmental order or requirement. Additionally, the policyholder's release of crude oil from its sewer system and the release of diesel oil were both determined to be within the scope of coverage under the National Union policy.

- With respect to "clean-up costs" that were within the scope of National Union coverage but excluded by the Illinois Union policy, National Union's coverage was excess only of a $ 5 million SIR. Because there was no other applicable insurance to cover such costs, National Union was obligated, upon exhaustion of the $5 million SIR, to "drop down" and cover such costs.

- Illinois Union's coverage for loss from property damage included third-party "business interruption expense" and residential "additional living expense" paid by the refinery in settlement of property damage claims.

- Illinois Union's coverage for loss from property damage included any payments by plaintiff to settle claims of liability under K.S.A. § 65-6203(a)(1) for actual damage to property. With respect to settlement of any claim seeking clean-up of affected property pursuant to 65-6203(a)(2), Illinois Union's coverage applied as well.

- The policyholder did not show as a matter of law that none of its remaining costs are based solely on government-mandated remediation. Thus, summary judgment was inappropriate on several matters, including whether any allocation can be made to account for non-covered flood damage to real property, the cost-effectiveness of plaintiff's residential purchase program, the extent to which costs allegedly associated with that program are within the scope of Illinois Union's property damage coverage (or alternatively National Union's coverage of clean-up costs), and the appraisal of fair market values for pre-flood and post-flood properties.

- The Illinois Union policy provided coverage for the policyholder's defense and claims resolution costs associated with property damage claims. The record did not establish the extent of plaintiff's losses attributable to property damage, and thus did not show the extent of defense and adjustment costs owing under the Illinois Union policy; and lastly,

- The National Union policy did not promise indemnification of the policyholder's defense and investigative expenses when National Union does not have a duty to defend.

In American Commercial Lines LLC v. Water Quality Ins. Syndicate, (S.D.N.Y. March 29, 2010), the court held that the insurer was obligated to continue to reimburse defense and investigation costs despite the policy limits on indemnity for oil spill claims. The action addressed the extent to which the insurer's policy covers the insured's investigation and defense costs involving a maritime accident and oil spill on the

Mississippi River in July 2008. Specifically, the accident occurred when an unmanned barge sank and released approximately 300,000 gallons of fuel oil into the river.

As a result of the accident, the insured (as owner of the barge) was sued for the clean-up costs. The policy issued by WQIS required the insurer to (1) indemnify ACL for "such amounts as it shall have become liable to pay and shall have paid for pollution response or damages" as owner or operator of the barge, and (2) reimburse ACL for "certain other costs and expenses" including costs associated with the discharge of oil (Coverage A), the discharge of hazardous substances (Coverage B), and investigation and defense (Coverage C). In ruling against the insurer, the court held that the policy language was unambiguous and that the provision, on its face, contained no temporal or quantitative limit on the reimbursement obligation.

Thus, the insurer's argument that its obligation to make payments for investigation and defense costs under Coverage C ended because payments under coverages A& B met the policy limits was deemed meritless. As such, the court ordered that the insurer was obligated under the policy to reimburse ACL for costs incurred in the investigation and defense of all claims asserted against it regardless of whether other indemnity limits under the policy have been reached.

3. What is a "pollutant"?

Large-scale environmental claims often involve either policies that offer affirmative pollution coverage, or exclude coverage arising out of pollution. In either situation, the determination of what constitutes a "pollutant" is often a threshold issue. The Barrett v. National Union Fire Ins. Co. of Pittsburgh, (Ga. App. May 11, 2010), case illustrates that the answer is not always easily determined. The Georgia Court of Appeals

ruled that natural gas is not a pollutant within the meaning of a CGL policy. An employee of a gas-line installation contractor suffered brain damage while working with natural gas lines. According to the decision, the employee suffered injury because he was wearing a plastic rain poncho and natural gas accumulated over 2+ hours he was working with the gas line. As a result of exposure to the accumulated gas, he sustained a serious brain injury.

The primary insurer acknowledged coverage, but the excess insurer denied citing the pollution exclusion. The trial court found in favor of the excess insurer, citing a case which held that the pollution exclusion unambiguously excluded coverage for carbon monoxide exposure. The Georgia Court of Appeals reversed. The Barrett court held that notwithstanding the holding applying the exclusion to carbon monoxide, the exclusion was ambiguous as it applied to the facts case. Based upon the facts presented, it was not alleged that the release of the gas caused the damage, but rather the negligence of the insured allowed the accumulation and it was the lack of oxygen, not the presence of gas, that caused the damage. The court also held that it was against public policy to allow an insurer to sell a policy that excluded coverage for the insured's main operations.

4. What are the policy terms and meaning as to geographic coverage and location?

An environmental loss or other catastrophe often begins in one location and touches several others. The source of the loss may not always be the location of the loss. This can lead to many issues surrounding what geographic areas were intended as covered by applicable insurance. In Jefferson Block 24 Oil & Gas LLC v. Aspen Ins. UK Ltd., (E.D. La. January 29, 2010), plaintiff filed a lawsuit claiming that defendants were

obligated to reimburse it for nearly $3 million in cleanup costs relating to an oil spill in the Gulf of Mexico. The leak occurred on November 2007 while plaintiff was testing a recently acquired pipeline. Plaintiff responded to the leak from November 2007 until April 2008. Plaintiff and its insurers disputed whether the pipeline constituted a covered facility under the terms of the Oil Pollution Act policy.

The court decided the insurers' summary judgment motion under New York law. The court held that the federal Oil Pollution Act requires an offshore facility that has an oil spill discharge of more than 1,000 barrels to establish and maintain $10 million worth of insurance. More than 75% of the pipeline in question was located outside of leases listed by plaintiff on forms related to the insurance policy. Accordingly, the court held that the policy did not unambiguously and clearly cover the losses with respect to the specific 16-inch pipeline at issue, finding the meaning of location to be ambiguous.

Finding the policy terms ambiguous, the court looked to extrinsic evidence of the parties' intent. The court noted that plaintiff did not include the facility in its coverage forms because it wished to minimize the insurance premium that it would have to pay. The court held that the normal presumption in favor of the insured where the policy was ambiguous did not apply, because plaintiff, not the insurer, was responsible for filling out the forms.

The court granted summary judgment in favor of the insurers, finding nothing in the record suggesting that either party expected the policy to provide broader coverage.

5. Deductibles and Self-Insured Retentions

In large loss situations, there are often varying deductibles and self-insured retentions. Often, various coverages have different deductibles and sub-limits. There is often dispute over the number of applicable deductibles, and how the insured allocated expense to erode a self-insured retention.

In Pennzoil-Quaker State Co. v. American International Specialty Lines Ins. Co., (S.D. Tex. Sept. 4, 2009), Pennzoil-Quaker State Company sued its insurer, American International Specialty Lines Insurance alleging breach of contract and a violation of Chapter 542 of the Texas Insurance Code. Pennzoil obtained a claims-made pollution legal liability policy from AISLIC for its Shreveport, Louisiana facility. In 2001, residents who lived near the Shreveport facility sued Pennzoil, alleging that Pennzoil released various pollutants into the air and groundwater surrounding the refinery, causing physical injury, mental distress, and property damage.

Pennzoil tendered its defense to AISLIC, which denied coverage for one lawsuit based on late notice. AISLIC acknowledged coverage for the four remaining complaints. It took the position, however, that the remaining complaints alleged separate pollution conditions each subject to the policy's $2 million deductible. Pennzoil objected, claiming that the remaining complaints had a causal connection because the releases alleged originated from the same refinery, affected the same group of people (nearby residents), contained benzene, caused exposure to airborne or waterborne contaminants, and were all allegedly caused by Pennzoil's failure to properly train its employees and maintain its equipment.

The District Court for the Southern District of Texas held that the underlying complaints did not allege injury or damage arising from the same, related or continuous pollution conditions and, therefore, that Pennzoil was obligated to pay more than a single $2 million deductible. In so ruling, the court stated that the proper focus was not on the alleged overarching cause i.e., the negligent employee training or maintenance equipment, but rather on the specific event that caused the loss. The court noted that the underlying suits alleged distinct kinds of emissions and releases with distinct causes. One underlying complaint alleged injury and damage arising resulting from a January 18, 2000 fire and explosion in a specific unit of the refinery, allegedly due to a corroded hear exchanger in that unit. Another discrete release of pollutants occurred on November 4, 2002, almost two years later.

6. Occurrence Issues

As a general rule, determination of the number of occurrences for insurance purposes requires a court to look to the event for which the insured is held liable, not some point back in the causal chain. *See Endicott Johnson v. Liberty Mutual Insurance Co.* 928 F. Supp 176 (S.D.N.Y. 1996) *citing Arthur A. Johnson Corp. v. Indemnity Ins. Co.* 7 N.Y.2d 222 (1959)*; see e.g. Maryland Cas. Co. v W.R. Grace & Co*., 23 F3d 617 (2d Cir. 1993), *cert. denied*, 513 US 1052 (1994); *Cortland Pump & Equip., Inc. v Firemen's Ins. Co. of Newark,* 194 AD2d 117 (3d Dept. 1993) *lv to appeal denied* 83 NY2d 760 (1994); *American Home Prods. Corp. v Liberty Mut. Ins. Co*., 748 F2d 760 (2d Cir. 1984); *Stonewall Ins. Co. v Asbestos Claims Mgmt. Corp.,* 73 F3d 1178 (2d Cir.1995); *Continental Casualty Co. v Rapid-American Corp.,* 80 NY2d 640 (1993);

Hoechst Celanese Corp. v Certain Underwriters at Lloyds London, 673 A2d 164 (Del. 1996) (applying New York law).

Under this approach, the court must determine whether there was one constant cause that resulted in all the injuries and damage. If the court determines that there was one continuous cause that gave rise to all the claims then there is one occurrence under the policy. *Id.* Stated differently, proximate cause is an integral part of any interpretation of the words 'accident' or 'occurrence' as used in a contract for liability insurance. Thus, where there is but one proximate uninterrupted continuous cause, all injuries and damages are included within the scope of that single proximate cause. *See e.g. Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178 (2d Cir. 1995); *see also Arthur A. Johnson Corp. v. Indemnity Insurance Co.*, 7 N.Y.2d 222, 228, 196 N.Y.S.2d 678, 683, 164 N.E.2d 704 (1959).

The New York Court of Appeals in *Arthur Johnson supra* laid the foundation for the "unfortunate events" doctrine. In that case, the Court of Appeals was asked to determine if the collapse of two walls at two different residential properties was caused by the accumulation of water in the basement. The Court determined that "the collapse of separate walls, of separate buildings at separate times, were in fact separate disastrous events and, thus, two different [occurrences] within the meaning of the policy." *Id.* The Court opined that the proximate cause of the two collapsed walls was due to "separate negligent acts of preparing and constructing separate walls …" *Id.* The Court dismissed the idea that the water was the root cause of the events and determined that there were two separate occurrences on the property. Subsequently, the Court of Appeals in *Hartford Accident & Indemnity v. Wesolowski*, 33 N.Y.2D 169 (1973), determined that

the term "occurrence" and "accident" are synonymous in applying the "unfortunate events" doctrine.

Since *Johnson,* New York courts have applied the "unfortunate events" doctrine in the property damage context. For example, in *Newmont Mines Limited v. Hanover Insurance Co.,* 784 F.2d 127 (2d Cir 1986) the issue was whether the collapse of two separate sections of the same roof constituted a single occurrence. Using the same "unfortunate events" standard, the Second Circuit determined that there were two distinct causal chains that were responsible for the damage. The Second Circuit stated that "in property damage cases, courts should consider whether the damage was part of a single continuous event, not whether the damage occurring at one point in time had a similar cause to damage occurring another time." *Id.*

More recently, in *Appalachian Insurance Company v. General Electric Company*, 8 N.Y.3d 1162 (2007), the New York Court of Appeals established certain factors to be considered in determining the number of occurrences – albeit in the asbestos context. They include whether there is a close temporal and spatial relationship between the incidents giving rise to the losses, and if the incidents can be viewed as part of the same causal continuum, without intervening factors or agents.

Appalachian dealt with claims of individuals who were exposed to asbestos over a twenty year time period. The insured argued that every claim due to the asbestos exposure from the same business was a single occurrence because it could be traced back to a single act of negligence: failure to warn. In that case, the equipment that contained the asbestos varied widely from jobsite to jobsite, and there were nearly 22,000 jobsites throughout the country. The Court of Appeals determined that "the incident that gave

rise to liability was each individual plaintiff's 'continuous or repeated exposure' to asbestos."

Before the exposures occurred, there was only the potential that some unidentified claimant would someday be harmed by GE's alleged failure to warn. To be sure, the exposure to asbestos was not sudden – it was gradual and, for many plaintiffs, continued over a number of years. But that does not make it any less the operative incident or occasion giving rise to liability in this factual context.

Another example is the district court decision in *Endicott v. Liberty Mutual Ins. Co.* 986 F. Supp. 120 (S.D.N.Y. 1997). The *Endicott* lawsuit involved discharge from a landfill over a number of years. The district court explained the occurrence issue using the terms of the policy, that is, given that the definition of occurrence "all property damage arising out of continuous or repeated exposure" constitutes one occurrence. The court explained:

> "plaintiff in this case was not ordered by EPA to clean up the waste sites based on the specific number of deliveries it made or based on differences in the substances dumped. Rather, plaintiff's liability has one cause: it disposed of tones of waste at [the landfill] over a twenty-year period."

As a result, the court found that even the remedial investigation and feasibility studies conducted by EPA would flow from the same occurrence and would not be treated as a separate and independent claim.

7. Causation and Anti-Causation

Where multiple distinct, separate causes of a loss are involved, some of which are covered and some of which are excluded, most courts will make a coverage

determination based on either a "concurrent causation" analysis, or the "efficient proximate cause" rule, in the absence of specific policy language governing causation. However, some property policies provide explicit language that certain excluded losses are excluded regardless of whether another covered cause of loss is at issue. Typical anti-concurrent causation language provides that the loss will be excluded "whether or not any other cause or event contributes concurrently or in any sequence to the loss." This anti-concurrent causation clause is typically included as part of only a small number of exclusions, including water damage, earth movement, nuclear hazard, etc.

While the vast majority of jurisdictions enforce anti-concurrent causation language in property policies under the basic principle of freedom of contract, a growing number of jurisdictions have determined that insurers cannot contract around the jurisdiction's public policy interest in enforcing the efficient proximate cause rule. California and North Dakota have statutes that courts have held to preclude enforcement of these clauses. Washington State courts have followed the California authority. The West Virginia Supreme Court has refused to enforce anti-concurrent causation clauses as a matter of judicially-adopted "public policy." *See Murray v. State Farm Fire & Cas. Co.*, 203 W. Va. 477 (W. Va. 1998).

8. **Care Custody and Control**

Liability insurance policies typically exclude property damage liability for "property leased or loaned to the insured." There are different variations of "care, custody and control" provisions. Therefore, the first step in evaluating the itemized costs is whether such costs are attributable to property owned or leased to the insured (*i.e.*, first party claim).

Under New York law, a lease of real property has been defined as the transfer "of absolute control and possession of property at an agreed rental." *See In the Matter of Dodgertown Homeowners Assoc. v. City of New York* 235 A.D.2d 538 (2nd Dept. 1997); *see also Slutzky v. Cuomo* 114 A.D.2d 116 (3rd Dept. 1986); *Rochester Postal Advertising v. State* 27 Misc.2d 99 (New York County 1961). In order for an agreement to be deemed a lease in New York, all of the essential terms must be clearly defined "such as the area to be leased, the duration of the lease, and the price to be paid." *See In the Matter Of Dodgerstown supra.* The Court of Appeals in *Feder v. Caliguira,* 8 N.Y.2d 400 (1960) stated that in order to understand the scope and terms of a lease courts "must look at the rights it [the agreement] confers and the obligations it imposes in order to determine the true nature of the transaction and the relationship of the parties." *Id.* Similarly, an evaluation under Tennessee law renders the same conclusion. As the Tennessee Court of Appeals in *Elizabeth v. Rogers Group* 2001 Tenn. App. Lexis 127 (2001) stated "[i]t is well settled that the test for determining what constitutes a lease, as distinguished from other rights or interests, is not necessarily the descriptive language used, but whether it is the manifest intent of the parties that *exclusive control and possession of specified space for a specified term has been grante*d." *Id.* In other words, Tennessee adopts the same definition of lease in that a lease is "a contract for exclusive possession of land for a determinate period, a conveyance grant or devise of realty for a designated period with reversion to the grantor, a conveyance of grant of an estate in real property for a limited term; the grant of use and possession in consideration of something to be rendered." *See Williams v. Starace* 1985 Tenn. App. Lexis 3434 (Court of Appeals, 1985) (citation omitted).

9. Costs Outside or Within The Definition Of "Ultimate Net Loss" of "Legally Obligated to Pay"

Typically an insured may enter into an Administrative Order with the overseeing government agency. As a result, there is caselaw stating that when an insured incurs investigation and remediation costs pursuant to a voluntary program, the insured is not legally obligated to pay said expenses. *See Central Illinois Light Co. v. The Home Insurance Co.* 342 Ill.App3d 940 (2003). Other courts have held that the policy clause "legally obligated to pay as damages" refers to sums awarded only by a court judgment. *AIU Insurance Co. v. Superior* Court 51 Cal.3d 807, 827-30, 834-42 (Sup. Ct. California) (1990) ("AIU"). In *AIU,* the court held that this language encompassed both court-ordered reimbursement of response costs and court-ordered injunctions, but expressly refused to construe this language as being broad enough to include "any economic outlay compelled by law to rectify and mitigate property damage caused by the insured's pollution." Moreover, in *Montrose Chemical Corp. v. Admiral Ins. Co.* 10 Cal.4th 645, 692 (Cal. App. 1995) ("Montrose"), the court noted the "fundamental" rule is that the "contractual duty of the insurer in the third-party case is to pay such *judgments* as shall be recovered against the insured...." *Id.* Likewise, in *Palmer,* the court observed that an insurer "has a duty to indemnify only where a *judgment* has been entered on a theory which is actually (not potentially) covered by the policy." (*Palmer v. Truck Insurance* 21 Cal.4th 1109, 1120 (Cal. App. 1999).

10. Whether Costs Constitute Property Damage

Many liability policies define "property damage" as "physical damage to or destruction of tangible property which occurs during the COVERAGE PERIOD". As

such, there is an argument that cleanup and/or remediation costs may not necessarily constitute damages under the policy. There are a limited number of cases which state that an insurer is not obligated to indemnify an insured in an action where the government sought response costs for the cleanup of a hazardous waste because response costs constitute an economic loss; not "property damage" as defined under the policy. *Mraz v Canadian Universal Ins. Co.* (4th Cir. 1986); *see also Compare Maryland Casualty Co. v. Armco, Inc.* 822 F.2d 1352 (damages do not cover cleanup costs). With that being said, the majority of recent cases have interpreted that cleanup costs are damages under an insurance policy. *See Village of Morrisville Water v. United States Fidelity Co.* ("environmental clean-up costs assessed under CERCLA are damages within the meaning of the CGL and Indemnity policies.")

Traditionally, the insertion of the words "as damages" in the insuring agreement is intended to confine an insurer's exposure to legal as opposed to equitable damages. The law relating to the imposition of legal damages is subject to certain clear limits, the most important of which for our purposes, is that the measure of damages for the destruction of property is ordinarily limited to the value of the property. The cost of restoring damaged property, real or personal, to its original condition is not a proper measure of damages unless such cost is less than the property's market value. Accordingly, it has frequently been held in New York and elsewhere, that a liability policy insuring against an award of legal "damages" does not cover an award of equitable relief, such as an injunction, or an order of restitution.

In *Borg-Warner Corp. v. Liberty Mut. Ins. Co.*, (N.Y., Tompkins Co., 1991), the court ruled that the defendant insurers were not obligated to defend the plaintiff-insured

in the underlying administrative proceedings because proceedings seeking cleanup costs do not seek "damages" for which the insured can be indemnified. The court noted that this holding is not necessary where policies contain pollution exclusions, but is dispositive of the issue of coverage for administrative proceedings where policies lack effective pollution exclusions. Subsequent courts, including the Second Circuit, have concluded, however, that "response costs" are damages within the meaning of a liability policy. *See also Gerrish Corp. v. Universal Underwriters Ins. Co*., 947 F.2d 1023 (2d Cir. 1991*); Halstead Oil Co., Inc. v. Northern Ins. Co.,* 178 A.D.2d 132 (4th Dept. 1991), and *Don Clark, Inc. v. USF&G*, 545 N.Y.S.2d 968 (Sup. Ct., Onondaga Co. 1989).

While the term "property damage" may include cleanup costs, the scope in which courts define what constitutes "cleanup costs" will be determined by caselaw as the policy is silent on this issue. *Aerojet-General Corp. v. Cheshire & Co.*, 211 Cal. App. 3d 216 (1st App. Dist. 1989) provides some guidance. There, plaintiff operated the facility for a number of decades. In 1979, government agencies discovered toxic chemicals had entered the ground beneath the plaintiff's facility. Eventually, the EPA brought suit seeking equitable relief and damages. The plaintiff sought indemnity under insurance polices that provided coverage for property damage. The insurers argued that damages should be interpreted strictly to mean damages awarded at law, not response costs incurred in the EPA action. While the court soundly rejected this position, it did provide a hypothetical to further explain the scope of damages covered in the context of a pollution claim. The court stated:

> This is illustrated by the following hypothetical: Petitioners have two underground storage tanks for toxic waste. Tank #1 has leaked wastes into the soil which have migrated to the groundwater or otherwise polluted the environment. Tank #2 has not leaked, but government inspectors discover that it does not comply with regulatory requirements, and could eventually leak unless corrective measures are taken. Response costs associated with Tank #1 will be covered as damages, because pollution has occurred. Tank #2 would not be covered. Likewise, the expense of capital improvements to prevent pollution in an area of a facility where there is none, or improvements or safety paraphernalia required by government regulation and not causally related to property damage, would not be covered as "damages." *Id.*

Applying the logic above concerning the scope in which property damage can be extended in the environmental cleanup, several of the costs attributable to the pollutant release fall outside scope of the policy. For example, costs relative to the containment of prevention of future spills would not be seen as property damage under the scope of the policy. *See Hakim v. Mass. Ins. Insolvency Fund*, 675 N.E.2d 1161 (Ma. 1997) (the cost of containment and prevention of future harm is not a property damage within the policy.) Similarly courts, such as the Ninth Circuit in *Gloria Price v. United States Navy*, 39 F.3d 1011 (10th Cir. 1994) rejected the notion that "medical monitoring" expenses are not considered property damage. The Circuit Court concluded, in part, given that monitoring "relates only" to an evaluation of the extent of a release and/or threat of release which centers on preventing and/or minimizing the future release of pollutants, it is not considered "costs" or "damages" under the policy. *Id.*

11. Costs Attributable to the Cost of Doing Business and/or Capital Improvements/Enhancements

The purpose of liability insurance policy is to "to protect the insured from liability for damages to property *other than his own work or property* that is caused by

the insured's defective work or product." *See Hartford Acci. & Indem. Co. v. Pacific Mut. Life Ins. Co.,* 861 F.2d 250 (10th Cir. 1988) A liability insurance policy is not intended to extend to ordinary "business risks," such as those relating "to the repair or replacement of faulty work or products." *See Hartford Acci. & Indem. Co. v. Pacific Mut. Life Ins. Co.,* 861 F.2d 250 (10th Cir. 1988); *see also Gulf Mississippi Marine Corp. v. George Engine Co., 697 F.2d 668,* 670 (5th Cir. 1983); *Indiana Ins. Co. v. DeZutti, 408 N.E.2d 1275*, 1279 (Ind. 1980). The question becomes which costs are attributable to actual damages and which are improvements and business expenses.

12. Costs Necessary And/Or Directed to Prevent Future Loss

Similarly, a policy of liability insurance may not extend to compensate for costs not necessarily linked to cleanup and/or to mitigate the possibility of future losses. *See Hakim v. Mass. Ins. Insolvency Fund*, 675 N.E.2d 1161 (Ma. 1997). In *Hakim v. Mass. Ins. Insolvency Fund*, 675 N.E.2d 1161 (Ma. 1997), the plaintiff sought coverage under a homeowners policy for losses that resulted when a petroleum storage tank ruptured causing contamination of adjoining property. The court held that the policy provided coverage, and that the coverage included efforts to stop continued contamination. The court stated:

> We conclude that a reasonable policyholder would expect coverage of some and possibly all of the disputed cleanup costs in the circumstances of this case. It is undisputed that the Hakims incurred their costs when oil contamination was discovered in the waterways adjacent to their property and when the department issued its notice of responsibility. When the repair of the ruptured fuel line stopped further leaks of the heating oil into the ground, the Hakims could reasonably have expected that the costs incurred to prevent continuing contamination of the waterways from the migrating oil would not be excluded

> from coverage. The Hakims were told by ENPRO that it was necessary to remove the "secondary source" of the contamination. They also, presumably, were aware that the oil absorbent booms and pads had to be maintained on the waterways for several months after the ruptured fuel line had been repaired. They could have concluded that contamination of the waterways would persist unless the contaminated soil was removed from their basement.
>
> *This does not necessarily mean that the Fund is liable for all of the cleanup costs incurred by the Hakims. The policy covers cleanup costs incurred to remediate or prevent further migration of the contaminants to the off-site waterways. Costs incurred for the sole purpose of remediating the Hakims' property are barred by the owned property exclusion of the policy. Id.*

A *prime facie* case for CERCLA recovery from a private party has four elements: (1) the property is a facility; (2) there has been a "release" or "threatened release" of a hazardous substance; (3) the release has caused the plaintiff to incur "necessary costs of response" that are "consistent" with the NCP; and (4) the defendant is in one of four categories of potentially responsible parties. *See Regional Airport Authority v. LGF*, 2006 Lexis 21035 (6th Cir. 2006).

It is the third prong of the CERCLA test, whether the costs were necessary, that is perhaps most applicable to this context. Courts have determined that response costs are deemed "necessary" if incurred in response to a threat to human health or the environment. *See Regional Airport Authority, supra*. To that end, a plaintiff must establish that an actual or real public health threat existed prior to initiating a response action. *See G.J Leasing v. Union Electric* 854 F. Supp 539 (S.D. Ill 1994). Conversely, costs incurred at a time when the plaintiff was unaware of any threat to human health or environment are deemed to be not "necessary."

The Sixth Circuit decision in *Regional Airport Authority* is perhaps the seminal case in determining what constitutes necessary cleanup costs. In *Regional*, the Regional Airport Authority commenced a CERCLA action against the previous owner for contamination found on its property during the construction of a runway. The airport submitted, as part of its remediation plan, several improvements that were planned prior to discovering the contamination. The defendant argued that costs associated with the improvement of the property were not response costs because they did not relate to cleanup and were not necessary under CERCLA.

The court concluded that much of the "remediation" centered on the construction of the runaway as opposed to the protection of human health or the environment. As the court declared:

> "[t]he 'response costs' and the runway construction costs were one and the same. Therefore, allowing the Authority to recoup its 'response costs' would be tantamount to a reimbursement of its runway construction costs. 'To require former occupants to assume liability for clean-up costs going beyond the level necessary to make the property safe for industrial use would be to provide *an unwarranted windfall* to the beneficiary of the clean-up." *Id.*

Similarly, the court in *G. J. Leasing supra* declared:

> "A theoretical threat is not enough. For response costs to become necessary, plaintiff must establish that an actual and real public health threat exists *prior to the response cost*. To show that costs incurred were "necessary" under CERCLA, a party must show (1) that the costs incurred *in response to* a threat to human health or the environment, and (2) that the costs were necessary to address the threat. Also, CERCLA liability attaches only where a release or threatened release of a hazardous substance 'causes the incurrence of response costs.' In this case the evidence established that plaintiffs had other business reasons for

> undertaking site investigations and abatement actions. To the extent that these actions were taken for purposes other than responding to an actual and real public health threat, there is no CERCLA liability." *Id.*

13. Co-Mingled Assets in Clean-up

Often it is key to determine the processing of the clean-up in relation to the insured's normal operations and waste removal. It is possible that procedures of clean-up have been combined with normal operating procedures and costs. Often a forensic accountant is needed to assist in differentiating these costs. An example might be a loss at a manufacturing site where the normal operations of the site require some level of daily waste disposal. Clean-up around the site due to an occurrence also requires disposal. An insured is not entitled to profit from an insured loss. As a result, it cannot also bill its insurer(s) for normal operational costs. That said, in the fast tempo of disaster response it is often difficult to apportion the costs between various operations, especially when the "old" normal may not be the "new" normal for operational costs.

Another issue that warrants consideration is whether clean-up costs are considered damages under the applicable policies and, as a result, are covered. Jurisdictions in the United States are split on the question as to whether waste site cleanup costs constitute "damages" or whether such costs are "restitutional," and therefore not covered. *Kutsher's Country Club Corp. v. Lincoln Ins. Co*., 119 Misc. 2d 889, 889-93, 465 N.Y.S.2d 136, 137-39 (Sup. Ct. 1983) (cleanup costs constitute "property damage" within CGL policy) *with County of Broome*, slip op. at 20-21 (costs involved in "remedial program" are not covered by CGL policy); *See e.g. United States Fidelity & Guaranty Co. v. Thomas Solvent Co*., 683 F. Supp. 1139, 1163-65, 1168-71

(W.D. Mich. 1988) (applying Illinois law) ("While . . . claims [for cleanup costs] might be characterized as seeking 'equitable relief,' the cleanup costs are essentially compensatory damages for injury to common property and for that reason the insurer has a duty to defend."), *vacated on other grounds, id*. at 1174-77 (W.D. Mich 1988) *and New Castle County v. Hartford Accident & Indemnity Co*., 673 F. Supp. 1359, 1362, 1364-1366 (D. Del. 1987) (applying Delaware law) ("an ordinary definition of the word 'damages' makes no distinction between actions at law and actions in equity") *and Broadwell Realty Servs*., 218 N.J. Super. at 225, 528 A.2d at 81-83 (recognizing "that the cost of complying with an injunctive decree does not ordinarily fall within" the definition of "damages," yet holding that certain cleanup expenses are covered by CGL policy) *with Continental Ins. Cos. v. Northeastern Pharmaceutical & Chem. Co*., 842 F.2d 977, 978, 984-87 (8th Cir.)(en banc)(applying Missouri law)(5-3 majority holding that cleanup costs are in the nature of equitable relief, and therefore "are not claims for 'damages' under . . . CGL policies"), *petition for cert. filed*, 56 U.S.L.W. 3850 (U.S. May 27, 1988); *Maryland Casualty Co. v. Armco, Inc*., 822 F.2d 1348, 1351-54 (4th Cir. 1987)(applying Maryland law)("damages" have a "legal, technical meaning" which exclude "the costs . . . of complying with the directives of a regulatory agency"), *cert. denied*, 484 U.S. 1008, 98 L. Ed. 2d 654, 108 S. Ct. 703 (1988).

14. Costs Attributable to Regulatory Compliance

Courts have regularly concluded that the cost attributable to “compliance with regulatory directives of a federal agency does not constitute a claim for ‘damages’ under the insurance policy.” *See Bausch & Lomb, Inc. v. Utica Mut. Ins. Co.,* 330 Md. 758 (Ct. Appeals Md 1993); *see also Avondale Industries, Inc. v. Travelers Indem. Co*., 697 F.

Supp. 1314 (S.D.N.Y 1988). These cases are consistent with the policy's definition of property damage as "physical damage to or destruction of tangible property." Furthermore, the policy excludes covering costs involving "fines or penalties." Simply stated, an insurer may not be obligated to compensate its insured for costs attributable to regulatory compliance and should be not seen as a response cost. Such costs may include: Fines/Penalties, Regulatory Oversight Costs, Human Health Assessments

Conclusion

Clearly, the issues surrounding insurance coverage for large-scale loss are numerous and complex. While little is often certain in terms of developing facts and outcome, a couple of things are certain – early issue identification and analysis, as well as direct communication with insurers will help the processing of claims surrounding the loss. I