

The Lawsuit Trigger: Closing the Gap in Environmental Insurance Coverage

By Donald C. Nanney, Esq. and Chris Falbo *

Over the past ten years, developers in urban areas have grown more sophisticated in risk management as they look to redevelop properties with known or potential environmental impacts from past uses. One such risk management tool, pollution liability insurance, is touted by the insurers that offer it as a fail-safe way to protect a developer's interests.

But do insurance companies always pay claims? Of course not! They will wiggle out if they can. Some forms of environmental insurance policies contain a hidden coverage gap providing the insurance company with an out if a lawsuit has not been filed against the insured. You have to know about this and fix it up front. Once the policy has been issued – and the premium paid – it is too late.

Expectation for coverage without lawsuit

Parties seeking environmental insurance generally want coverage for first party cleanup costs as well as for claims by third parties alleging bodily injury, cleanup costs or property damage as a result of pollution conditions. The expectation is that coverage will apply when cleanup costs are incurred or when a claim is asserted, without a requirement that a lawsuit be commenced in order to trigger coverage. Whether that expectation is realized depends on the policy language as interpreted by the courts.

Coverage for “damages” requires a lawsuit

The California Supreme Court has interpreted language under older comprehensive general liability (CGL) policies obligating the insurer to “pay all sums that the insured becomes legally obligated to pay as dam-

ages” with respect to risks covered by the policy. One might think that *damages* is merely the plural of *damage*, in which case the insurer must pay for any covered damage when such harm results in a claim. Not so. The Court ruled that *damages* means “money ordered by a court” and hence that a lawsuit was required to trigger coverage. Therefore, a cleanup order or directive from an environmental agency was insufficient to trigger coverage, because it was a mere claim and not an actual lawsuit in court. Certain Underwriters at Lloyd’s of London v. Superior Court (Powerine Oil Company), 24 Cal.4th 945 (2001) (“Powerine I”). The insurer took the issue all the way to the California Supreme Court to establish that wiggle room! Following the Powerine I decision, another insurer (in a matter being handled by one of the authors) withdrew from an insurance settlement under a reservation of rights because there was no lawsuit, only a voluntary cleanup agreement with an environmental agency.

Environmental matters are often handled more economically when parties are cooperating rather than litigating, and insurance funding may be a critical element of a resolution. The prospect of having to become a recalcitrant party and force a lawsuit in order to trigger insurance coverage is an unfortunate consequence of the decision in Powerine I. Because insurers in fact do wiggle out when they can, this is a potentially very expensive issue.

Coverage for “expenses” is triggered by a claim

The Powerine I case interpreted language under a primary CGL policy. The California Supreme Court came down the other way

when interpreting the language of a standard excess or umbrella policy that provided coverage for “*damages... and expenses, all as more fully defined by the term ‘ultimate net loss’ on account of:...property damage*” and the term “*ultimate net loss*” included “*claims*” as well as “*suits*.” The Court ruled that the term *expenses* is broader than *damages* and does not require a lawsuit so that the umbrella policy was triggered by an administrative cleanup order or directive even though the primary policy was not. Powerine Oil Company v. Superior Court (Central National Insurance Company of Omaha), 37 Cal. 4th 377 (2005) (“Powerine II”). But another, non-standard excess policy that used the term *damages* and

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not *expenses* was not triggered without a lawsuit. County of San Diego v. Ace Property & Casualty Insurance Company, 37 Cal. 4th 406 (2005) (“Ace Property & Casualty”).

How are new environmental insurance policies triggered?

Let’s examine some typical coverage language available under environmental policies today to see whether the language is like that used in Powerine II, so that the insured should obtain coverage as expected without need for a lawsuit, or whether the language would be governed by Powerine I and Ace Property & Casualty, at least in California and any other state that has interpreted the term *damages* the same way (not all states have).

With respect to first party cleanup costs, a typical insuring clause obligates the company to “*pay on behalf of the Insured, Cleanup Costs resulting from Pollution Conditions on or under [or beyond the boundaries of] the Insured Property ...*” The term “*Cleanup Costs*” means the “*reasonable and necessary expenses...for the investigation, removal, remediation, including associated monitoring, or disposal of soil, surfacewater, groundwater or other contamination...*” Notably, the term *damages* is not used with respect to first party Cleanup Costs, which are *expenses*, so that the Powerine I problem should not apply. So far so good.

With respect to third party claims, a typical insuring clause would require the company to “*pay on behalf of the Insured, Loss that the Insured is legally obligated to pay as a result of Claims for Cleanup Costs,...Bodily Injury or Property Damage resulting from Pollution Conditions on or under [or beyond the boundaries of] the Insured Property...*” At first blush this looks good too. Coverage appears to be triggered by a mere *Claim*, overcoming the Powerine I issue. Well, maybe. It depends on what *Loss* means.

Digging deeper, one finds that “*Loss*” means “(1) *monetary awards of compensatory damages ... for Bodily Injury or Property Damage*; (2) *... [defense costs]... or (3) Cleanup Costs.*” There it is, the term *damages*. Without *damages* – money ordered by a court – there would be no *Loss* as defined and hence no coverage with respect to third party claims for Bodily Injury or Property Damage. (However, the term *damages* is apparently not used with reference to third-party Cleanup Costs, which includes *expenses*, so that a claim may be sufficient to trigger coverage for such costs but not other forms of property damage).

In the sample language, the insurer took the term *damages* out of the coverage clause (where it would be more obvious) and instead tucked it into the definition of *Loss*. Thus, a lawsuit may still be required in order to trigger coverage for third party claims for Bodily Injury or Property Damage, preserving wiggle room for the insurance company. That is not consistent with the reasonable expectations of the insured.

Solutions

The authors have achieved solutions to this issue in two ways. One has been to obtain an endorsement from the insurer actually amending the definition of *Loss* suitably to overcome the issue. Insurance companies rarely amend their definition of *Loss* because it states the heart of the risk they are assuming. The fact that at least one of the major environmental insurers has been willing to do so reflects that the mutual intent really is to provide coverage without a lawsuit trigger for Bodily Injury and Property Damage claims as well as for Cleanup Costs.

For companies not willing to issue an endorsement, the second solution has been to obtain a “comfort letter” confirming that, notwithstanding the use of the term *damages* in the definition of *Loss*, the mutual intent is

to provide coverage in the event of a claim and that a lawsuit is not required to trigger coverage. This could provide a basis for a bad faith claim should the insurance company later deny coverage on the ground that no third party lawsuit has been commenced.

Some environmental policy forms have eliminated use of the term *damages* so that the concern does not apply. However, in those cases one must make sure that the policy language still covers court judgments or awards too in case there is litigation.

Selection of Environmental Insurer

The policies offered by environmental insurers are nuanced and should be carefully reviewed for coverage gaps. The lawsuit trigger is one potential gap that should be considered in particular. An insurer that uses the term *damages* and will not agree to clarify the intent by endorsement or, at least, a comfort letter, is attempting to preserve wiggle room (in California and similar states) and may not deserve your business!

Every insurance policy should be written to respond as expected and to provide certainty in the management of the risk for which the insured sought coverage. New environmental insurance policies have become an especially important risk management tool facilitating many transactions. However, care is needed to make sure that valid expectations are achieved regarding the lawsuit trigger and other issues.

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