

STRATEGIES FOR DEFEATING AND DEFENDING THE 1973 POLLUTION EXCLUSION

by Elizabeth Bader

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In the last several decades, as environmental cleanup has become a major national goal, American businesses have discovered that liability for pollution cleanup costs or for damages caused by toxic hazards can be costly indeed. Confronted with liability for cleanup costs imposed without fault or large damage awards, businesses have turned to their insurance carriers for defense costs and coverage.¹ Insurers too are reluctant to foot these large bills: coverage is often denied.

The pollution exclusion found in comprehensive general liability (CGL) policies from 1973 to approximately 1985 frequently forms the core of the denial of coverage. Although that exclusion purports to ban pollution-related coverage, it contains an exception to that ban for pollution which is "sudden and accidental." In the litigation which has followed insurers' disavowal of liability for pollution claims, courts in scores of jurisdictions have debated, but often not definitively decided, the scope of coverage for "sudden and accidental" pollution and other claims.

This article will explore the litigation strategies available to both insurers and insureds in these subtle and complex cases. First examined is the formal legal/linguistic problem:

is the grant of coverage in the pollution exclusion for "sudden and accidental" claims ambiguous? The public policy concerns informing the debate will be discussed, and a conceptual model for analyzing the strengths and weaknesses of a pollution exclusion case will be presented. Next, the prevailing interpretation of the exclusion in the more typical fact patterns giving rise to litigation will be surveyed. Strategies for attacking the exclusion not premised on finding "sudden and accidental" coverage will then be examined, followed, finally, by an analysis of current trends in the cases.

TERMS OF THE STANDARD COMPREHENSIVE GENERAL LIABILITY POLICY

The standard pollution exclusion, written into comprehensive general liability policies beginning in 1973, excludes coverage for:

bodily injury or property damage arising out of the discharge, dispersal, release, or escape of smoke, vapors, soot, 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; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.²

The CGL policy in which the exclusion generally appears provides coverage only when there has been an "occurrence." The 1966 version of the CGL policy defined the term occurrence as:

an accident, including injurious exposure to conditions, during the policy period, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.

In 1973, the occurrence definition was modified to read:

1. For example, in one widely reported recent case, cleanup costs imposed on the Shell Oil Company were estimated at one billion dollars. Shell unsuccessfully sued its liability insurers for coverage for the loss. See *Shell Oil Co. v. Accident & Casualty Co. of Winterthur*, Cal. Super. Ct., San Mateo Co. No. 278-953 (Oct. 6, 1988) (Lanam, J.).
2. For a detailed history of the exclusion, see Averbach, *Comparing The Old And The New Pollution Exclusion Clauses In General Liability Insurance Policies: New*

Language - Same Results? 14 B.C. Env. Aff. Law Rev. 601 (1987), esp. pp. 604-610, and Note, *The Pollution Exclusion Clause Through The Looking Glass*, 74 Geo. Law J. 1237 (1986) (hereafter "Georgetown Note"), esp. pp. 1241-1253. In 1985, the insurance industry redrafted the exclusion to, among other things, omit the "sudden and accidental" exception to the exclusion. See also text at fn. 3, *supra*.

an accident, including continuous or repeated exposure to conditions, during the policy period, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.³

An insured seeking coverage under a CGL policy containing the 1973 pollution exclusion must prove (1) an "occurrence" under the policy; and (2) the loss comes within the "sudden and accidental" exception to the exclusion or (3) the pollution exclusion does not apply.⁴ By far the most common method of attack has been to invoke the "sudden and accidental" exception.

An unforeseeable explosive release of a polluting substance readily falls within the "sudden and accidental" exception, and, conversely, intentional acts of pollution clearly do not. Environmental claims frequently, however, involve unintentional or long-term seepage or dumping by third parties over whom the insured has had no control. These are the cases giving rise to litigation.

The word "accidental," standing alone, will not exclude coverage for gradual pollution, because it is now more or less accepted that "accidental" means "neither expected nor intended."⁵ The word "accidental" also cannot bar gradual pollution because the policy defines an occurrence as an accident which includes "continuous or repeated exposure to conditions."⁶ "Accidental" thus includes rather than excludes "continuous" or gradual conditions.

The word "sudden" is the sticking point, as the appellate and supreme court opinions in one well-known case illustrate. In *Waste Management of Carolinas, Inc. v. Peerless Insurance Company*, 72 N.C.App. 80, 323 S.E.2d 726 (1984), rev'd 315 N.C. 688, 340 S.E.2d 374 (1986), after hazardous waste in a landfill leached into the groundwater, the owners and operators of the landfill were sued by the United States under Section 7003 of the Resource Conserva-

tion and Recovery Act ("RCRA"), 42 U.S.C. § 6973 *et seq.* In response, the owners and operators cross-complained against the insured, a waste collection and transportation service. The insured, who had trucked solid waste to the landfill over a six-year period, had allegedly been negligent and "contributed" to the contamination of the groundwater.

Under RCRA Section 7003 both the owners and operators and the insureds could be liable for "contributing" to the pollution without proof of intent. In fact, the insurers had stipulated that "the insured neither expected nor intended the resulting claimed damage." *Waste Management*, 323 S.E.2d at 729. The insurers refused to defend the suit.

As the North Carolina intermediate appellate court analyzed the issue:

[I]f the word "sudden" means only "an instantaneous happening" then an occurrence which happens over a period of time is subject to exclusion from coverage under the pollution exclusion. . . . [but] We find that the word "sudden" is reasonably susceptible of differing constructions and we construe it not to mean just "instantaneous" but also "unforeseen" or "unexpected." This construction renders the pollution exclusion consistent with the definition of "occurrence" in the coverage provisions.⁷

In other words, since the occurrence definition explicitly recognized that a covered event, including an accident, may include "continuous or repeated exposure to conditions," long-term polluting events fall within the "sudden and accidental" exception if the word "sudden" does not necessarily exclude them. Those courts which have found the word "sudden" to mean merely "unexpected," without any temporal connotation, have thus been able to find coverage for the insured. The *Waste Management* intermediate appellate court using this reasoning, for example, found coverage for

3. Note that the incorporation of the phrase "continuous or repeated exposure to conditions" makes clear that, at least for the purposes of the occurrence definition, the coverage triggering event may occur over a period of time. This point assumes significance when courts construe the language of the pollution exclusion by contrasting it with the language in the occurrence definition. See discussion, *infra*, at n.6.

4. *International Minerals & Chemical Corp. v. Liberty Mut. Ins. Co.*, 168 Ill.App.3d 361, 522 N.E.2d 758, 764 *et seq.* (Ill. App. 1988).

5. See, e.g., *Lansco, Inc. v. Dept. of Environ. Prot.*, 138 N.J.Super. 275, 350 A.2d 520, 524 (1985); see also *Georgetown Note*, 74 Geo. Law Rev. at 1241-1246 (noting that due to the history of judicial interpretation of the word "accident" in CGL policies, insurers did not expect

"accidental" to exclude long-term conditions). But see, *Technicon Electronics Corp. v. Am. Home Assur.*, 533 N.Y.S.2d 91 (N.Y.App.Div. 1988) (pollution is "accidental" within the meaning of the exception to the pollution exclusion only if the "discharge, dispersal, release, or escape" is unintended or expected).

6. See, e.g., *New Castle County v. Hartford Accident & Indemnity Co.*, 673 F.Supp. 1359, 1362-65 (D.Del. 1987); and *Jackson Township Municipal Utilities Authority v. Hartford Accident & Indemnity Co.*, 186 N.J. 156, 451 A.2d 990, 994 (Law Div. 1982). Contra, *Fireman's Fund Insurance Cos. v. Ex-Cell-O Corporation*, No. 85-71371 (E.D.Mich. December 14, 1988), slip op. at 11-14.

7. *Waste Management*, 323 S.E.2d at 732.

a series of "sudden" polluting events which allegedly took place over a six-year period.

The virtue of this position is that it gives coverage to a broad range of insureds, especially innocent insureds, while still allowing courts to deny coverage to the intentional polluter.⁸ Perhaps for that reason, pro-coverage interpretations have been adopted by a large number of courts.⁹

But other courts disagree.¹⁰ In *Waste Management*, for example, the North Carolina Supreme Court reversed the intermediate appellate court, stating:

The [sudden and accidental] exception describes the event — not only in terms of its being unexpected but in terms of its happening instantaneously or precipitantly. Courts that have construed "sudden" broadly, defining it in terms of the expectation element of accident rather than focusing on its temporal significance, have deemed polluting events excepted that otherwise appear to fit squarely within the exclusion.¹¹

Thus, the North Carolina Supreme Court found the insurers free of a duty to defend. The North Carolina Supreme Court's analysis, and that of the pro-coverage intermediate appellate court, typify the legal debate occurring across the nation.

PUBLIC POLICY AND FAIRNESS QUESTIONS: WHO SHOULD FINANCE ENVIRONMENTAL CLEANUP?

The legal arguments in pollution cases form but a backdrop for a much more wide-ranging debate about broader social issues, such as: who is ultimately going to pay the costs of cleaning up the environment? To what extent should insurance be used to spread the losses involved? Courts' sensitivity to these broader issues is well illustrated by one pollution-related case, recently overruled, which held that even though a policy exclusion was not ambiguous, coverage existed solely because public policy required it.¹²

8. See, e.g., *Niagara County v. Utica Mut. Ins. Co.*, 439 N.Y.S.2d 538, 549 (N.Y.App. 1981) ("the pollution exclusion... was intended to apply only to actual polluters").
9. See *New Castle County v. Hartford Acc. & Indem. Co.*, 673 F. Supp. 1359 (D. Del. 1987) 685 F. Supp. 1321 (1980) ("sudden" is ambiguous); *Allstate Ins. Co. v. Klock Oil Co.*, 73 A.D.2d 486, 426 N.Y.S.2d 603 (N.Y. App. 1988) ("sudden" does not necessarily mean an instantaneous happening); *Farm Family Mut. Ins. Co. v. Bagley*, 64 A.D.2d 1014, 409 N.Y.S.2d 294 (1978) (noting ambiguity in phrase "sudden and accidental" as applied to spraying of chemicals on oat fields); *Benedictine Sisters v. St. Paul Fire & Marine Ins.*, 815 F.2d 1209 (8th Cir. 1987) (subjective knowledge of insured governed whether occurrence was a "sudden accident"); *Broadwell Realty v. Fidel. & Cas.*, 218 N.J.Super. 516, 528 A.2d 76, 85-87 (1987) ("sudden" means unexpected, unforeseen); *Buckeye Union Ins. v. Liberty Solv. & Chem.*, 17 Ohio App.3d 127, 477 N.E.2d 1227, 1235 (1984) ("sudden and accidental" means unintended or unexpected); *CPS Chem. Co. Inc. v. Continental Ins. Co.*, 199 N.J.Super. 588, 489 A.2d 1265 (1984), rev'd 203 N.J.Super. 15, 495 A.2d 886 (1985) (duty to defend because "sudden and accidental" did not unambiguously exclude dumping by insured's agent, a disposal company, but judgment reversed when court informed complaint against insured alleged intentional acts); *Shapiro v. Public Service Mut. Ins. Co.*, 19 Mass.App.Ct. 648, 477 N.E.2d 146, 150 (Mass. App. 1985) rev. den. 395 Mass. 1102, 480 N.E.2d 24; 482 N.E.2d 328 (Mass. 1985) (seepage from underground tank "sudden and accidental"); *United Pac. Ins. Co. v. Van's Westlake Union, Inc.*, 34 Wash.App. 708, 664 P.2d 1262 (1983) (gas leakage from a hole in underground line "sudden and accidental").

For additional cases, see note 54 at the end of this article. See also *National Grange Mut. Ins. v. Continental Cas. Ins.*, 650 F. Supp. 1404 (S.D.N.Y. 1986) (coverage consistent with reasonable expectation of insured) questioned on other grounds, *Fed'l Ins. Co. v. Cablevision*, 836 F.2d 54 (2d Cir. 1987).

10. See, e.g., *State of New York v. AMRO Realty Corp.*, 1988 U.S. Dist LEXIS 11534 (N.D.N.Y., Oct. 11, 1988) (liberal construction of the word "sudden" should not be allowed to defeat the exclusion); *U.S. Fidelity & Guar. v. Star Fire Coals, Inc.*, 856 F.2d 31, 34 (6th Cir. 1988) ("it is [not] possible to define 'sudden' without reference to a temporal element"); *American Motorists Ins. Co. v. General Host Corp.*, 667 F. Supp. 1423 (D. Kan. 1987) (sudden must be on "brief notice"); *Fischer & Porter Company v. Liberty Mutual Ins. Co.*, 656 F. Supp. 132 (E.D. Pa. 1986) (continuous dumping not "sudden" even if accidental); *Claussen v. Aetna Cas. & Sur. Co.*, 676 F. Supp. 1571 (S.D. Ga. 1987) (leaching of contaminants not "sudden" even if accidental); *Centennial Ins. Co. v. Lumbermen's Mut. Cas. Co.*, 677 F. Supp. 342 (E.D. Pa. 1987) (rejecting interpretation of "sudden" as meaning accidental); *Intern. Minerals v. Liberty Mut. Ins.*, 168 Ill.App.3d 361, 522 N.W.2d 758 (1988) ("sudden" has temporal significance); *State v. Mauthe*, 142 Wis.2d 620, 419 N.W.2d 279, 281 (1987) ("sudden and accidental" does not apply to damage occurring over a substantial period of time).
11. *Waste Management*, 340 S.E. 2d at 382.
12. *Summit Associates, Inc. v. Liberty Mutual Fire Insurance Co.*, No. L-47287-84 (N.J. Super. Ct., Law Div., Middlesex County, February, 25, 1987), rev'd and remanded, No. A-4233-86T7 (N.J. Super., App.Div., July 29, 1988).

Insurers have vigorously argued the courts have created a pollution insurance liability crisis by their willingness to find coverage, thus unduly burdening the insurance industry with the cost of the clean-up of the environment. As insurers point out, environmental claims often emerge years, even decades, after the expiration of the insured's policy. As a result, insurers, uninformed of the existence of even a potential claim, generally have not set reserves for them. These vast, maverick claims, insurers contend, have devastated the pollution insurance market, in turn crippling environmental cleanup. The argument has been forcefully articulated as follows:

The end result of the uncertainty and high stakes [in pollution exclusion cases] has been referred to as the "collapse of the insurance market." European insurance companies have refused to reinsure American companies against major losses on their liability policies that include pollution-related coverage. This, in turn, has forced American insurers to exclude from coverage pollution-related damage.

The insurers' inability to insure against environmental hazards at an economically efficient rate has hindered economic progress. Under recent legislation and regulations, operators of hazardous waste storage, treatment, and disposal facilities, as well as transporters of hazardous waste, must meet financial responsibility requirements. They fulfill these requirements primarily with liability coverage for sudden and nonsudden contamination. Contractors, particularly smaller ones, that handle hazardous waste cleanup are unable to obtain insurance. Therefore, they may be forced to abandon their contracts, delaying cleanup of threatening sites. Similarly, the lack of pollution insurance means the federal Environmental Protection Agency (EPA) will license fewer facilities The indirect result [of the pro-insured decisions] has been

to create an expanding class of victims while toxic waste cleanup crews and fully functional disposal sites stand idle for want of insurance.¹³

A number of courts denying coverage in the last few years have been impressed with this analysis.¹⁴

Insurers have also successfully claimed that denying coverage, even to an innocent insured potentially liable for the conduct of a third party, "prevents companies, whose wastes are regularly disposed of improperly, from hiding behind their ignorance and seeking insurance for damages caused by pollution that accrues in the regular course of business."¹⁵ In other words, a free flow of insurance money encourages, rather than discourages, companies to pollute because the clean-up of the catastrophes they cause is paid for by others.

When the insured is a giant conglomerate, as not a few polluters are, these public policy arguments may apply with special force. After all, the utility of encouraging environmental consciousness among those most able to prevent environmental disaster is undisputable. This may explain why, in a recent case initiated by Shell Oil Company against its insurers on a \$1 billion claim for coverage for cleanup costs, the trial court, in a radical gesture, refused to apply the traditional rule construing ambiguities in an insurance policy in favor of the insured. The court's decision was apparently based on evidence that the insured, Shell Oil, was a sophisticated corporate entity well aware of the implications of the sudden and accidental clause and the costs it would have had to pay to buy more expanded coverage. The *Shell* case may thus be a signal that when dealing with corporate insureds, insurers can successfully bypass traditional pro-insured coverage rules if they can emphasize the insured's sophistication and savoir-faire.¹⁶

13. See *Georgetown Note*, 74 Geo. Law J. at 1279 - 1280 (1986).

14. In *Claussen v. Aetna Cas. & Sur. Co.*, after referring to the *Georgetown Note* cited above, the court denied coverage, asserting the word "sudden" should not be "stripped of its essential temporal attributes." *Claussen*, 676 F. Supp. at 1580. Similarly, in *Centennial Ins. Co. v. Lumbermen's Mut. Cas. Co.*, 677 F. Supp. at 349, after noting the "excellent analysis" of the pollution exclusion contained in the *Georgetown Note*, the court rejected a broad interpretation of the word "sudden." In *American Motorists Ins. Co. v. General Host Corp.*, 667 F.Supp. 1423 (D. Kan. 1987), the court felt it "must agree" with the *Georgetown Note's* claim that the pro-coverage cases had "distorted the phrase 'sudden and accidental' beyond recognition." *American Motorists*, 667 F.Supp. at 1429. However, the court also went on to state that even under a

pro-insured "sudden and accidental" analysis, on the facts of the case there would be no coverage. *American Motorists*, 667 F. Supp. at 1429-30.

15. *Centennial Ins. Co. v. Lumbermen's Mut. Cas. Co.*, 677 F.Supp. 342, 349 (E.D. Pa. 1987).

16. As a practical matter, *Shell* also gives insurers guidance on areas which should be explored in discovery in order to prove the insured's knowledge and sophistication. In *Shell*, for example, the court found that Shell understood that the word "sudden" was to have a temporal meaning based on evidence that the word "sudden" was a subject of specific negotiation by the contracting parties; a graph prepared by Shell's Insurance Manager and distributed to Shell's senior management showed Shell understood the word "sudden" to have a temporal connotation; correspondence indicated Shell had wanted to remove the word "sudden" from the

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In some cases involving smaller insureds, even where it is not clear the insured understood all the nuances of policy language, insurers have claimed that since it was never their intent to cover gradual pollution, they should not be forced to do so.¹⁷ Insureds, on the other hand, have found strong evidence that insurers actually *did* intend the sudden and accidental exception to be merely a restatement of the occurrence definition, not a narrowing of coverage. Specifically, insureds have introduced evidence showing that this is the position taken by the Insurance Rating Board, an insurance industry organization responsible for drafting the pollution exclusion, when the industry was seeking regulatory approval for the new language in the early 1970's. In light of this evidence, insureds in subsequent cases should be sure to aggressively pursue discovery designed to uncover any particular insurer's involvement in the development of Ratings Bureau policy or the exclusion itself.¹⁸

Another argument favoring insureds flows from the very nature of existing American environmental law. Under contemporary statutes, innocent insureds may be held liable for damages or cleanup costs even when the offending pollution was caused by polluting acts, often intentional, of third parties. For example, liability may accrue because of an in-

nocent, good faith association or agency relationship with a polluter.¹⁹ Insureds contend there can be no deterrent effect to denying coverage if insureds are actually being held liable for acts they never knew about, as when, for example, a vandal or an errant disposal company has caused an environmental problem. And, as insureds are quick to point out, CGL policies were purchased by most insureds precisely because they are marketed as a business hedge against unforeseen, late-arising forms of liability.

Insureds also argue that denying coverage forces them into bankruptcy, ultimately negating any incentive to act in an environmentally responsible manner.

Any costs beyond a company's assets would have no economic impact on a polluter's decision making, since the company would never have to pay for these costs. One commentator has characterized this phenomena as the "deterrence trap." The deterrence trap frequently permits active businesses to avoid considering the effects of their pollution because the size of pollution liabilities often exceeds their assets. Furthermore, polluting companies are often out of business before the contamination injuries they have caused become apparent. The public or the injured parties will bear the costs of pollution that exceed polluters' assets.²⁰

exclusion but elected to retain it when informed that to do so would require a thirty-percent increase in premium, and the word "sudden" had been defined in correspondence. See "Decision Concerning Phase I Issues," *Shell Oil Co. v. Accident and Casualty Ins. Co. of Winterthur, Calif.*, No. 278953, (Cal. Super. Ct., San Mateo Co., Dept. No. 6) p. 41 (Oct. 6, 1988) (Lanam, J.).

In addition to intensive discovery on the state of knowledge of the insured and the insured's employees, insurers should probably also investigate what position the insured's trade association or Risk Insurance Management Society took on the exclusion, and what kind of information had been transmitted by the trade association to the insured about the exclusion.

Discovery on whether the insured purchased Environmental Impairment Liability policies may also be probative. The insured would only have purchased such policies if it realized its CGL policy would not cover all claims; conversely, a deliberate decision not to purchase CGL coverage may show the insured decided to take a calculated risk to do without pollution coverage in order to avoid paying the high premiums involved.

17. Compare e.g., *Pepper's Industries, Inc. v. Home Ins. Co.*, 67 Cal. App. 3d 1012, 1017, 134 Cal. Rptr. 904 (1977) (declaration stating insurer's intent in drafting a pollution endorsement does not raise a triable issue of fact) with *American Motorists Ins. Co. v. General Host Corp.*, 667 F.Supp. at 1429, citing the *Georgetown Note* (courts

have inappropriately ignored the insurers' intent in writing the exclusion).

18. Compare *Kipin Industries, Inc. v. Am. Universal Ins. Co.*, C-860658, (Ohio App., Aug. 12, 1987) with *Claussen v. Aetna Cas. & Sur. Co.*, 677 F.Supp. 1571 (S.D. Ga. 1987). Insureds' discovery on this issue should focus on the insurer's intent and the insurer's state of knowledge. Insureds should investigate to what extent the insurer knew that the Insurer's Rating Bureau had taken the position that the "sudden and accidental" clause did not narrow coverage, whether the insurer had input into the Rating Bureau at the time that position was adopted, whether the insurer had any input into the drafting of the pollution exclusion, and whether the insurer made any pronouncements, either through its own spokespersons or through its trade associations, on the meaning/intent behind the exclusion. Discovery of insurers' files, correspondence, memoranda and documents, depositions of risk managers, insurance coordinators, and top corporate personnel may be necessary to gather this evidence.
19. See, e.g., Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA") 42 U.S.C. § 9607(a)(3), which imposes strict liability on generators of hazardous wastes regardless of whether they are negligent or otherwise at fault.
20. Averback, *supra*, note 2, 14 B.C. Env. Aff. Law Rev., 648-649 (citations omitted).

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