Recent Court Decisions

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Insurance claims under comprehensive general liability policies to recover the cost of environmental clean up frequently reach the courts. In several recent decisions, the courts have addressed the scope of the comprehensive general liability policy and some of the exclusions written into those policies. These cases suggest that policy exclusions can serve to limit insurers' exposure to large environmental claims that may otherwise be covered as damages. (The cases summarized here, however, should not be viewed as representative of the state of the law. There is a significant amount of litigation and many conflicting results.)

Clean Up and Injunction Costs Are Damages Under General Policy

AIU Insurance Co. v. Superior Court, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990).

In a thorough review of the arguments, the California Supreme Court concluded that governmentally ordered clean up costs are damages within the meaning of the standard comprehensive general liability policy. The insured, FMC, faced extensive liability for the disposal of waste at seventy-nine different sites. Various government agencies sued to recover clean up costs and for injunctions compelling FMC to clean up sites. FMC sought coverage for its clean up costs and defense of the claims from its insurers under numerous general and excess liability policies. Under the policies, the insurers agreed to cover damages that FMC became legally obligated to pay as a result of property damage. The insurers argued the policy language did not extend to reimbursing the government for the cost of complying with environmental regulations. Without addressing issues raised by policy exclusions, the supreme court concluded that the policies' general provisions to cover damages extended to clean up costs.

Initially, the court noted there is a division on the issue in the reported decisions. One line of cases concludes that the damages coverage clause should be interpreted broadly in favor of coverage. These courts refuse to make a distinction among the remedies the government is seeking. Another line of cases, however, favors a more technical definition of the term "damages" and excludes coverage for remedial or equitable remedies such as injunctions. These cases fall into one of four types. Some find a distinction between damages and other remedies based on a federal provision in the environmental laws specifically authorizing damages in addition to remedial and injunctive relief. A second line of cases requires the claimant to suffer some proprietary loss; since the government does not have a proprietary interest in the clean up, those costs are not damages. A third line concludes that the term "damages" is unambiguous and does not include equitable remedies. A fourth applies a technical definition of damages and concludes that equitable remedies are not within that technical-legal term. In each line of cases, however, there is an interpretive assumption. Thus, the supreme court began its analysis by stating its interpretive approach.

Based on the evidence before it, the court chose the traditional view that the policy is interpreted in light of the parties' intent with any ambiguity being resolved in favor of coverage. The court found there was no evidence to support a finding that the parties specially negotiated the terms of the insurance contract or that the parties intended the terms to have a technical meaning. As a result, the court stated that it would interpret the contract under the normal presumption that terms would be given their ordinary, nontechnical, meaning, and any ambiguity would be resolved in favor of extending coverage.

Using this approach, the court then addressed the interpretation of the policy. According to the court, three phrases determined coverage. First, the insured must be legally obligated to make a payment. Second, the obligation must be damages. Third, the obligation must arise because of property damage.

Though the insurers argued that remedial relief or compliance with an injunction was not a legal obligation, the court had little difficulty determining that FMC was "legally obligated." The insurers argued that remedial or injunctive relief was under the court's equitable jurisdiction, and thus was not an obligation at law. While the court accepted the characterization, it did not find it controlling. The court found that even a legally sophisticated policy holder might not anticipate the term "legally obligated" to preclude coverage of remediation. Thus, the plain meaning of the term supported coverage. Even if the term were ambiguous, the term would be resolved in favor of coverage.

The meaning of the term "damages" posed a more difficult problem for the court. The court found that the term as defined by several sources required compensation in money recovered by a party for loss suffered through the acts of another. The court then applied the definition to the demand for coverage of clean up costs and the costs of complying with an injunction.

First, the court found that damages included clean up costs. Though the government was seeking to recover costs it incurred as a result of cleaning up a waste site, it also was seeking compensation in money for losses it suffered due to the act of another.

The court then rejected three arguments to recharacterize clean up costs. First, the insurers argued that federal law makes a distinction between clean up costs and damages for environmental injury. The court found that Congress intended the terms to overlap and did not feel it was bound by the distinction when interpreting insurance contracts. Second, the insurers argued that the costs were a cost of doing business and, therefore, were similar to the costs of compliance with general governmental regulation. The court rejected the second argument because the costs were primarily incurred for remediation, not to prevent future violations. Finally, the insurers argued that the recovery was intended as restitution of the costs of cleanup rather than the loss of value to the property. Once again, the court rejected the argument because damages often included restitution. Moreover, those cases denying recovery generally related to attempts by insureds to recover amounts paid as penalties. In the case of an environmental clean up, however, there is no allegation of fault. Rather, the goal was to remedy injury to the environment.

The costs of compliance with an injunction, however, presented the court with a more complicated problem. While the costs of complying did not fall within the common notion of damages, the court nonetheless concluded that compliance remedying an existing problem was within the meaning of damages. Whether the government sought recovery for its clean up costs or caused the insured to incur those costs by injunction, the same basic result would occur—the insurers would pay for cleaning up the site. Given the similarities of the remedies, each presented a claim for "damages" within the policies' terms.

Finally, the court concluded that the costs were incurred due to an injury to property. Contamination of the environment came easily within the meaning of the phrase. Thus, environmental damage satisfied the third element of the coverage provision.

Based on its interpretive starting point, the supreme court concluded that the coverage provision of the comprehensive general insurance policy extended coverage to clean up costs and costs of complying with an injunction. Given this interpretation, the insurers must look to policy exclusions to limit the scope of coverage. The courts have addressed several of the standard exclusions in recent decisions.

Business Judgment to Pollute Not Within Coverage

American Motorists Insurance Co. v. General Host Corp., No. 88-1503 (8th Cir. March 21, 1991) (LEXIS, Genfed, Currnt file).

An insurer need not defend a claim resulting from intentional acts of pollution under the standard exclusions for coverage contained in general liability policies. In a prior suit, several property owners complained that discharges from an American Salt plant had damaged the water and land of their property. Further they demonstrated that American Salt officers consciously decided to accept the consequences of spills in trade for reduced maintenance costs. As a result, the trial court in the private action found the