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The California Supreme Court Grants Review

Powerine—"Go Ahead, Sue Me"

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Policyholders across the country let out a collective sigh of relief when the California Supreme Court—unanimously—granted review of *Certain Underwriters at Lloyd's London v. Superior Court ("Powerine")*. The grant of review eliminates the precedential value of the lower appellate court opinion pending the decision of the California Supreme Court. Prior to this grant of review, the lower appellate court opinion provided insurance companies with arguments which struck at the very heart of environmental health and safety regulatory policy. Since the decision in *Powerine* was published, liability insurance companies have argued that they have no obligation to pay to clean up environmental damage under policies they sold *unless* an in-court formal lawsuit has been filed against the policyholder. These insurance company arguments are seriously flawed because they ignore the liability insurance policy language which requires insurance companies to pay "all sums" a policyholder becomes legally obligated to pay.

The California Attorney General as well as prior decisions of the California Supreme Court both support the view that the possibility of insurance coverage for environmental damage should not simply be eliminated because a policyholder has not forced the regulatory agency to commence a formal, in-court lawsuit.

The California Attorney General—"A Major Step Backward"

The California Attorney General, in his capacity as the chief law officer of the State of California, declared that the appellate court decision in *Powerine* was a "major step backward." In a letter brief submitted in support of the Supreme Court of California's review of *Powerine*, the California Attorney General explained that for thirty years, the California Legislature repeatedly and explicitly had empowered state environmental agencies with the ability to impose legal obligations on responsible parties to clean up toxic contamination. In the great majority of instances, these administrative orders resulted in compliance, often with the early involvement of the insurance companies of the policyholders. The intermediate appellate court decision in *Powerine* had provided insurance companies with arguments that directly conflict with the State of California's pollution cleanup program:

> In summary, expeditious and cost-efficient investigations and cleanups of toxic sites, funded by liable parties instead of the general public, constitute the core goal of the State of California's pollution cleanup program. In light of this Court's holding in *AIU* that environmental cleanup costs constitute damages and the forceful, injunctive-type administrative liability programs being actively implemented though Regional Board and DTSC orders pursuant to the clear intention of the Legislature, it was inappropriate for the Court of Appeal below to hold that such orders do not create legal obligations in the context of indemnity insurance. The scope of *AIU* should not be so confined, nine years after the decision was issued. When the Regional Boards or DTSC issue detailed administrative orders legally requiring liable parties to perform remedial work, their insurers should not stand idly by at the critical initial stages of the toxic site cleanup process. Litigation over environmental cleanups should be avoided,

not encouraged.

The Attorney General's position recognizes that if insurance coverage is not available when administrative cleanup orders are issued, liable businesses will be less likely to cooperate, and that this "stalemate scenario" would result in additional costly and time-consuming litigation to enforce legislatively established obligations. The California Attorney General states that this is "wholly unnecessary from a strictly legal standpoint, because the very same statutory duty or obligation—to pay for the cost of investigating and cleaning up a toxic waste site or to remedy a discharge of waste into state waters—is in effect in *both* an administrative order setting and in a civil litigation setting."

Powerine *Is Not In Line With Prior California Supreme Court Decisions*

It is the law of California that the "all sums" and "as damages" language of CGL policies requires insurance companies to pay on behalf of their policyholders for costs incurred in investigating and cleaning-up environmental damages.

In *AIU Insurance Co. v. Superior Cour*t , the Supreme Court of California, held that costs and expenses incurred to investigate, monitor and clean up contaminated sites were "damages" that activated the insurance company's duty to indemnify. The California Supreme Court did not restrict the duty to indemnify to those instances where a "suit" has been commenced. Rather, the California Supreme Court stated in *AIU* that "costs of compliance must be interpreted as 'damages' in the environmental context, because *to hold otherwise would make insurance coverage hinge on the 'mere fortuity' of the way in which government agencies seek to enforce cleanup requirements,* would unreasonably constrain the agencies' choice of cleanup mechanisms, and would introduce substantial inefficiency into the cleanup process." (emphasis added). The *AIU* court's refusal to allow the possibility of insurance coverage to hinge on the "mere fortuity" of whether or not a policyholder was named in a lawsuit is supported by the language of the insurance policies. The *AIU* court recognized that: (1) the word "suit" does not appear in the indemnity clause; and (2) the phrase "legally obligated" was ambiguous and should be resolved in favor of coverage.

The reasoning of *AIU* is echoed in *Vandenberg v. Superior Court*, the California Supreme Court's 1999 decision interpreting an insurance company's duty to indemnify under a CGL insurance policy. In *Vandenberg*, the insurance companies refused to indemnify a policyholder for an arbitration award asserting that damages for a policyholder's nonperformance of a contract were not covered under CGL insurance policies. The trial court granted the insurance companies' motion for summary judgment. On appeal, the appellate court reversed and the Supreme Court affirmed holding that the coverage phrase "'legally obligated to pay as damages, as used in a CGL insurance policy, may provide an insured defendant with coverage for losses pleaded as contractual damages." The *Vandenberg* decision confirms that "[c]overage under a CGL insurance *policy is not based upon the fortuity of the form of action chosen by the injured party*." (emphasis added).

The *AIU* and *Vandenberg* rationale is consistent with the unquestionable majority of courts to have addressed the meaning of "as damages" under the language of standard form CGL insurance policies.

Foster-Garner Is a Duty To Defend Case—Period.

The intermediate appellate court in *Powerine* relied extensively on *Foster-Gardner, Inc. v. National Union Fire Insurance Co*. In *Foster-Gardner*, the California Supreme Court interpreted the duty to defend policy language and did not address an insurance company's indemnity obligation. The insurance policy language does not limit an insurance company's *duty to pay* based on the existence of "suits" or "judgments." In fact, neither the word "suit" nor the word "judgment" appear in the duty to indemnify provision. Significantly, a duty to indemnify may exist even where there is no duty to defend.

Conclusion: A Policyholder's Paradox Shows Why Form Over Substance Should Not Be The Law

The intermediate appellate court decision in *Powerine* is untenable because it elevates the *form* in which liability for environmental damage is imposed over the *substance* of that liability and creates the following paradox:

Case No. 1: Policyholder A generates waste material that is taken to a landfill. Policyholder A subsequently becomes liable for the clean up. Rather than assist in the remediation, Policyholder A sits on its hands,

does nothing, and waits until it is sued by the enforcement agency.

Its share of the clean up costs: $10 million.

Result: Sitting on its hands and awaiting a lawsuit creates the possibility that liability insurance will be available for the $10 million clean up. This also creates public health issues as well as unnecessary litigation between the policyholder and the enforcement agency.

Case No. 2: Policyholder B generates waste material that is taken to a landfill. Policyholder B subsequently becomes liable for the clean up. Rather than waiting to be instructed to commence expensive clean up, Policyholder B immediately moves to clean up the landfill without the delay and increased costs of litigation with the government.

Total clean up costs: $7.5 million.

Result: Under the insurance company view of *Powerine,* Policyholder B has forfeited its rights to liability insurance coverage by acting in an environmentally-responsible fashion.

This paradox creates a disincentive for policyholders to conduct any clean up of California environmental sites until they are formally "sued" in-court by the government. Those policyholders, which act responsibly in addressing environmental damage before a lawsuit is commenced, thereby avoiding unnecessary litigation and delay, are unjustifiably penalized.

The dissent in the intermediate appellate decision in *Powerine* put it aptly:

> The result of the majority's holding encourages circumvention of the administrative enforcement procedure at the expense of the insured and the environment, raises the specter of collusion, increases the prospect of litigation, and ignores the reasonable expectations of the insured. Also, this result frustrates the legislative purpose behind the administrative procedure to effect speedy, efficient response and remediation of our environment.

Hopefully, California will not be faced with a chorus of potentially responsible parties all chanting, "Go ahead, sue me." ■

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