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COMMENT

Supreme Court does service to policyholders

Two of the chief evils of the way the insurance industry works, from the perspective of most policyholders, are the phenomena of "post-claim underwriting" and "insurance nullification by judicial decision."

Post-claim underwriting happens when insurance companies successfully convince the courts to apply exclusions in an overly broad fashion to eliminate risks from coverage after a loss has occurred. Insurance nullification by judicial decision happens when insurance companies convince the courts to construe exclusions in an insurance policy to thwart the reasonable expectations of a policyholder that their insurance policy protects them.

At issue was whether environmental cleanup costs mandated by federal law constitute "damages."

On July 11, the Wisconsin Supreme Court resoundingly refused to sanction post-claim underwriting by Employers Insurance of Wausau and undid its own act of insurance nullification when it overruled its 1994 decision in City of Edgerton vs. General Casualty Co. of Wisconsin. The court held, in a case involving Johnson Controls Inc., that cleanup costs under federal environmental statutes qualify as insured "damages" under commercial general liability insurance, and the insurer's duty to defend is triggered by government administrative actions such as an injunction to clean up contaminated property.

The Johnson Controls case addressed environmental cleanup costs at 21 environmental sites in 16 different states, including smelting plants and landfills,

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where Johnson Controls faced liability under federal law. At issue was whether environmental cleanup costs mandated by federal law constitute "damages" as defined in standard liability policies sold between 1954 and 1985, which cover environmental damage. Also at issue was whether a "potentially responsible party" letter sent to an insured by a state or federal governmental agency constitutes a "suit" triggering the duty to defend. A decade ago, in the city of Edgerton case, the Wisconsin Supreme Court ruled against policyholders on both counts.

The cleanup costs associated with environmental property damage are staggering. The Edgerton rule created a strong disincentive for policyholders faced with government cleanup orders to initiate a cleanup until they were sued in court, whether by the government or by third parties. Those policyholders that acted responsibly by addressing environmental damage before a lawsuit was commenced, thereby avoiding unnecessary litigation and delay, were faced with the likelihood that coverage would be denied on grounds that the policyholder had not suffered damages. Thus, the prudent choice for a policyholder was to await a lawsuit to avoid being stripped of any possibility of insurance coverage.

In the Johnson Controls case, the Wisconsin Supreme Court forthrightly noted the ill effects of the Edgerton rule, writing that "the Edgerton" opinion was too quick to embrace the strict dichotomy between legal damages and equitable actions and that this dichotomy had led to "indefensibly arbitrary" results contrary to "the expectation of a reasonable insured." The court also acknowledged that "it makes little sense in determining whether 'damages' have occurred under the policy whether the party bringing a legal action for contribution to remediate damaged property is a governmental agency or some other entity."

In describing the Edgerton line of cases, the Wisconsin Supreme Court noted that the results had become very far removed from the promises contained in the insurance policies sold by the defendants in those cases. As the Supreme Court admitted:

An especially disconcerting result of the nearly decade-old Edgerton line of cases is that the categorization scheme for determining liability coverage is now well removed from the language of the insurance contract. The source of this problem can be traced to Edgerton's failure to comport with the broad language of Johnson Controls' policy and with the reasonable expectations of the insured.

By acknowledging and correcting a prior error, the Supreme Court has done a real service to Wisconsin policyholders by undoing a decade of insurance nullification and refusing to facilitate the insurance industry's blatant post-claim underwriting.

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