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# Environmental Law

# You Should Be Covered for Natural Resource Damages

## Policyholders of all stripes have much to gain and little to lose in pursuing coverage for NRDs

**By John G. Nevius and John N. Ellison**

New Jersey businesses should be aware that the state's Natural Resource Damages initiative could expose them to significant liabilities — some of them decades old and inherited from predecessor companies. At the same time, businesses should know that their liability insurance policies — particularly historic policies, which contain fewer potentially-applicable exclusions — may provide coverage for NRD claims.

Existing case law involving insurance coverage for NRDs suggests that three factors will determine whether insurance coverage for NRDs is available in specific instances.

First, the timing of the actual occurrence is crucial. The events giving rise to environmental property damage likely must have taken place before 1985, when the so-called "absolute pollution exclusion" became a standard part of virtually all commercial general liability policies. Because CERCLA was enacted in 1980, conversely, if the pollution involved did not continue after 1980, covered liability is less likely.

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Second, the timing of notice of a covered occurrence under liability insurance almost inevitably will be an issue. NRDs are not assessed in every case. Where they are, insurance companies likely will argue that the policyholder should have foreseen an action for NRDs and that NRDs are directly linked to other environmental costs already incurred — and possibly covered.

The counterargument to a late notice allegation, of course, is that insurance companies have not suffered any prejudice. This is true, in part, because in general, NRDs merely reflect an after-the-fact assessment of existing damage to natural resources.

Late notice allegations are to be expected, however, because insurance companies reflexively deny any claims even remotely relating to the environment under virtually all forms of occurrence-based policies.

Third, if past history is any guide, the specifics of how NRDs are assessed scientifically and legally will give rise to coverage issues and arguably implicate some sort of policy fine print.

Policyholders, in short, should expect a fight from their insurance providers when they seek coverage for NRDs. They should not be deterred, however. Policyholders of all stripes have much to gain and little to lose in pursuing insurance coverage for NRDs.

### Background

Under Superfund or "CERCLA," the most widely-recognized federal environmental law, natural resources are defined as "land, fish, wild life, biota, air, water," while NRDs are defined as "the dollar value of the appropriate degree of restoration necessary to assess, restore, rehabilitate, replace or otherwise compensate for the injury to natural resources as a result of a discharge."

Under CERCLA — officially known as the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C.A. §9601, et seq. — the Environmental Protection Agency, or a duly authorized equivalent state environmental agency, may seek damages for harm to "natural resources resulting from the release of hazardous substances or the discharge of oil."

Hazardous substances can be almost anything. Natural resources are held in trust for everyone. Under CERCLA, an appointed trustee or panel of trustees reduces NRDs to a specific monetary amount, often in conjunction with specific mitigation projects.

Accordingly, successfully making an insurance claim against the liability insurance in effect at the time environmental property damage occurred should be a straightforward process. This is particularly true in New Jersey, where insurance law mandates that policies be interpreted in accord with the reasonable expectation of policyholders and the language and expressed intent of most standard-form liability insurance.

"Superfund," created in 1980 by a special CERCLA tax to fund cleanup, has effectively gone bankrupt. Government agencies charged with protecting the envi-

ronment increasingly are looking for alternative sources of environmental funding.

### Historic Promises

This imperative may at least partially explain New Jersey's NRD initiative. The latest wave of government action to recoup cleanup costs underscores the value of historic (pre-1985) Comprehensive General Liability insurance as a means to offset environmental costs, as opposed to the alternatives — your profits and tax dollars.

Under *Morton International, Inc. v. General Accident Ins. Co.*, 134 N.J. 1 (1993), New Jersey has led the way in holding insurance companies to their historic promises. Under the doctrine of regulatory estoppel, liability insurance companies are held to their original regulatory filings that explained what was intended to be covered under standard-form policy contract language.

Specifically, New Jersey courts have held that CGL insurance policies sold between approximately 1970 and 1985, which contain a more qualified polluter's exclusion than post-1985 policies, cover most environmental damage that was not "expected or intended" by the policyholder. (Prior to 1970, CGL policies generally contain no pollution exclusion at all.)

Accordingly, in New Jersey, pre-1985 CGL insurance policies should cover NRDs. Companies hit with a suit seeking damages for NRDs (or more likely a trustee's demand letter) should immediately notify their brokers and liability insurance companies. Insurance companies should defend against any legal claims or threats and investigate the scope of any alleged environmental liability. Your insurance company(ies) also should indemnify you against NRDs.

There are several important limits on the recovery of NRDs. First, if *all* the damage took place before Dec. 11, 1980, under CERCLA you should effectively be off the hook. See 42 U.S.C.A. §9607(f); *In re Acushnet River & New Bedford Harbor Proceedings re: Alleged PCB Pollution*, 716 F.Supp. 676 (D. Mass. 1989).

Second, state and federal trustees may only recover NRDs where the resources are "publicly held," though damage to privately-owned resources subject to government authority may also create liability. See *Ohio v. U.S. Dep't of the Interior*, 880 F.2d 432 (D.C. Cir. 1989).

Third, a variety of monetary limits apply to the governments' potential recovery, the most important being the $50 million cap under CERCLA in the absence of willful conduct or negligence. See 42 U.S.C.A. § 9607(c)(1), and *State of Cal. v. Montrose Chem. Corp.*, 104 F.3d 1507 (9th Cir. 1997). New Jersey's initiative appears unlikely to involve liabilities of this magnitude.

Nonetheless, New Jersey is concerned about its reputation, and this initiative will be watched closely by other states. Up to now, NRDs generally have been sought only in response to catastrophic events like the Exxon Valdez oil spill or the historic discharge of more than a million pounds of PCBs into the Hudson River. But as Bradley Campbell, New Jersey's commissioner of environmental protection, stated: "Like in other states our natural resources have been diminished far more by the accretion of small environmental insults from various sources of contamination [rather than from catastrophic events]." See *The New York Times*, Sept. 10, 2003 at B5.

New Jersey's hard line, however, likely will be tempered by the state's willingness to consider environmental compromises — including alternative restoration or mitigation projects — instead of collecting monetary damages.

### Insurance Coverage

A handful of state and federal appellate courts have addressed insurance recovery for NRDs. NRDs are third-party property damage. See *Aetna Cas. & Sur. Co. v. Pintlar Corp.*, 948 F.2d 1507 (9th Cir. 1991), (the government has a "quasi-sovereign interest in environmental resources.").

Accordingly, in states like New Jersey where CGL insurance coverage exists for environmental damage such as groundwater contamination, obtaining coverage for NRDs should be achievable. NRDs are similar to other CERCLA-imposed costs that most states consider covered damages under CGL insurance.

The most recent state supreme court to analyze this matter reversed its own prior holding on insurance coverage involving CERCLA damages. See *Johnson Controls, Inc. v. Employers Ins. of Wausau*, 264 Wis.2d 60, 665 N.W.2d 257 (2003). In so doing, the court had occasion to analyze the extent to which NRDs are sufficiently similar to other CERCLA damages for which insurance coverage exists.

The court held that both NRDs and CERCLA response costs "compensate for loss incurred," and therefore should be covered.

The U.S. District Court for the District of New Jersey has not directly addressed insurance coverage for NRDs. The court did, however, find arguments involving NRDs, CERCLA response costs and "insurance coverage implications," persuasive in upholding the contribution rights of a party that settled CERCLA claims without admitting CERCLA liability. See *United States v. Compaction Systems Corp.*, 88 F.Supp.2d 339 (D.N.J. 1999).

One New York court, on the other hand, has held that untimely notice precluded coverage for NRDs. In *Reynolds Metals Co. v. Aetna Cas & Sur. Co.*, 696 N.Y.S.2d 563 (3d Dept.), the court held that coverage was precluded in part because the policyholder was held to have had sufficient prior knowledge of the potential assessment of NRDs — notwithstanding that no action seeking NRDs had been commenced and there was no showing of prejudice to the insurance company.

Similarly, the U.S. District Court for the District of Nevada also rejected coverage for NRDs, but based on a relatively recent "hazardous substances" exclusion. See *Montana Refining Co. v. Nat'l Union Fire Ins. Co.*, 918 F.Supp. 1395 (D. Nev. 1996). In so holding, however, the court determined that CERCLA clean-up costs were equivalent to NRDs for purposes of interpreting a post-1985 CGL insurance policy. This decision is of limited relevance to New Jersey, insofar as the *Montana Refining* court expressly rejected New Jersey's analysis in *Morton*. Furthermore, the exclusion in question expressly referred to NRDs.

While this case has limited general relevance, it plausibly can be used to argue that less recent CGL insurance poli-

cies (which very likely do not expressly address coverage for NRDs), provide coverage for NRDs. It generally is accepted in New Jersey and elsewhere that insurance companies have the burden of establishing limitations upon coverage.

### Read the Fine Print

The *Montana Refining* case, at a minimum, demonstrates that insurance companies are capable of crafting standard-form policy language specifically addressing NRDs. Where insurance companies have not included any such policy language, NRDs should be covered as surely as any other CERCLA-related investigation, clean-up or response costs.

While the EPA to date has not pursued recovery of NRDs on a scale anywhere near that of CERCLA response actions, the EPA itself has contemplated the recovery of insurance proceeds with respect to NRDs. As far back as 1994, the EPA negotiated an environmental settlement agreement with a bankrupt entity that addressed recovery of NRDs and left the door open to related insurance recovery for the benefit of creditors. See *In re Energy Co-op., Inc*., 173 B.R. 363 (N.D. Ill. 1994). The settlement involved both CERCLA response costs and NRDs, and included provisions allocating a portion of any subsequent insurance proceeds to a trust fund.

The argument that NRDs should be covered is supported by the EPA's similar treatment of CERCLA response costs and NRDs; by the EPA's recognition of the potential for insurance coverage for both; and by the court's acceptance of the settlement. The timing of notice and actions involving NRDs almost certainly will be a major issue with respect to insurance recovery.

As discussed above, in states like New York where defenses to coverage involving untimely notice do not require the insurance company to demonstrate prejudice, notice issues may preclude coverage for NRDs. In one of the earlier cases to address insurance recovery for NRDs, however, other coverage defenses involving timing were rejected. See *Aetna Cas. & Sur. Co. v. Pintlar Corp*., 948 F.2d 1507 (9th Cir. 1991).

In *Pintlar*, the insurance companies argued generally that environmental harm taking place before the enactment of CERCLA does not give rise to recoverable damages under CERCLA and, therefore, insurance recovery is precluded for such harm "as damages" under CGL insurance. The term "damages" is not defined in most CGL insurance policies.

In response, the *Pintlar* court held that even where the CERCLA definition of damages — that is, "the monetary quantification stemming from an injury" — is adopted, coverage for NRD claims may exist.

The court's holding also was based on the lack of any requirement in typical occurrence-based insurance policies that environmental injury take place contemporaneously with the discovery of environmental property damage or the assessment of any resulting damages. Accordingly, the Ninth U.S. Circuit Court of Appeals overturned the district court's grant of summary judgment and held that insurance coverage may be available for NRDs.

The *Pintlar* holding is in accord with the fact that liability insurance fundamentally is expected to, and does, cover costs the policyholder must pay to a third party. When damages take place and the policyholder's legal obligation to pay for them is established, CGL coverage is triggered.

All the elements necessary to obtain insurance coverage for NRDs exist, especially in New Jersey. Existing case law on insurance coverage for NRDs is mixed but encouraging. A great deal depends on the jurisdiction.

If the NRD police come knocking, always give notice of a potential claim to your brokers and insurance companies, whether or not you have successfully pursued an environmental claim in the past. Many New Jersey businesses may view NRDs as an inappropriate second bite at the apple by environmental regulators. Insurance companies likely will take a similarly dim view of NRD claims.

No one anticipated this kind of liability. But unanticipated liabilities are precisely what liability insurance is designed to cover — and why it should now be available to offset the costs of remediating damage to the nation's natural resources. ■