ENVIRONMENTAL INSURANCE UPDATE

by James K. O'Brien

This article will discuss recent case law developments concerning the insurance of environmental risks in Michigan. Some four years ago, the Michigan Supreme Court decided a trilogy of cases[1] on insurance of environmental damage, and in the process, clarified Michigan law concerning general liability coverage for long-term pollution incidents, under policies containing a "pollution exclusion."

The history of litigation regarding environmental insurance coverage, and particularly the pollution exclusion[2] has been the subject of dozens of articles in Michigan, and hundreds of articles nationwide.

Currently, the highest courts of eight states (Florida, Iowa, Massachusetts, Michigan, Minnesota, New York, North Carolina, and Ohio) have found the standard pollution exclusion to be unambiguous, and have applied it to exclude coverage for gradual, long-term pollution. An equal number of states (Colorado, Georgia, Illinois, New Jersey, South Carolina, Washington, West Virginia and Wisconsin) have either held that the "sudden and accidental" exception to the pollution exclusion is ambiguous, or for other reasons does not necessarily exclude gradual pollution from insurance coverage.

It was reasonable to predict, and many did, that litigation over insurance coverage for environmental losses was a thing of the past in Michigan after the *Upjohn* trilogy. Yet, like "serious impairment of body function" in the area of "no-fault" automobile personal injury cases, insurance coverage for environmental damage or injury has become the issue that wouldn't die in Michigan.

Next Month — Negligence Law

Duty to Defend

In addition to paying judgments against insureds, arising from covered claims, most commercial general liability insurers also extend coverage for the costs of defense of "suits." This is not an insignificant item where litigation tends to be long, complex and expensive. Typically, such lawsuits only take place after an equally, complex, and expensive administrative process in which the EPA coerces responsible parties to cleanup environmental contamination, or face crippling economic sanctions.[3] Even though the precise issue had not been decided at the Supreme Court level in Michigan prior to 1994, it was clear that if faced with the question, Michigan's Supreme Court would determine that a "duty to defend" under general liability insurance policies extended only to traditional litigation, and not EPA enforcement activities.[4] It was certainly a reasonable assumption that, under Michigan law, a letter pursuant to the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) designating an insured as a potentially responsible party (PRP), and demanding that contamination be cleaned up, would not trigger a liability insurer's duty to defend.

The Supreme Court defied such predictions in *Michigan Millers Mutual Insurance Company v Bronson Plating Companys.*[5] In 1986, the EPA notified Bronson Plating Company that there had been a "release" of hazardous materials at the company's facility, demanded information about past activities at the site, and "requested" the companies participation in an investigation, and subsequent cleanup at the site. Prior to receipt of the letter, Bronson Plating had notified its insurers that it was the target of an EPA investigation of contamination, and anticipated further enforcement activity by EPA. Even though no suit had been started, Bronson Plating demanded and received a "defense" from its insurers and the Supreme Court affirmed that a duty to cover defense existed. After an unconvincing explanation,[6] the Court concluded that expanding the definition of suit to include EPA enforcement actions was a practical and desirable result, in any event.

The mischief (or generosity) wrought by the *Bronson* court became apparent less than three months later in *American Bumper and Manufacturing Company v Hartford Fire Insurance Company.*[7] In *American Bumper*, the insured carried on metal finishing operations that involved the storage of waste water, contaminated by various chemicals, in an unlined seepage lagoon. In 1978, the DNR ordered American Bumper to investigate elevated phosphorous levels in groundwater beneath the property, and dissolved metals found in the lagoon. In 1986, the EPA proposed adding the site to the National Priorities List, and in 1987, American Bumper entered into a consent agreement with the EPA, under which the company would perform a remedial investigation and feasibility study (RI/FS). According to the court, the

EPA at that point concluded that no further remedial action was necessary, although the Michigan DNR (MDNR) requested further testing.

Also in 1986, American Bumper put it's liability insurers on notice of the EPA's options at the site, apparently anticipating that EPA would name it a potentially responsible party and demand an RI/FS in 1987. Two of it's insurers agreed to defend the EPA administrative action, but in 1991, American Bumper commenced a suit in the Ionia County Circuit Court seeking coverage for the costs of the RI/FS, apparently characterizing them as "defense costs." The trial court granted summary judgment to the defendant insurance companies on the basis of a limited pollution exclusion, providing coverage for "sudden and accidental" releases, only, and on the basis that no "occurrence" had taken place, as required for coverage under the policies. In addition, the "loss-in-progress" doctrine[8] precluded coverage.

The court of appeals reversed the trial court's grant of summary disposition to defendant insurers, based on a circuitous explanation, paraphrased as follows:

1) The *Bronson Plating* decision holds that EPA investigation is the equivalent of lawsuit, for purposes of triggering a duty to defend under a liability insurance policy;

2) A duty to defend is owed where there are uncertainties as to the nature of the discharge (that is, whether the discharge of pollutants was "sudden and accidental," or not);

3) Where "no pollution was ever found," the facts can never be developed which will show that any alleged pollution was not "sudden and accidental" and therefore not entitled to coverage; and

4) Thus, the insurance company must provide a defense until it is shown "to the EPA's satisfaction" that no discharge occurred, that no pollutants were present, or that any discharge which did occur was not the result of a sudden and accidental discharge."[9]

The Court did not seem too concerned with the fact that the EPA is not a trier of fact, and that there is no requirement under CERCLA, or the Michigan Environmental Response Act (MERA) to show that a discharge of pollutants is sudden, gradual, intentional or accidental; a polluter's obligation to clean up any resulting pollution attaches in any event.

Next, the court reversed summary judgment on the "occurrence" argument, by reversing the usual burden of proof[10] and requiring an insurer to defend "until it is established that an occurrence has not occurred . . ."

The court failed to reach one of the most important questions presented for determination on appeal: whether the costs of the RI/FS constitute "defense costs" covered by an insurer's obligation to provide a defense (as opposed to the separate obligation to indemnify the insured for "damages," if coverage, and liability are established). A previous appellate court decision, *Gelman Sciences. Inc. v Fireman's Fund Insurance Company*[11] held that costs in the nature of a remedial investigation or feasibility study should not be considered defense costs, but see also: *Fireman's Fund Insurance Company v Ex-Cell-0*,[12] that suggests such costs' might be "defense costs" to the extent they tend to disprove or minimize CERCLA liability.

The issue will almost certainly be raised again, given the new ground broken by *Bronson* and *American Bumper*. The analogy between a "suit" and an EPA ratification is a very poor one: the pleadings in a lawsuit, should, at least theoretically, describe actions, events, and damages with sufficient particularity to allow an insurer to determine whether a duty to defend exists. An EPA "demand letter" pursuant to CERCLA Section 107 need only state that a discharge, or a threat of a discharge of a hazardous substance is believed to have occurred, and that the insured may have strict liability, based on ownership or status. Absent a declaratory judgment action, many pollution incidents involve uncertainty as to the duty of defense owed to potentially responsible parties by their liability insurers. In some cases, as the *American Bumper* court candidly admits, the uncertainty as to the duty to defend may continue until the EPA loses interest, years, and millions of dollars later. *Traverse City Light and Power Board v Home Insurance Company* offers a contrary view.

In another recent decision, the Sixth Circuit, in *Anderson Development Company v Travelers Indemnity Company*,[13] decided the following points:

1) *Following Bronson, PRP letters trigger a duty to defend;*
2) *The cost of complying with an EPA order to clean up a site constitutes recoverable damages under a general liability insurance policy; and*
3) *If a cleanup is required by a threat to the environment, coverage is not excluded by the "owned-property" exclusion, since the environment is in the public domain.*

Pollution Exclusion

Auto Owners Insurance Company v City of Clare[14] stands for the proposition that an insurer's duty to defend is broader than the duty to indemnify and arises when coverage is even arguable, though the claim may be groundless or frivolous. It is also noteworthy, however, for perpetuating the uncertainty created by *City of Woodhaven* as to whether the unambiguous phrase "sudden and accidental" in the limited pollution exclusion refers to the initial disposal of pollutants, or the "release" of those pollutants at a later time, when, for example, a landfill liner is breached.[15] In *City of Clare*, involving "intentional disposal of material for years," the result would be the same under either analysis, and thus the court did not decide the question. Under the right set of facts, however, the "initial discharge rule" may make a difference, and *City of Woodhaven* may have to be further clarified. The *City of Clare* opinion also made it clear that certain types of activities are not "sudden and accidental" and claims involving intentional, long-term disposal or discharges may be decided as a matter of law through summary disposition.

Although the panel did not cite

City of Clare, Michigan Millers Mutual Insurance Company v Johnson[16] certainly exemplifies the holding in that case. In *Michigan Millers*, the defendant, purchaser of contaminated property, argued that the seller's insurer (plaintiff) should provide coverage for the cost of remediation (or the purchase price of the property). At the trial court level, Johnson argued, unsuccessfully, that the limited pollution exclusion, for a discharge, etc., to a "body of water," was ambiguous, and did not include groundwater.

The Court of Appeals held that in Michigan, application of the pollution exclusion focuses "exclusively on the discharge . . . into the atmosphere or environment." Implicitly, any discharge, to any medium, is excluded unless it is "sudden and accidental." Under the facts of that case, involving long-term spillage of gasoline and leaking pipes or tanks, the discharges were not sudden and accidental, as a matter of law, and summary disposition was properly granted.

Occurrence

In *Bogle v Travelers Indemnity Company,*[17] a landlord sought coverage under a liability policy issued to its tenant, St. Clair Rubber Company, polluted the leased premises. As is common in such situations, the lease required St. Clair to procure liability insurance "for the benefit of the landlord." The tenant company obtained liability insurance through defendant but did not name Bogle the plaintiff-landlord as an additional insured under the policy. The property was subsequently sold by Bogle, and in 1986 the DNR notified the then current owners that the property was dangerously contaminated, and determined Bogle was a potentially responsible party under CERCLA. The ensuing underlying litigation is best known for determining that attorney fees were recoverable in a private CERCLA cost recovery action,[18] only to be overruled a few months later by the Supreme Court as a companion case to the *Keytronic* decision.

That litigation also triggered a demand by the landlord for indemnity coverage and defense costs under the insurance policy procured by its tenant, leading to the instant coverage litigation. The landlord's claim for coverage was dismissed by the trial court, and affirmed by the Court of Appeals. Bogle claimed that although she was not a named insured in the tenants policy, she was "equitably subrogated" to her tenant's rights against Travelers. The *Bogle* court held that equitable subrogation was limited in application to situations where contractual duties run between the parties, as when an excess insurer may become subrogated to it's insured's rights against a primary insurer, or when necessary to allow recovery by an injured party against the wrongdoer actually responsible.

Neither of those situations were applicable to Bogle's circumstances, according to the Court of Appeals. Nor was plaintiff entitled to recover money owed to its tenant by the tenant's insurer; however, it would have been entitled to a lien on the tenant's insurance proceeds, if coverage was otherwise available. Coverage was not otherwise available. Even though the insurance policy at issue did not have a pollution exclusion, in order for coverage to be available under a general liability insurance policy the claim for coverage must result from an "occurrence." That is, the injury or damage must be "neither expected or intended from the standpoint of the insured." Consistent with previous Michigan cases on the subject, the Court concluded that "the intentional dumping of toxic wastes into storage pits and lagoons" was intentional, and the resulting contamination should have been expected both by the insured, and the plaintiff as owner of the property.

The *Bogle* court noted that, when faced with a similar definition of "occurrence," another panel of the court of appeals in *Arco Industries Corp. v American Motorists Insurance Company*[19] held that "repeated intentional discharge of volatile organic compounds (VOCs) into a plant's drainage system for storage in unlined lagoons was not an occurrence."

The Michigan Supreme Court, however, reversed the Court of Appeals in *Arco Industries.*[20] After *Arco Industries*, holding that the requirement that an occurrence be unexpected and unintended is to be determined from the insured's subjective viewpoint, focusing on whether the ultimate environmental damage, and not the act per se, was intended. For a similar analysis in a recent federal court case involving property damage from contamination at several sites, see *Upjohn Company v Aetna Casualty and Surety Company.*[21] In that case, the court held long-term, routine and intentional storage or disposal of hazardous substances could be an "accident" as required by the standard definition of an occurrence. The question of whether such activities were "expected or intended" was a fact question, to be determined from the subjective point of view of the insured. Nevertheless, such long-term, routine disposal activities would be excluded by the limited pollution exclusion, because they were not "sudden and accidental." Pollution damages resulting from vandalism, or an apparently intentional fire, however, could be covered under the general liability policies at issue.

Also see *Traverse City Light and Power Board v Home Insurance Company,*[22] wherein coverage was excluded for groundwater damage resulting from daily disposal of fly ash from 1975 through 1987. The court applied the "initial discharge" rule from *City of Woodhaven*, and held, contrary to *American Bumper*, that uncertainty as to the causation or extent of resulting damage does not prevent summary disposition where the character of the initial act clearly involved an "expected and intended" discharge of pollutants.

Liability Insurance

Cases involving liability for pollution incidents under professional liability, or "errors and omissions" policies have been discussed far less frequently in reported Michigan opinions than cases involving claims under commercial general liability

insurance policies. One such case is *Progressive Architects/Engineers/Planners, Inc. v Security Insurance Company of Hartford.*[23] In that case, the plaintiff performed services in connection with the preparation of a site for a Meijer retail store, and either directed or permitted the burial of on-site debris in connection with the construction of a berm, designed to hold contaminated soil discovered at the site. When the debris was also determined by the DNR to be contaminated, by hazardous substances, and required to be removed, the plaintiff architectural engineering firm was sued by the site owner, and sought coverage under its professional liability policy. The policy contained an exclusion for claims arising from the discharge, dispersal, release or escape of pollutants. The exclusion was given a broad reading by the court that found no coverage for the claim, and noted that even the removal of nonhazardous debris from the berm may not have been a covered cost under the policy.

Lost Insurance Policies

Americhem Corporation v St. Paul Fire and Marine Insurance Company[24] concerns a claim for environmental damage,[25] but actually decides an issue of pure insurance law, albeit one that comes up frequently in the context of environmental claims: proving coverage when the insurance policy has been lost. In *Americhem*, the period during which the contaminated site (Barrels, Inc.) was used by the plaintiff insured, and therefore, the period for which insurance coverage at issue was 1975-1980. During that period, it was Americhem's practice to discard insurance policies after the period of coverage had expired. Neither the defendant insurer, nor the plaintiff-insureds' insurance agent could locate copies of the policies, and while the existence of insurance policies for the period was admitted, the terms of those "multi-cover" policies were in dispute.

The insurance agent admitted on deposition that he had no recollection of the first three policies issued during the period in question, but his testimony that "multi-cover" policies included general liability insurance, combined with his testimony that two later policies offered general liability coverage, created an issue of fact as to whether the 1975-1980 policies included general liability insurance.

With regard to the limit of liability, testimony that $100,000 was a "fairly standard limit" in 1975, and that the limit would not have decreased in later years, created an issue of fact regarding the limits of liability under the policy as well.

The court noted the defendant insurer's stipulation that it only sold insurance policies in this state approved by the Michigan Insurance Commissioner. Because the defendant insurer first received approval of a general liability insurance policy including a pollution exclusion (with an exception for a "sudden accident") in 1980, the court ruled that the plaintiff insured had introduced sufficient evidence as to the pertinent terms of the pre-1980 policies to create an issue of fact, and avoid summary judgment. The *Americhem* case is notable for the plaintiff's resourceful use of limited information, and the court's interpretation of the evidence. It must certainly lie along the lower boundary of acceptable proof of the terms of a lost policy.

Compare the insured's treatment in *Americhem* with the result in *Contra-Aire v Commercial Union Insurance Company.*[26] In *Contra-Aire*, the court granted summary disposition for the defendant insurer where all but one of the policies covering the period at issue had been lost, and the only evidence of the lost policies' existence were corporate records of policy numbers and policy periods. The court ruled that the insured would be unable to sustain its burden of proving the terms of the policies, and granted summary disposition to the defendant insurers. The one existing policy contained a limited pollution exclusion, sufficient to exclude coverage, and the court granted summary disposition as to that policy as well.

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Footnotes

1 *Upjohn Company v New Hampshire Insurance Company*, 438 Mich 197 476 NW2d 392 (1991); *Polkow v Citizens Insurance Company*, 438 Mich 174, 476 NW2d 382 (1991); *Protective National Insurance Company v Woodhaven*, 438 Mich 154; 476 NW2d 374 (1991)

2 Although there is some variation in their terms, most commercial general liability insurance policies issued between 1973 and 1984 contained an exclusion from 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 water course or body of water; but this exclusion does not apply if such discharge. dispersal, release or escape is sudden and accidental. . .
The pollution exclusion, or "limited" pollution exclusion may be contrasted with the "absolute" pollution exclusion which came into general use in 1984 and attempted to exclude coverage for all pollution incidents, sudden or gradual, accidental or intended.

3 See e.g.: 42 U.S.C. Section 9607 of the Comprehensive Environmental Response Compensation and Liability Act (CERCLA); MCLA 324.20126 (The Michigan Environmental Response Act). Eor a more detailed discussion of the CERCLA and MERA enforcement processes, see Chapter 6 of the *Michigan Environmental Law Deskbook* (ICLE, 1992)

4 *Ray Industries, Inc. v Liberty Mutual Insurance Company*, 974 E2d 754 (CA 6, 1992)

5 445 Mich 558 (1994)

6 For a convincing explanation of "suit" as a reference to a legal action in a court, please see the dissent in *Bronson.*

7 #152655, 154355 (Mich App, September 20, 1994)

8 The Loss-In-Progress Doctrine holds that, once a loss has begun, it cannot be insured under a policy which commences coverage at a later date.

9 Slip Opinion, Page 4

10 See e.g.: *Elston-Richards Storage Co v Indemnity Insurance Company of North America*, 194 ESupp 673 affd. 291 F2d 627 (CA 6, 1961)

11 183 Mich App 445, 455 NW2d 328 (1990)

12 790 F.Supp 1318 (E.D. Mich., 1992)

13 #93-2140/2166, 1995 Fed App 0099P (Sixth Circuit, March 20, 1995)

14 446 Mich 1 (1994)

15 *City of Clare* Footnote 12, Slip Opinion, Page 15)

16 Mich App #151961 (October 5, 1994, unpublished)

17 Mich App #154889, February 14, 1995 (unpublished)

18 *Donahey v Bogle*, 987 F2d 125 (CA 6, 1993)

19 198 Mich App 347 (1993), lv gtd 445 Mich 879 (1994)

20 No. 96782, 96784 (Mich Sup Ct, April 18, 1995)

21 #4:88:CV-124 (WD Mich July 20, 1994)

22 #151170, (Mich App March 6, 1995)

23 #1:93-CV-539 (WD Mich, July 15, 1994)

24 #5:93-CV-47 (WD Mich, January 9, 1995)

25 Plaintiff allegedly "arranged for disposal" of hazardous materials by sending its "empty" chemical containers to the Barrels, Inc. Act 307 site (*Americhem* slip opinion, Page 1).

26 #D-93-2234-CK (Cir. Ct. Kalamazoo County, Michigan, September 23, 1994, discussed in *Michigan Environmental Law Journal* V 13, No. 4, Page 40)