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ENVIRONMENTAL LIABILITY AND INSURANCE

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Civil liability in the environmental context usually means an award of money damages to the injured party, and/or the responsible party being held liable for some or all of the cost of cleaning up the damaged area. The penalties in existence under our current environmental statutory framework create the possibility for severe financial consequences for many types of businesses. The cost of cleaning up an environmental site for a responsible party may be as high as $100,000,000 or more. This potential legal liability creates a serious financial risk for companies engaged in activities which may be impacted by environmental laws.

Environmental liability may arise from transactions or activities which have no relation to traditional notions of pollution or manufacturing. Seemingly innocuous activities, such as the merger or acquisition of businesses or the purchase or mortgaging of real estate, can lead to unknown environmental liability, as can activities which occurred several decades ago.

Where this liability exists, the obvious focus then becomes financial: how much will this liability cost (to either compensate or clean up), and how will it be paid? *Environmental Law and Insurance*, a book by this author scheduled for 1996 publication by Clark Boardman Callaghan, will fully address those questions by providing the reader with a detailed discussion of insurance coverage which may cover some or all of a particular liability or loss. The types of insurance policies discussed are not specifically "environmental" insurance. In fact, many businesses have policies which cover environmental liability and have not realized that they are entitled to defense or indemnification from the insurer. In many cases, insurance policies which have seemingly expired can still be a source to satisfy environmental liability.

Environmental pollution can be remedied in a variety of means. The EPA, as well as local governmental entities, have enforcement powers over entities that violate the Clean Air Act or the Clean Water Act. Also, the EPA and some local governments regulate the management and cleanup of hazardous waste through the enforcement of RCRA and CERCLA. This enforcement comes in the form of fines, equitable orders to cleanup and/or remediate a site, and/or actions by the EPA to recover for cleanup costs that it has incurred. The cost of these remedies is often in the millions of dollars. The parties that have to pay for these remedies rarely are financially able to, or desire to, pay such huge sums. As a result, liable parties often look to their insurer to pay for such liability. This article contains an introductory discussion of some basic insurance principles which are necessary to an understanding of the application of insurance to environmental liability.

General Principles

Fortuity

Fortuity, like the other general insurance concepts of "risk", "known risk", and "known loss", must be understood in the context of environmental liability. A fortuitous event is an event which happens by chance or accident. An event is not fortuitous if it is brought about intentionally by the insured or if the insured knew or should have known that the event was likely to occur. If an event is not fortuitous, it will not be covered under an insurance contract unless the parties specifically agree otherwise. In other words, insurance covers events which may occur, not those which are reasonably certain to occur or those which have already occurred.

While much of insurance litigation is dependent upon contract interpretation, the requirement of fortuity exists independent of the contract.

Risk vs. Known Risk or Known Loss

Inherent in the application of the fortuity doctrine is the concept of risk. Risk necessitates protection, and one form of protection is insurance. Insurance operates to shift the risk from the insured to the insurer. The insured will invariably make an evaluation of risk when deciding whether or not to insure and in determining the appropriate scope of coverage. The insurer will likewise make an evaluation of risk which is typically based upon particularized factual data about the insured, as well as more generalized data from similar cases. This generalized concept of risk is a cornerstone upon which the insurance industry has grown.

Where the risk of a particular event occurring increases in probability to the point where the risk is "substantial", the doctrine of "known risk" arises. The doctrine of fortuity (as well as the "known risk" and "known loss" doctrines) holds that the risk of a casualty occurring must not be so high as to deem that casualty as inevitable. There must be some uncertainty involved. When a risk is so great that there exists a substantial probability that the event will occur, the risk becomes a "known risk", and in some jurisdictions it cannot be the subject of an insurance contract.

Attempting to distinguish the generic concept of "risk" from the legal doctrine of "known risk" can be difficult. Obviously an insured must be convinced that the risk of an event occurring is great enough to require insurance protection. Yet when the risk of that event occurring becomes too high, the known risk doctrine operates to bar recovery by the insured. The difficulty arises when attempting to determine the level of certainty of the event occurring which will bar recovery by the insured. In other words, whether a risk is "substantial", or a "substantial probability" exists, is a difficult factual question to answer, and it is often the source for litigation.

A risk can become a known risk when the insured receives some evidence or indication that a loss may occur. Examples found in the case law include declaration of property as a hazardous waste site prior to issuance of a comprehensive general liability (CGL) policy (*Ascon Properties, Inc. v. Illinois Union Ins. Co.*, No. 89-55082 (C.D. Cal. 1990), 4 Mealey's Lit. Rep. (ins.), No. 18 (Aug. 31, 1990)) and receipt of a PRP letter from the EPA. (*Time Oil Co. v. CIGNA Property and Casualty Ins. Co.*, 743 F. Supp. 1400, 1415 (W.D. Wash. 1990), in which the court stated that the PRP letter notified Time Oil that there was a "substantial probability" that a loss would occur in the form of cleanup costs for the property in question.)

The term "known loss" has been used interchangeably with "known risk" by some courts, and it has been distinguished by others. If one were to imagine a continuum of certainty with "risk" at one end and "known loss" at the other, it might be said that "known risk" falls somewhere in the middle. When an insured has a known loss, he is certain that a loss will or has occurred. This is a higher level of certainty than a "substantial probability" that a loss will occur.

Regardless of terminology of standard required, the known loss doctrine operates to deny coverage under a CGL policy where the insured knew or had reason to know of the loss. In states where the courts have refused to expand the known loss doctrine, and recognize a broader known risk doctrine, insurers may find themselves more likely liable to defend, indemnify, and cover losses under CGL policies.

Liability Insurance

The CGL policy may provide an effective means of obtaining insurance coverage for environmental liability for past occurrences. There are two types of policies that have been utilized by the insurance industry since the inception of CGL insurance: the accident-based policy, and the occurrence-based policy. Both of these types of policies are often at issue when environmental liability arises, and the threshold issue in these instances is whether an accident or occurrence took place.

Accident

Prior to 1966 the standard CGL policy provided coverage for bodily injury or property damage "caused by accidents which occur during the policy period." Since the term "accident" is not defined anywhere in the CGL policy, the definition and interpretation of "accident" have been the subject of a great deal of litigation over the years.

Occurrence

In response to the issues regarding the term "accident", in 1966 the National Bureau of Casualty Underwriters and the Mutual Insurance Rating Bureau, the authors of the standardized CGL form, made revisions which included the elimination of the term "accident" as the trigger for coverage. In its place the term "occurrence" was substituted. The current definition of "occurrence" as revised in 1988, in the standardized CGL policy is as follows: "An occurrence means an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

With regard to whether an event was expected or intended, the courts use two different standards. These two standards are the "substantial probability" test and the "foreseeability" test. That is, courts will decide whether there was an "occurrence" based on whether the insured knew or should have known that there was a substantial probability that certain results would follow the insured's actions, or that those results were foreseeable.

Property & Casualty Insurance

Loss

Another type of insurance that provides coverage for environmental liability is property and casualty insurance. Property insurance policies are generally called "first party" policies, because they are designed to protect the property of the insured from loss or unavoidable risks. Environmental loss may be covered by a variety of types of property and casualty insurance policies, including "named risk", "multi-risk", and "all risk" policies. These various policies cover environmental losses which are considered direct physical loss of or damage to covered property at the premises described in the policy caused by or resulting from any covered cause of loss."

The threshold question that triggers coverage under a property and casualty insurance policy is whether there has been a direct physical loss. The term "direct" loss has been interpreted to mean that the loss is the natural consequence of the cause, or named peril. (*See, e.g. Louisville & Jefferson County Metropolitan Sewer Dist. v. Travelers Ins. Co.*, 753 F.2d 533, 537 (6th Cir. 1985); *Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co.*, 526 Minn. 404, 415, 98 N.W.2d 280, 289 (1959).) The term "physical" loss has been interpreted to mean actual loss or damage, and not simply the loss of use of property. (*See, e.g. Glen Falls Ins. Co. v. Covert Auto Co.*, 526 S.W.2d 222 (Tex. Ct. App. 1975); *Blaine Richards & Co. v. Marine Indemnity Ins. Co. of America*, 635 F.2d 1051 (2d Cir. 1980).) In *Gatti v. Hanover Ins. Co.*, (601 F.Supp. 210 (E.D.Pa. 1985)) the insured claimed a loss of property as the result of a leak in an underground water main. The insurer argued that there was no direct physical loss because there was no damage to property. The court concluded that the loss of water after it had passed through the water meter constituted a direct physical loss.

Gatti is demonstrative of the type of case that arises in an environmental setting. For example, in *Lexington Ins. Co. v. Ryder Sys., Inc.* (234 S.E.2d 839 (Ga. Ct. App. 1977)), the court concluded that the loss of oil from an underground storage tank was a covered loss. In this case, not only was the loss of property covered, but the cost of removing the escaped fuel from the ground was also covered. (*Lexington*, 234 S.E.2d at 840. This conclusion was supported by a specific provision in the insurance policy which covered debris removal.)

Once the initial determination that a loss has occurred is made, then the insured must determine if the type of property lost is covered and whether the loss resulted from a covered peril. Thus, the growth of a national environmental awareness has caused the creation of a statutory framework of liability. Parties deemed responsible for pollution have turned to their insurers for financial reimbursement for such liabilities. When liability has arisen within the scope of insurance policy provisions, coverage has provided a source for payment of these liabilities.