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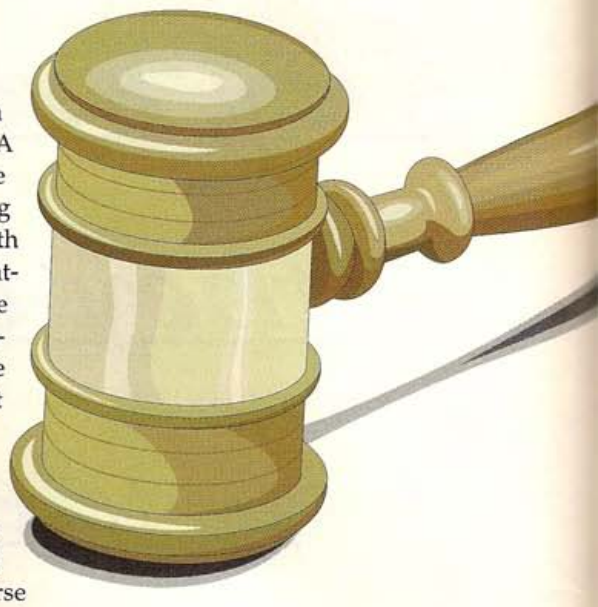
Recovering Cleanup Costs From Your Insurance Carriers



Recently, two cases involving an insured's ability to recover costs for cleaning up contaminated property from its insurer were decided in Illinois. Together, Lapham-Hickey Steel Corp. v. Protection Mutual Insurance Co., 166 Ill.2d 520 (1995), and Zurich Insurance Co. v. Carus Corp., 689 N.E. 2d 130 (1st Dist. 1997), appear to hold that an insurer's duty to defend and indemnify its insured is triggered by the filing of a lawsuit against the insured, and in the absence of a lawsuit, no such duty exists. As such, costs that the insured incurs through voluntary cleanup efforts would not be covered by the insured's comprehensive general liability (CGL) policy. The holdings of these cases may substantially inhibit voluntary cleanup efforts, as well as inhibit the effectiveness and viability of Illinois' recently legislated voluntary Site Remediation Program. See 415 ILCS 5/58 et seq. (West 1996).

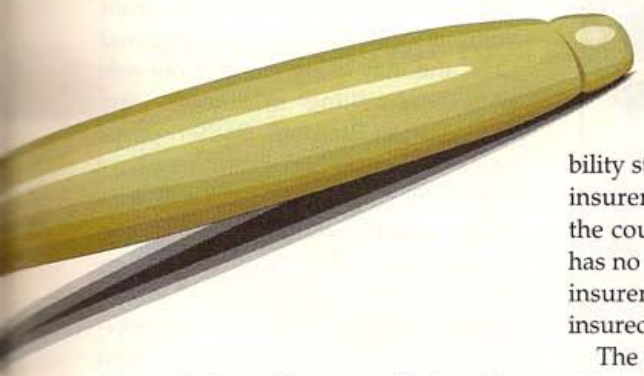
In the case of Lapham-Hickey, Lapham-Hickey Steel Corp. had purchased an insurance policy from Protection Mutual Insurance Co. to cover "all risks of physical loss or damage," and required Protection Mutual to "defend any suit against the insured alleging liability for such damages." Two years after purchasing the policy, Lapham-Hickey was notified by the United States Environmental Protection Agency (USEPA) and the Minnesota Pollution Control Agency (MPCA) that a site investigation was planned at one of Lapham-Hickey's facilities covered under the insurance policy. The company agreed to voluntarily conduct the investigation in return for a "no-action" letter from the MPCA stating that the MPCA had made no determination regarding Lapham-Hickey's culpability with respect to the presence of any contamination at the site. After the site investigation confirmed the existence of contamination at the facility, Lapham-Hickey sought to recover the costs it had incurred from the site investigation from its insurer.

The Supreme Court of Illinois held that Protection Mutual did not have a duty to reimburse Lapham-Hickey because, under the terms of the policy, Protection Mutual did not have a duty to defend the company in the absence of a "suit." 166 Ill.2d at 532. Because "suit" was not defined in the policy, the court defined "suit" under its ordinary meaning as "a proceeding in a court of law." 166 Ill.2d at 531. The court found that Lapham-Hickey's site-investigation costs were voluntarily incurred, not as the result of a court proceeding. As such, because there was no court proceeding requiring Lapham-Hickey to incur the site-investigation costs, Protection Mutual had no duty to reimburse for such costs. 166 Ill.2d at 533.

Illinois Appellate Court Extends Decision

The Illinois Appellate Court for the First District recently extended the Lapham-Hickey decision regarding an insured's ability to recover so-called voluntary cleanup costs arising from environmental contamination from its insurer under its CGL policies. In Zurich, the court held that an insurer not only has no duty to defend an insured in the absence of a lawsuit, but the insurer has no duty to indemnify the insured for costs it has incurred in the absence of such a suit. 1-96-0885 at 7.

In Zurich, Carus Corp. owned and operated a chemical-manufacturing facility and purchased a series of CGL policies from several insurance carriers to cover the facility. In 1992, after conducting a Screening Site Inspection at the facility, the USEPA and Illinois Environmental Protection Agency (IEPA) notified Carus of the presence of hazardous substances in the soil and groundwater. In an effort to avoid being placed on the National Priorities List of sites targeted for cleanups under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. §9601 et seq. (1994), Carus petitioned IEPA to enter into Illinois' Site



Remediation Program. Under the program, Carus conducted a remedial investigation and feasibility study under the supervision of IEPA and pursuant to the mandates of CERCLA. Carus was then notified by USEPA and IEPA that hazardous substances had been found at an adjacent site, as well. Carus notified its insurers and sought reimbursement for the costs it had incurred under the Site Remediation Program and demanded indemnification.

The Appellate Court held that the insurers had no duty to indemnify Carus under the CGL policies for what it said were voluntary costs Carus incurred in the site remediation program. Id. The CGL policies stated: "The [insurer] will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of:

Coverage A: bodily injury

Coverage B: property damage

to which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suits against the insured seeking damages."1-96-0885 at 2.

The court found Lapham-Hickey to be controlling, and held that because there was no lawsuit filed against Carus forcing it to incur the costs of the remedial investigation and feasibility study, there was no duty for the insurers to defend Carus. Moreover, the court held that where an insurer has no duty to defend an insured, the insurer has no duty to indemnify the insured either.

The court went on to reject Carus's alternative argument, as well. Carus asserted that the costs of the remedial investigation and feasibility study qualified as costs that it was "legally obligated to pay" as the provision is used under the CGL policy. The court disagreed and held that Carus voluntarily incurred these costs by voluntarily petitioning IEPA and enrolling in the Site Remediation Program. As such, Carus was never "legally obligated" to pay these costs, and the insurers were not required to reimburse Carus for these costs. Id.

Other Rulings

Other courts facing similar issues have found differently. For example, in Aetna Casualty & Surety Co. v. Pintlar Corp., 948 F.2d 1507, 1518 (9th Cir.), the court held that an insurer's duty to defend was triggered by the insured's receipt of a Potentially Responsible Party (PRP) notification letter sent by the EPA rather than the formal filing of a complaint against the insured. Applying the plain-meaning rule to determine the definition of the term "suit," the court reasoned that because a PRP notification letter carries with it immediate and severe implications and the insured's substantive rights and ultimate liability are affected from the start of the administrative process, an ordinary person would believe that receipt of such a notice is the effective commencement of a suit. Id. at 1517. As such, costs that the insured incurred conducting a remedial investigation and feasibility study were recoverable from its insurer.

Moreover, other courts have held that costs an insured has incurred through voluntary cleanup efforts constitute costs that the insured is "legally obligated to pay." For example, in Weyerhaeuser Co. v. Aetna Cas. & Sur. Co., 874 P.2d 142 (Wash. 1994), Weyerhaeuser sought coverage from its insurers for costs it had incurred through cleanup efforts it had taken in cooperation with government officials, but that were taken in the absence of a government or other third-party enforcement action. The Washington Supreme Court held that, because environmental statutes impose liability without fault, the existence of such a statute creates the threat of legal action similar to the filing of a complaint. Id. at 154. Therefore, the court held that the costs that Weyerhaeuser incurred through its cleanup efforts were recoverable from its insurers because they constituted costs that it was "legally obligated to pay." Id.

Lapham Hickey and Zurich will have a substantial, adverse impact on the voluntary cleanup of hazardous waste sites and the voluntary Site Remediation Program that encourage this practice. Recently, several states, including Illinois, have enacted legislation to encourage the voluntary cleanup and redevelopment of contaminated or potentially contaminated industrial and commercial property

known as Brownfields. Because these cases hold that an insured will not be able to obtain coverage for voluntary costs it has incurred in addressing environmental contamination, property owners may likely refrain from voluntarily cleaning up contaminated sites, and may likely refrain from voluntarily enrolling in Illinois' Site Remediation Program. Rather, property owners may likely wait for a lawsuit to be filed against them before taking cleanup action so that they can be reimbursed for those costs from their insurers.

In addition to discouraging participation in Illinois' Site Remediation Program, these two cases may likely increase the transaction costs associated with cleaning up contaminated property, as well as increase the risk of harm to human health and the environment. Because property owners would be reimbursed for cleanup costs by its insurer only after they have been subject to a lawsuit, the amount of litigation will likely increase and cause an overall increase in the transaction costs associated with cleaning up contaminated sites. Moreover, because corrective action will not be taken until the insured is subject to a lawsuit, the contamination will remain in the soil and groundwater and continue to pose a threat to human health and the environment.

If a company decides to pursue coverage from its insurer, it should seek the advice of counsel prior to taking any corrective action. ●ASI

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