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Don't Be Too Sure

Three 'clearly ambiguous' pollution liability policy conditions can make some claims iffy.

by Christine M. Fleming

Insurers began to offer pollution liability policies in the late 1980s in response to issues that had arisen under commercial general liability policies.

Because CGL policies were occurrence policies—covering losses that occur during the policy period—and because pollution is often not discovered for several years or decades, claims were being reported long after the event occurred. Often, the event would occur over several years, triggering several policies.

In response, CGL policies began to include pollution exclusions intended to exclude coverage for gradual pollution events, which became known as the "sudden and accidental" provision. Later, CGL policies were further modified to exclude coverage for all pollution events, known as the "absolute pollution exclusion."

CGL policies were usually standard ISO form policies issued by the insurer. Insureds did not bargain to include language favorable to them. Therefore, if there was ambiguity in the policy language, the court would often rule in favor of the insured, with respect to interpreting coverage provisions and finding ambiguities, whenever coverage was in dispute.

For example, if the insured did not provide timely notice of a claim as required under the policy, courts would often extend coverage anyway unless the insurer had been prejudiced by the late notice. The condition excluding coverage for pollution unless it was "sudden and accidental" was often interpreted to mean "unintended" from the standpoint of the insured, with no temporal element of "suddenness" required. Litigation surrounding the application of CGL coverage to pollution claims exploded.

In response, a market developed for pollution-specific coverage, and insurers began to write pollution liability policies, sometimes referred to as site-specific environmental impairment policies, or pollution legal liability policies. Unlike CGL policies, pollution liability policies were not standardized, but rather tailored to meet the unique needs of the parties entering into the contract. Therefore, courts are not as inclined to rule in favor of insureds' arguments regarding ambiguity and construction.

Pollution liability policies are also claims-made policies, which means the policy covers a claim

Key Points

- **The Case:** Pollution liability policy language can seem clear and unambiguous until a claim is filed.
- **The Merits:** Insureds that are up-front about potential losses and have solid documentation about prior losses often avoid disputes.
- **The Verdict:** Both sides will reach common ground regarding coverages and exclusions only after disputed policy language is resolved–likely via litigation.

Contributor Christine M. Fleming, J.D., ACAS, MAAA, is principal and claims consultant with Milliman. She can be reached at christine.fleming@milliman.com

made against the insured during the policy period. With a claims-made policy, it doesn't matter when the occurrence took place and it is clear which policy should respond to the claim.

With a wealth of litigation experience and lessons learned from the CGL days, with policy terms and conditions being negotiated and customized, and particularly with the use of claims-made coverage instead of occurrence coverage, one might think that coverage disputes could rarely arise with respect to pollution liability policies.

Surprisingly, this is not the case. Terms and conditions that appear clear and unambiguous in pollution liability policies have often given rise to disputes between insureds and insurers, sometimes leading to litigation. Three oft-disputed areas are: the definition of a "claim"; the timely notice requirement; and the "known loss" condition.

As it turns out, a policy that covers a claim made against the insured during the policy period, reported by the insured to the insurer as soon as practicable, for a loss that was not known to the insured prior to policy inception, can be found to be ambiguous.

What Is a Claim?

Most pollution liability policies are claims-made, meaning that the claim has to be made against the insured during the policy period. Although this requirement seems clear, the question of what constitutes a claim has been the basis of coverage disputes.

For example, in *Hatco Corp. v. W.R. Grace & Co.*, the insured was a prior owner of a contaminated site. The insured received a letter from the current owner of the site that included an administrative order directed to the current owner, and a warning that the current owner would hold the prior owner liable for any costs it incurred in connection with the administrative order.

The insured had a pollution liability policy in which "claim" was defined as a "demand for money." The court held that the letter was not a demand for money, but rather a threat. Thus, the court reasoned that it was notification of a potential future claim and not a claim as defined under the policy.

In another case, *Alan Corporation v. International Surplus Lines Insurance Co.*, the insured purchased a pollution liability policy. The government contacted a third party, not the insured, during the policy period regarding contamination at the insured's site. That third party spoke to the insured about the contamination, also during the policy period. After expiration of the policy period, the government initiated action against the insured related to the site.

The insurer's position was that no claim had been made against the insured during the policy period. The insured argued that the communication with the other party discussing the contamination constituted a claim because it set off a chain of events that eventually led to the government action. The court held for the insurer, and rejected the insured's position that a claim had been made during the policy period.

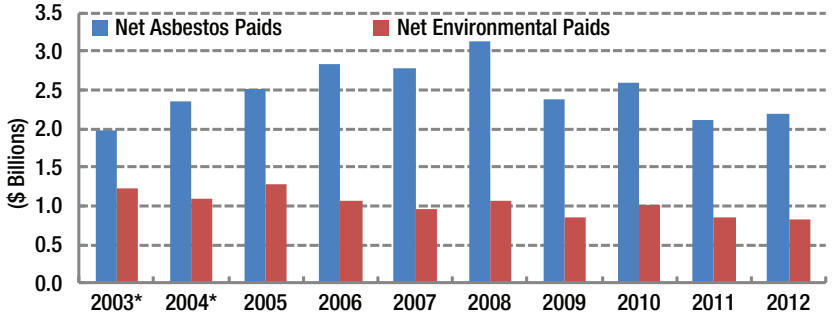
Similarly, in *Cargill Inc. v. Evanston Insurance Co.*, a case where "claim" was defined in the policy as a demand for money or services, the insurer argued that there was no claim where a state agency told the insured that it needed to investigate and/or remediate contamination, but did not make a demand for money. Rather, the insurer argued, at that point the communications conveyed only the potential for a claim. The claim itself—the demand for money—did not come until after the expiration of the policy period.

The trial court agreed, holding that a third-party demand for money is required in order to be a claim, and statements that future action may be needed are not sufficient to constitute a claim. However, on appeal, the appellate court reversed the trial court, finding that the correspondence leading up to the actual demand did constitute a "claim."

Other policies that define "claim" more broadly, however, could yield a different result. For example, in a case where the policy defined "claim" as including the insured's awareness of an event that could give rise to a claim, the letter referenced in *Hatco* would likely be considered a claim. These examples illustrate that changing from an occurrence policy to a claims-made policy did not eliminate disputes about triggers of coverage.

The Takeaway: Don't assume that a "claims made" policy resolves the issues raised by occurrence policies, or that the report date will

U.S. Asbestos & Environmental – Normalized Net Paid Losses (2003-2012)



* 2003-2004 exclude $1.3 billion in Western MacArthur asbestos payouts from two insurers.
Source: A.M. Best data & research

now be clear. Questions will continue to be raised and litigation will continue to revolve around when a claim was brought against the insured and, indeed, even what it means to have a claim.

What Is 'Late Notice'?

In most pollution liability policies, the insured is required to give notice of the claim to the insurer quickly. The exact requirement varies, but a common requirement is "as soon as practicable." Some policies require that the notice be given in the policy period.

Although the condition of prompt notice seems to be fairly clear, the issue is often the subject of dispute. First, of course, is the understanding of "as soon as practicable." Second, the question arises whether the insurer needs to show that it suffered harm as a result of the delay, or "show prejudice"—that is, was unable to conduct a prompt investigation. Under the CGL policies, it was often held that late notice in and of itself should not bar coverage if there was no harm done.

Many courts have found that no showing of prejudice is required. In *W.R. Grace & Co. v. Maryland Casualty Co.*, the policy required that the claim be made against the insured during the policy period, and that the insured notify the insurer during the policy period. The insured notified the insurer of a claim as part of its policy renewal application.

The court held that this was not in and of itself sufficient to meet the notice requirement. The insured also instructed its broker to provide notice of the claim to the insurer, but not until shortly after the policy expired. The court held that because notice was required during the policy period, the broker notification also failed to meet the policy requirements. The court rejected the insured's argument that the insurer was not prejudiced by the late notice.

Again in *Cargill Inc. v. Evanston Insurance Co.*, the insured gave notice of a claim almost three years after receipt of the claim, and about 18 months after expiration of the policy period. The policy required that notice be made as soon as practicable.

The insured argued that it did not give notice earlier because there was no reason to think the loss would exceed the deductible; also, the insurer suffered no prejudice as a result of the notice being late.

The court rejected that argument and held that the language of the notification requirement does not depend upon the loss exceeding the deductible. The court further found that a finding of prejudice is not needed to enforce the timely notice requirement.

Despite best efforts by both insureds and insurers to construct unambiguous and customized pollution liability policy language, disputes still arise with respect to pollution-specific coverage.

The appellate court upheld the lower court's finding with respect to prejudice, but reversed the lower court's finding that notice was late as a matter of law.

Even pollution liability policies that clearly require that notice be made during the policy period have been the subject of disputes.

In *John Boerman v. American Empire Surplus Lines Insurance Co.*, the insured purchased four consecutive annual pollution liability policies. Each policy required the insured to notify the insurer of a claim within the policy period.

The insured notified the insurer of a claim during the fourth policy period, but the claim had been made against the insured during the third policy period. The insurer denied coverage because it did not issue one policy for a continuous term of four years, but rather four distinct policies each with its own terms and conditions.

The court agreed with the insurer, and noted that with respect to claims-made coverage in particular, the purpose of the policy is to limit coverage to claims that are made during that period, regardless of whether prior or subsequent policies combined to form a continuous stream of coverage.

The Takeaway: The issue of timely notice is still unclear and unresolved. When in doubt, insureds should give notice as quickly as possible, and should not assume that the insurer has constructive notice, that deductibles need to be met or that a showing of prejudice is required.

What Is 'Known Loss' and How Much Disclosure Is Sufficient?

Typically, pollution liability policies exclude coverage for losses that are known to the insured at the time the policy was written if the insured did not disclose material facts about the loss at that time.

What constitutes "known loss" sufficient to trigger the known-loss exclusion? In one civil case, *Goldenberg Development Corp. v. Reliance Insurance Co. of Illinois*, an insured added an additional site to its existing pollution liability policy.

Prior to adding it to the policy, an environmental engineer had reported to the insured that it had discovered small amounts of non-hazardous waste, which could be easily removed. One month after adding the site to the policy, the insured discovered large volumes of hazardous waste.

The policy had a "known conditions" exclusion that precluded coverage if pollution conditions existed at the time the policy was entered into; those conditions were known to the insured; and material facts about those conditions were not

disclosed to the insurer at the time the policy was entered into. The insurer denied coverage because the insured failed to disclose information about the site at the time the site was added to the policy.

The insured in turn argued that although it had not provided the engineering report, the insurer knew of the report's existence and could have requested to see it.

The insured also argued that the report's findings of small amounts of easily removed nonhazardous waste did not constitute a "material fact" about pollution conditions at the site. The court decided there were issues of fact that needed to be determined and therefore did not make a definitive substantive ruling—thus leaving open the question of what constitutes a pollution condition that needs to be disclosed and how much disclosure is required.

In *Greenwich Insurance Co. v. SLC Holdings*, the insured purchased a pollution liability policy and, during the application process, disclosed that environmental reports had been prepared regarding underground storage tanks that had been removed from the site.

According to the insurer, however, the reports (which were not produced by the insured) in fact identified much more extensive environmental contamination, including estimated future cleanup costs. Moreover, in its application the insured stated that it was not aware of any circumstances that could give rise to a pollution claim.

The policy was issued, and the insured filed a claim. The insurer disputed coverage for several reasons including "known loss." Again in this case, the identification of a report in and of itself was insufficient disclosure of a known condition (in the insurer's eyes), giving rise to a dispute.

Other courts have ruled on summary judgment motions regarding not only how much disclosure is required, but whether and when an insured "knows" about a loss.

In *City of Cleveland v. Chartis Specialty Insurance Co.*, the insured had remediated a site three years before purchasing a policy, during which certain pollutants were discovered. Three years later, the insured purchased a policy that contained a known-loss exclusion as well as a specific exclusion for the types of pollutants. Shortly after purchasing the policy and during the policy period, contaminated debris was discovered and remediation was required.

The insured filed a claim for cleanup costs—also during the policy period. The insurer denied coverage and filed for summary judgment on the grounds that the substances found during the policy period were the same as the material removed during the remediation years earlier, and therefore was excluded under the known loss exclusion.

The Takeaway: Insureds should take no chances in reporting pollution activities and events to their insurers in a way prescribed by the policy and, if the policy is silent, in a manner that is clear and obvious. It is still not clear when a "loss" is known, or indeed even when a "loss" is a loss. Even if a loss is known, it is not clear what constitutes adequate disclosure of material facts about that loss.

Despite best efforts by both insureds and insurers to construct unambiguous and customized pollution liability policy language, disputes still arise with respect to pollution-specific coverage. These disputes often involve terms that appear otherwise clear, such as covering a claim made during the policy period, notifying the insurer as soon as practicable, or disclosing pollution conditions known to the insured. Clearly both insureds and insurers need to stay informed with respect to pollution liability policy construction. BR