

## **Environmental Insurance - New Appleman on Insurance Law Library Edition, Chapter 27**

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With climate change, weather-related catastrophes, energy shortfalls, and a historically large oil spill in the Gulf of Mexico, it is no surprise that businesses and individuals are rapidly and collectively joining in a resurgence of environmentalism. Businesses depend on insurance to help guard against the many kinds of environmental risk and liability that exist. Environmental risks and liabilities exist not only in the manufacturing, industrial, utility, waste disposal, and energy sectors, but in all cross sections of businesses. Today's environmentally conscious society places an increased emphasis on how businesses operate and whether they are taking active steps to reduce and avoid global environmental problems. The scope and nature of environmental risks and liabilities continue to evolve, as does the insurance that responds to those risks and liabilities.

This chapter examines environmental insurance coverage in the context of three lines of coverage: historical comprehensive general liability ("CGL") policies, first-party property policies, and modern environmental insurance policies, products or arrangements. The chapter also describes the emergence of new insurance products and options (commonly referred to as "green" insurance) that are tailored to the budding risks and liabilities that businesses may face as they adopt sustainable and environmentally-friendly business practices, including construction and design of "green" buildings.

A common misconception is that environmental insurance can only be found under policies specifically targeted at environmental liability. In reality, for long-tail environmental claims, many policyholders find valuable coverage in their historic CGL policies that generally insure against past occurrences of third-party property damage and bodily injury. Section 27.01 of the chapter looks at the myriad of coverage issues that may arise when a policyholder seeks CGL coverage to pay for environmental remediation or to defend a third-party claim of bodily injury or property damage. As in any insurance matter, consideration should always be given, at the

outset, to choice of law analysis because coverage decisions vary from jurisdiction to jurisdiction.

The threshold finding of an “occurrence” under a CGL policy (or “accident” under much older CGL policies) first requires proof that the insured did not expect or intend the damage to occur. Courts disagree on whether a subjective or objective test should apply, but the better reasoned approach is a subjective standard because the typical policy looks at what was expected or intended “from the standpoint of the insured.” Usually it is the insured who bears the burden of proving an occurrence was neither expected nor intended as part of the prima facie case for coverage, but an argument can be made that this burden should be on the insurer because the “neither expected nor intended” clause of an occurrence definition is limiting in nature.

An “occurrence” finding for an environmental claim may also depend on how the CGL policy defines “occurrence,” “bodily injury” or “property damage.” For example, if a CGL policy requires injury or damage during the policy period, coverage should extend to a typical environmental claim that alleges ongoing property damage year after year. Conversely, if the CGL policy requires an “event” during the policy period, the policyholder may have more difficulty establishing coverage absent allegations of a specific release or isolated happening during the policy period.

The temporal issues are also frequently debated in the context of bodily injury claims, which include an increased number of medical monitoring claims. Such claims often allege increased risk for disease or illness based on past, harmful exposure, while conceding no diagnosed disease or illness presently exists. With some courts allowing medical monitoring claims to go forward absent any allegation of present injury, the question arises whether past exposure to an allegedly harmful substance equates to “bodily injury” during the policy period in order to satisfy coverage. The courts seem to be split on this issue, but the better reasoned approach is to require the insurer to defend such medical monitoring cases, just as they would more traditional bodily injury cases, in order to protect the reasonable expectations of the insured.

Environmental claims under CGL policies raise other interesting issues, such as when the insurer’s duty to defend may be triggered. Generally, the CGL insurer’s duty to defend is triggered when a “suit” seeks covered “damages” from the insured.

Yet, policyholders often seek coverage when they receive a PRP letter or similar compliance request for remediation, which technically do not constitute “suits” seeking “damages.” Most courts forego technicality and hold that the coercive PRP letter triggers the duty to defend because it is the functional equivalent of a suit. Similarly, they find remedial costs are the functional equivalent of “damages.” This majority approach is the preferred approach because it protects the reasonable expectations of the insured who, at a fundamental level, is faced with cost and liability for unintended property damage.

Once the duty to defend is established, the parties may continue to dispute which remedial costs are “defense” and which remedial costs are “indemnity.” The insured may have an incentive to categorize costs as “defense” so that they do not erode the indemnity limit of the CGL policy. In deciding these issues, courts tend to focus on whether the costs were incurred to minimize, investigate and determine liability (i.e., defense costs), or whether they were related to the planning and execution of the actual cleanup (i.e., indemnity costs).

Because the CGL policy is premised upon third-party liability, it does not cover – and typically excludes – damage to the property that is owned or occupied by the insured. If the environmental claim requires remediation of groundwater, coverage is usually afforded on the sound theory that groundwater is not owned by the insured. A small minority of courts disagree. Coverage may also apply for remediation costs incurred to prevent an imminent threat of harm to the groundwater or other adjacent and non-owned property. This approach encourages preventative remediation and is therefore the preferred view.

Some CGL policies also contain pollution exclusions that have been described as either partial, absolute, or total in application. Generally speaking, the more recent the CGL policy, the more likely it will contain a pollution exclusion and the broader the exclusionary language will be. Older CGL policies (pre-1970s) generally did not exclude pollution claims. Then, in the 1970s, the insurance industry tried to exclude pollution claims unless they were caused by “sudden and accidental” releases or discharges. The focus of the inquiry was therefore on the nature of the release, spill, or discharge. Some courts have found coverage for gradual releases under the “sudden and accidental” language, reasoning that “sudden and accidental” really only requires a showing of pollution that was without notice, unexpected, and unintended. About an equal number of courts, however, reason “sudden” means abrupt, thus

precluding coverage for ongoing, gradual releases. Notably, even if a court requires the initial polluting event to be abrupt under this type of policy language, it may still find coverage for subsequent gradual releases that follow.

The insurance industry drafted a broader exclusion in the mid 1980s. This exclusion is often misnamed an “absolute” exclusion. The exclusion is absolute in that it no longer matters whether a release is gradual or abrupt, but the exclusion is not absolute in its scope and application. First, numerous cases find the subject material litigated in a case is not a “pollutant” within the laundry list of materials that are identified in the “absolute” exclusion. Second, many courts refuse to apply the exclusion outside the context of traditional, environmental pollution. In a similar vein, some courts refuse to apply the exclusion when the pollutant is released indoors. These decisions make clear that the “absolute” exclusion is not “absolute.”

Finally, more recent CGL policies contain a so-called “total” pollution exclusion. The “total” pollution exclusion categorically limits coverage for all pollutants. This approach eliminates the “negative inference” adopted by courts interpreting the “absolute” exclusion (i.e., if the material was not listed, it was not meant to be excluded). Yet, the exclusion is neither “total” nor “absolute” because some courts are still hesitant to exclude coverage in the context of non-traditional pollution.

In addition to the contractual exclusions of a CGL policy, certain common law or statutory defenses such as “late notice” or “known loss” may also come into play for environmental claims. By and large, late notice is an unsuccessful defense to coverage under an “occurrence” based CGL policy unless the insurer can establish actual prejudice. Similarly, the “known loss” defense to coverage usually does not prevail unless the insured’s liability was already certain when the policy issued.

When environmental claims involve ongoing injury or damage, it raises complex and often-litigated issues over which policy periods apply and how the risk should be spread over the applicable policy periods. Numerous “trigger” theories have developed among the courts. Synthesizing the decisions is challenging because the cases are fact specific and the trigger theory may depend on whether bodily injury or property damage is alleged, and sometimes it could be argued that a court has mischaracterized the theory it is actually applying.

In general terms, an “exposure” theory finds coverage during the entire period of exposure to the harmful substance or material, while a “continuous” trigger finds coverage during the entire period of exposure and up until the time of an injury’s manifestation, even if it is delayed from the exposure. An “injury in fact” trigger theory looks at when the injury actually occurred, but this inquiry leads to varying results as different courts take varying views of what is meant by “injury.” Indeed, under a broad view of “injury,” the “injury in fact” trigger may actually render the same results of an exposure or continuous trigger theory. Given the unpredictability of the “injury in fact” trigger, it is not a preferred theory. Finally, a few courts invoke a “triple trigger” theory in the context of asbestos claims, specifically, in an attempt to expand the scope of triggered coverage for these claims. Under a triple trigger, coverage is implicated by a claim that a victim was either exposed to asbestos products, suffered exposure in residence, or manifested an asbestos-related disease during the policy period. Notably, the triple trigger theory jurisdictions tend to be jurisdictions that also apply an “all sums” allocation, discussed below, which leads to a combined result that the insured can pick and choose which policies to apply to the loss. Finally, Rhode Island courts use their own version of a triple trigger theory, which invokes coverage either when the injury or damage first manifests itself, when it is actually discovered or when it is discoverable. The “discoverability” of the damage or injury is often evidenced by expert affidavit.

In allocating the environmental liability among the triggered policies, courts may apply an “all sums” approach that holds each policy liable for “all sums,” subject only to the limit of coverage under the policy. The “all sums” approach stays true to most CGL policy’s insuring provisions, which typically insure against “all sums” the insured becomes legally obligated to pay. Other courts spread the risk over many policy periods using a “pro rata” approach that can be calculated in a variety of ways. Some courts will spread the risk among multiple insurers based on their respective time on the risk, while others look at both time on the risk and comparative policy limits during those years. Still others spread the loss equally without regard to policy years or limits. Under a “pro rata” approach, an insured may be forced to absorb liability that is attributable to uninsured periods and it may have to pay self insured retentions for each triggered year. A “modified pro rata” or “modified all sums” approach looks like a pro rata allocation, but puts the burden of insurance insolvency and periods of non-insurance on the carriers as opposed to the insured. All of these allocation approaches impact settlement and litigation strategies when dealing with

multiple years and layers of coverage. Discussion of settlement credits, contribution, and exhaustion conclude the discussion of environmental claims under CGL policies in Section 27.01.

Section 27.02 next considers environmental insurance under first-party property policies. Rather than protecting insureds against third-party liabilities, the first-party property insures against loss to the insured's own property. Many property policies exclude coverage for loss caused by "pollutants" unless it is caused by, or results in, certain other specified types of loss. Even so, insureds faced with an environmental loss may have a sub-limit of coverage in their property policy that covers pollutant cleanup and removal on their own property. Further, costs to avoid or mitigate loss may be recoverable, too.

Section 27.02 concludes with a discussion of the insurance implications of the 2010 Gulf of Mexico oil spill. Not only does the oil spill create massive energy insurance payouts for the responsible parties involved, but it creates interesting and nuanced coverage issues for business owners who will suffer either property loss or business interruption because of the oil spills' profound negative impact on the surrounding fishing and tourism industries. Business interruption, contingent business interruption, civil authority and ingress/egress provisions may cover the secondary environmental claims of business owners impacted by the Gulf spill. As highlighted in the cases, and depending on the facts of each case, courts take varying views of how much, or whether the insured must sustain physical damage; what correlation there must be between physical damage and business interruption; how limited access to the property must be in the case of civil authority or ingress/egress coverage; and how long business interruption coverage may extend even if a covered loss occurs.

Section 27.03 then considers environmental insurance options under modern environmental policies and products. Such policies can be tailored to fund environmental cleanup or otherwise provide needed security in the context of facilitating real estate transfers and financing. Understanding the key terms and their nuances is key to procuring a policy that will meet the expectations of both the insured and the insurer.

As explained in Section 27.03, environmental insurance coverage is notably different than CGL coverage in that coverage is often triggered by "claims" rather than

“occurrences. In fact, most environmental policies require not only that the claim be made during the policy period, but also that the insured report the claim to the insurer during the policy period. Most policies offer extended reporting periods to avoid unintentionally harsh results for the insured. Also, modern environmental policies tend to have long policy periods, lasting sometimes up to 20 years in duration.

Pollution Legal Liability (“PLL”) coverage (which goes by a host of varying names) varies greatly, as policies are often drafted on a manuscript basis. Nonetheless, PLL coverage usually provides three coverage components: (1) third-party coverage for bodily injury, property damage and cleanup costs; (2) defense cost reimbursement for third-party claims; and (3) first-party coverage for cleanup related to pre-existing environmental conditions that are first discovered during the coverage period.

Unlike CGL coverage (or even PLL’s predecessor, the Environment Impairment Liability policy), PLL coverage is not concerned whether contamination is caused by gradual or abrupt releases. Also, unlike CGL coverage, the defense costs payable under the PLL policy typically erode policy limits. Even though the PLL policy may not specifically state that the insurer has a duty to defend, courts interpreting the “defense cost” provisions of these policies sometimes equate the insurer’s obligation to a duty to defend under a CGL policy. This approach generally favors policyholders because the duty to defend extends to even potentially covered claims.

It is of utmost importance to consider the scope and language of any “known condition” exclusion in a PLL policy. Modern PLL policies generally allow coverage for pre-existing and continuing contamination if the pollution conditions were unknown when the policy incepted. “Known condition” exclusions are often highly negotiated and the parties should ensure the provision defines what level and type of knowledge triggers the exclusion.

Other germane provisions include coverage for on-site versus off-site damages. Many PLL policies cover on-site remediation if the conditions requiring cleanup were first discovered by the insured during the policy period (and, in some cases, even if no government demand is made). Beyond on-site remediation, PLL policies usually limit coverage to pollution “on, at, under, or migrating from” an “insured site,” although coverage can be negotiated for pollution liability arising out of off-site waste disposals.

PLL coverage, like property coverage, generally extends to “loss of use” and business interruption, although generally speaking, both coverages are triggered by actual property damage to the insured’s property. Similarly, insurance may be obtained for the “stigma” or diminished market value of property threatened by contamination, although the cost may in some cases be prohibitive.

PLL policies generally exclude coverage for civil penalties, intentional acts, and some contractual liabilities. If a contractor undertakes remediation and agrees to indemnify the property owner, the contractor should make sure the indemnity agreement is identified as an “Insured Contract” under the policy because it may otherwise fall outside the scope of coverage.

It is important to note that property and health damage resulting from mold and fungi has led to increased environmental liability in recent years, but typical environmental policies do not cover loss arising out of mold and fungi. An insured should be aware of this typical default and contract around the exclusion if desired. In a similar vein, an insured wanting coverage for natural resource damage should make sure such protection is included in the subject policy. Some policies do insure loss such as physical injury to wildlife, flora, air, land, and ground water that is controlled by a public natural resource trustee.

Another popular environmental protection in today’s market is Cost Containment or Cost Cap Coverage. Cost cap protection essentially provides “stop loss” protection. The insured pays for the policy and then pays for cleanup costs to an agreed-upon amount, and then the insurer is responsible for the excess, up to the policy limit. Securing Cost Cap insurance requires an approved remediation plan with cost estimates from a reputable environmental consulting firm. As such, it typically is not a viable option in early stages of most sites and cleanup costs outside of an approved plan may not be covered. Further, depending on the jurisdiction, post-closure monitoring costs may fall outside the scope of coverage. If a cost cap policy is obtained, a potential buyer, seller and lending institution can each be named as insureds to facilitate the transfer and redevelopment of a contaminated site. Due to increased losses in this market in recent years, it is becoming increasingly difficult to obtain cost cap insurance and the coverage terms are increasingly restrictive.

Blended finite risk insurance programs can also be used to address known and unknown environmental risks by basically combining elements of PLL and Cost Cap

insurance to support a structured settlement of environmental liabilities and cleanup costs, for both known and unknown contamination, at a particular site. These programs usually come into play with very large Brownfields projects or substantial Superfund sites. Their innovative design break the mold of most insuring arrangements. Under a finite risk program, the insured pays the policy premium and also pays the estimated future remediation costs, upfront, in an interest-bearing trust account. The insurer issues payments from the account during the period of remediation. If the trust account has an excess balance, the insurer gets to keep the money. If the trust account has a deficiency, the insurer has to pay the deficit, up to the limits of coverage. Understandably, then, negotiation of the estimated future remediation costs is of critical importance to both parties.

The foregoing discussion focused primarily on environmental insurance for the property owner, but it is worth noting that secured creditors are able to obtain environmental insurance as collateral protection, and contractors may now find environmental insurance on either a claims-made or occurrence basis. A contractor's pollution liability policy helps protect against claims of third-party bodily injury or property damage, including defense and cleanup costs. Property owners, who generally are not covered during the period of remediation, usually require consultants and contractors to have this type of coverage. Professional liability or errors and omissions policies for consultants, risk assessment firms, laboratories, architects and engineers may also provide valuable coverage.

Consideration should also be given to which parties are named as insureds under an environmental policy. A sale or remediation may mandate inclusion of many parties, but the inclusion of these parties as named insureds could create problems if the policy contains an "insured versus insured" exclusion. The potential for future risk may warrant an increased premium for removal of such an exclusion.

When applying for environmental insurance, the policyholder needs to appreciate the time involved and proceed carefully with the insurance application, which is frequently incorporated by reference into the policy. The application can form the basis for "known condition" exclusions or later disputes about the adequacy of disclosure.

Also, environmental policies often contain detailed and specific notice and reporting provisions that are usually enforceable as pre-conditions to coverage, which means

non-compliance may forfeit the insured's recovery on an otherwise covered claim. In a similar vein, the insured may have to obtain the insurer's consent before incurring cost, charge, or expense, and has a general duty to cooperate, under an environmental policy. If coverage disputes arise, some environmental policies require arbitration rather than court litigation.

Lastly, Section 27.04 of this chapter looks at the emerging "green" insurance products that are on the market, in response to an increased governmental and societal demand for sustainable and environmentally-friendly construction, development and business practices. For example, property insurers are offering products that allow an insured to restore and repair damaged property by using "greener" materials and processes (which are often costlier and more time consuming). For example, coverage may extend to the costs of recycling waste material, improving heating and cooling systems or indoor air quality, building a vegetative or green roofing system, implementing systems to conserve water and energy, or using locally produced materials to avoid the negative environmental impacts of product transportation. It is important to note, however, that these enhancements increase the recovery that is available to the insured once a covered loss occurs, but they do not impact the underlying question of whether a loss is covered.

CGL carriers and professional liability carriers also offer "green" insurance to provide enhanced protection for building owners or the contractors, architects, and engineers who are involved in a collaborative "green" project. For example, CGL policies may provide limited coverage or crisis management service if a building owner faces reputational damage or third-party liability when a building or product fails to be as "green" as marketed or advertised. This new coverage may extend to third-party suits seeking non-monetary relief on behalf of the public at large – which normally falls outside the scope of covered claims under a CGL policy. Also, on the professional liability side, carriers have drafted specific language to provide coverage if a project fails to achieve green certification, fails to meet specified energy performance criteria or fails to qualify for certain economic incentives related to "green" certification. These endorsements obviate coverage disputes that might otherwise exist when the standard of care is rapidly evolving and claims might be brought on an otherwise excluded breach of warranty theory.

**Cross References:** For practice guidance with respect to D&O insurance coverage issues, see [New Appleman Insurance Law Practice Guide Chapter 42](#).

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