

California Supreme Court Decision

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SIGNIFICANT CHANGES IN INSURANCE COVERAGE FOR ENVIRONMENTAL CLAIMS

On December 29, 1997, the California Supreme Court issued a significant and helpful opinion for companies and individuals seeking defense costs from their insurance companies. In *Aerojet-General Corp. v. Transport Indemnity Co.*, 97 Daily Journal D.A.R. 15551 (Dec. 29, 1997), Justice Stanley Mosk, writing for the majority in a divided court, resolved two issues pertaining to an insurer's duty to defend its insured in a lawsuit seeking damages for a covered claim. First, the Supreme Court held that environmental site investigation costs can be defense costs that an insurer must pay. Second, in a holding that has implications for non-environmental lawsuits also, the Court announced that insurers cannot allocate defense costs to policyholders pro rata based on periods of time when the policyholder was uninsured.

The Underlying Facts

Hazardous substances such as trichloroethylene had, for decades, been routinely discharged into the soil and groundwater at Aerojet General's property in Sacramento County. The resulting contamination spawned at least thirty-eight lawsuits against Aerojet seeking damages for personal injury and property damage and an injunction requiring Aerojet to clean up the contamination. Aerojet turned to its 54 insurance carriers under 245 insurance policies to reimburse its defense costs and judgments in these lawsuits. In 1982, Transport Indemnity Company and Associated International Insurance Company filed a complaint for declaratory relief against Aerojet and Aerojet's other insurers, and Aerojet cross-complained against its insurers. The Aerojet cross-complaint filed in the 1982 lawsuit is the subject of Justice Mosk's December 29th opinion.

Aerojet, in defending the many lawsuits against it, incurred over \$10 million in legal costs, \$25 million in site investigation costs, and \$30 million in environmental remediation costs. The issues raised in Aerojet's cross-complaint against its insurers were ultimately tried in three phases in the Superior Court. The California Court of Appeal reviewed all three phases of the trial and consolidated them for consideration and decision. Following the decision of the Court of Appeal, both Aerojet and its insurers petitioned the California Supreme Court and were granted review of the Court of Appeal decision.

Site Investigation Costs Are Defense Costs

The first issue considered by the Supreme Court was whether "under standard comprehensive or commercial general liability insurance policies, site investigation expenses may constitute defense costs that the insurer must incur in fulfilling its duty to defend." Aerojet at 15557. The Supreme Court reasoned that insurers have a duty to defend and therefore must undertake efforts to avoid or minimize liability. Consequently, the insured's site investigation expenses are defense costs that must be paid by an insurer if the following requirements are met:

- The site investigation must occur between the time defense is tendered to the insurer and the time the lawsuit is concluded;
- The site investigation must amount to a reasonable and necessary effort to avoid or minimize liability; and
- The actual investigation expenses must be reasonable and necessary to avoid or minimize liability. Aerojet at 15557.

Justice Mosk emphasized that the issue of whether the insurer must pay site investigation expenses must be determined objectively. What matters under the first requirement listed above, for example, is whether the site investigation actually occurs during the correct time period. Under the second requirement, what matters is whether a reasonable insured in similar circumstances would conduct the same site investigation to avoid or minimize liability. Finally, under the third requirement, the question is whether a reasonable insured would incur the expenses of the site investigation under the same circumstances.

Insurers Are Limited In Their Ability To Allocate Defense Costs To Policyholders

The second issue decided by the Supreme Court concerned conditions under which defense costs can be allocated to the insured under standard comprehensive or commercial general liability insurance policies. During the thirty-year time period considered in this case, there was a period of nine years during which Aerojet was uninsured for defense costs. The Court of Appeal had concluded that Aerojet could fairly be required to pay a portion of the defense costs proportional to the nine years out of thirty that it was uninsured.

The Supreme Court reversed, stating that whatever duty to defend each insurer may have, that duty was not affected by Aerojet's subsequent decision to be uninsured for several years. Accordingly, the insurance companies had a duty to fully fund the defense of any claim that was potentially covered under the insurance policy.

The insurance companies argued that their duty to defend was limited to that part of the claim that came within their policy periods. The Supreme Court disagreed, holding: "If specified harm may possibly have been caused by an included occurrence and may possibly have resulted, at least in part, within the policy period, the duty to defend perdures to all points in time at which such harm may possibly have resulted thereafter." Aerojet at 15561. In other words, even though the trigger for the duty to defend must occur during the policy period, the duty to defend is broader, covering other periods as well.

Both Holdings Are Key For Policyholders

Given the number of environmental cases in California and the costs of environmental investigations, the holding that such costs may be defense costs payable by carriers is important for insureds. Insurers will likely seek to demonstrate that the site investigation expenses do not qualify as defense costs because they were not necessary to avoid or minimize liability.

The holding on allocation is likewise a key victory for insureds. A company facing a claim based on continuous loss often has some years of missing insurance policies or self-insurance during the relevant time period. The Aerojet decision states clearly that, although the trigger of the insurer's duty to defend must occur during the policy period, the extent of that duty to defend is not limited by the policy period.

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Practice Areas

Environmental