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Pollution Loss Allocation and Other Insurance Coverage Issues Before CA Supreme Court

by Kurt W. Melchior and Deborah E. Beck

Accepting what may be one of the most important insurance coverage cases in some time, the California Supreme Court has granted review in *State of California v. Underwriters at Lloyd's, London*, 146 Cal. App. 4th 851 (2006). In that case, the State sought indemnification from its comprehensive general liability (CGL) insurers for damages caused by discharges at the Stringfellow waste disposal site. The State's policies included the 1970 form of the pollution exclusion, which precludes coverage for damages caused by the discharge of pollutants unless the discharge was "sudden and accidental." (Later policies commonly contain the "absolute pollution exclusion," which bars indemnity even for sudden and accidental pollution.)

The trial court granted summary judgment in favor of the insurers. The 4th District Court of Appeal reversed. Two of the court's rulings—holding the policy language "arising out of" ambiguous and interpreting the so-called "watercourse exclusion"—differ from other courts' rulings and are controversial. Perhaps of greatest interest, however, are the appellate court's rulings on the allocation of losses.

- **"Arising out of" held ambiguous:** The court held that releases from a collection basin could have caused the damage and could be a covered event even though the original deposit into those basins had been intentional, ruling that the phrase "arising out of" was at best ambiguous with respect to the actual cause of the damage because it could refer either to the deposit of chemicals into the collection basin or to their escape from it. For that reason, the court construed the policy term **against** the insurers.
- **"Watercourse exclusion" held inapplicable:** The court held that releases to groundwater do not fall into the policy exclusion barring coverage for releases into a "watercourse or body of water."
- **Inability to allocate losses held not a bar to coverage:** The State conceded that it could not distinguish between costs incurred to remediate damages caused by accidental releases and those incurred to remediate damages caused by non-accidental releases. Earlier cases—most notably the 2nd District Court of Appeal's decision in *Golden Eagle Refinery Company v. Associated International Insurance Company*, 85 Cal. App. 4th 1300 (2001)—put the burden on the policyholder to distinguish between damage caused by covered and non-covered releases. This court, however, relying on two California Supreme Court cases involving first-party claims (seeking indemnity for damage to the insured's own property), ruled that since the policies insure against damage caused by tortious conduct, if **any portion** of the damage was caused by tortious conduct—here, by the negligent release of contaminants—then insurers are required to indemnify the policyholder **in full**.
- **Burden of proof placed on the insurer:** The court ruled that an insurer who wants to avoid liability must prove (1) what portion of the damage arose from policyholder conduct during that insurer's policy period and (2) that that conduct was not in any way attributable to conduct during the

policy period. To the extent damage is indivisible, the insurer's duty to indemnify is not excused.

The Supreme Court's grant of review puts all these issues in play, and the forthcoming Supreme Court decision will have broad repercussions with respect to the many as-yet-unresolved risks that arose 20 or 30 years ago.

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