Client Alert

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Powerine II – Significant Insurance Coverage Implications for Administrative Cleanup Costs

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In welcome news to umbrella policyholders, the Supreme Court of California issued an opinion on August 29, 2005 in *Powerine Oil Co., Inc. v. Superior Court*, 2005 DJDAR 10545 (Cal. Aug. 29, 2005) (*"Powerine II"*) that could breath life into policyholder efforts to recover costs of complying with pollution cleanup and abatement orders issued by administrative agencies -- costs that the court previously held are not covered under standard comprehensive general liability (CGL) insurance policies. *See, Certain Underwriters at Lloyd's of London v. Superior Court*, 24 Cal.4th 945 (2001) *("Powerine I").*

In *Powerine II,* the California Supreme Court held that under a literal reading of the standard excess/umbrella liability policies at issue, the wording of the insuring agreement is broad enough to include coverage of environmental cleanup and response costs ordered by an administrative agency.

In a separate opinion, however, the California Supreme Court held in *County of San Diego v. Ace Property & Casualty Ins. Co.,* 2005 DJDAR 10554 (Cal. Aug. 29, 2005) (*"County of San Diego"*) that an insuring provision of a non-standard "manuscript form" excess policy did not extend coverage to costs and expenses associated with responding to administrative orders outside the context of a government-initiated lawsuit, but rather limited the carrier's indemnity obligation to "damages," meaning "money ordered by a court."

As discussed below, the court's divergent decisions in the two cases turned on the "materially different" insuring language found in the excess and umbrella policies at issue. The question of whether a policyholder's excess and/or umbrella policies potentially provide coverage for liability for environmental cleanup and response costs ordered by administrative agencies will thus hinge on an analysis of the express language of the insuring agreements contained in those policies.

Background and Relevant Precedent

Powerine II and *County of San Diego* each involved disputes over coverage for costs incurred by the respective insureds in complying with California Regional Water Quality Control Board remedial cleanup and abatement orders pertaining to soil and/or groundwater contamination. Both cases presented issues of whether excess or umbrella policies covered such cleanup costs.

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The California Supreme Court's analysis of the questions presented in *Powerine II and County of San Diego* are informed by and best understood in context of the court's earlier decisions in *Foster-Gardner, Inc. v. National Union Fire Ins. Co.,* 18 Cal.4th 857 (*"Foster-Gardner"*) and *Certain Underwriters at Lloyd's of London v. Superior Court*, 24 Cal.4th 945 (2001) (*"Powerine I"*). A brief review of those decisions follows.

Foster-Gardner

Foster-Gardner addressed the scope of the duty to defend under a standard CGL insurance policy. In *Foster-Gardner*, the California Supreme Court adopted a "literal" approach to interpreting a standard provision imposing on the insurer the duty to defend the insured in a "suit seeking damages." *Foster-Gardner*, 18 Cal.4th at 869. The court held that the duty to defend provision when considered in its full context clearly limited the insurer's duty to defend to a "civil action prosecuted in a court," and did not extend to a proceeding conducted before an administrative agency. *Id.* at 878-888. The court thus held that the insurer's duty to defend under a standard CGL policy was limited to a civil action. *Id.*

Powerine I

Powerine I addressed the scope of the duty to indemnify under a standard CGL insurance policy. In *Powerine I*, the California Supreme Court interpreted a standard insuring provision that required the insurer to indemnify the insured for: "all sums that the insured becomes legally obligated to pay as damages." The court held that the insurer's duty to indemnify under the standard CGL insuring provision is limited to "damages," *i.e.,* "money ordered by a court." *Powerine I,* 24 Cal.4th at 960-964. Therefore, the duty to indemnify for "damages" does not extend to any "expenses" required by an administrative agency pursuant to an environmental statute. *Id.* at 966.

The court explained its *Powerine I* decision in part by what it called the *Foster-Gardner* "syllogism," which it summarized as follows:

> "The duty to defend is broader than the duty to indemnify. The duty to defend is not broad enough to extend beyond a 'suit' i.e., a civil action prosecuted in a court, but rather is limited thereto. A fortiori, the duty to indemnify is not broad enough to extend beyond 'damages,' i.e., money ordered by a court, but rather is limited thereto." *Id*. at 961.

The *Foster-Gardner* and *Powerine I* decisions taken together established that under a standard CGL policy: (1) the duty to defend a "suit" is restricted to civil actions prosecuted in a court and does not extend to claims by administrative agencies; and (2) the duty to indemnity for sums that the insured becomes "legally obligated to pay as damages" is limited to money ordered by a court, and does not extend to expenses that the insured incurs in response to administrative agency orders. Policyholders were thus foreclosed under CGL policies from recovering any costs associated with environmental cleanups ordered by administrative agencies, absent a lawsuit.

The *Powerine II* and *County of San Diego* cases afforded the California Supreme Court the opportunity to decide whether umbrella and/or excess policies could provide indemnity coverage for costs of complying with remedial cleanup orders

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issued by administrative agencies, notwithstanding the court's earlier decisions that CGL policies do not. The result was mixed, the answer turning on specific policy language.

The Court's Decision in *Powerine II*

In *Powerine II,* the California Supreme Court focused its analysis on the standard excess/ umbrella policy insuring agreement and unanimously held that "the indemnification obligation is expressly extended beyond court-ordered money 'damages' to include expenses incurred in responding to government agency orders administratively imposed outside the context of a government lawsuit to cleanup and abate environmental pollution." *Powerine II*, 2005 DJDAR at 10550.

The insuring language in the excess/umbrella policies provides, in relevant part:

> "The Company hereby agrees … to indemnify the Insured for all sums which the Insured shall be obligated to pay by reason of the liability … imposed upon the Insured by law … *for damages*, direct or consequential *and expenses, all as more fully defined by the term 'ultimate net loss'* on account of: … property damage … caused by or arising out of each occurrence happening anywhere in the world." (Italics in original.) *Id.*

The court found that the foregoing language is unambiguous and clearly extends beyond money ordered by a court. Unlike the standard CGL policy language considered in *Powerine I,* the court observed that the insuring clause of the standard excess/umbrella policy provides indemnification coverage for "damages, direct or consequential, *and expenses*…." The court reasoned that "damages" and "expenses" are not synonymous and found that the addition of the term "expenses" in the insuring clause extends coverage beyond the limitation imposed where the term "damages" is used alone. Use of the term "expenses" thereby enlarges the scope of coverage beyond "money ordered by a court." *Id.*

Moreover, the court pointed out that the insuring clause further defines the indemnification obligation by reference to the definition of "ultimate net loss," which in turn includes sums the insured becomes "obligated to pay by reason of … property damage … either through adjudication *or compromise and shall also include … all sums paid* … for litigation, *settlement, adjustment and investigation of claims* and suits…." The court stated that sums the insured becomes legally obligated to pay through "compromise" or the "settlement adjustment and investigation of claims" do not necessarily reflect an underlying court suit. *Id.*

The court concluded: "It follows that where the express insuring language of an excess/umbrella policy broadens indemnity coverage for sums paid in furtherance of a 'compromise' or 'settlement' of a 'claim' initiated by an administrative agency for such remedial relief, the insured's liability for such expenses falls within the policy's indemnification obligation even though no government suit was filed." *Id.*

Finally, the court noted that the excess/umbrella policies at issue were not merely intended to operate as excess insurance, but rather also provide umbrella coverage which may serve to "fill gaps" in coverage left open by the underlying primary policy. Therefore, the insured would have expected the policies to grant broader coverage than that provided by the primary insurance. The more

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expansive reading of the excess/umbrella insuring clause thus gives effect to the mutual intent of the parties. *Id.* at 10551.

The Court's Decision in *County of San Diego*

In *County of San Diego*, the California Supreme Court again focused on specific wording in the insuring provision, but in this case held that the language of the non-standard excess policy restricted coverage to court-ordered money judgments, and did not include expenses incurred in responding to administrative agency orders. *County of San Diego,* 2005 DJDAR at 10557.

The insuring language of the non-standard excess policy provides that the insurer is obligated to indemnify for "all sums which the insured is obligated to pay by reason of liability imposed by law or assumed under contract or agreement" for "*damages* … by reason of injury of any nature sustained by any person or persons" and "*damages* because of injury to or destruction of tangible property." (Italics in original.) *Id.* at 10556.

In a divided decision, the California Supreme Court found this language to be unambiguous and to be governed by the court's earlier decision in *Powerine I* regarding the limitation that the term "damages" imposes on the scope of indemnity coverage. The court reasoned that like the standard CGL policy considered in *Powerine I*, "damages" is used as the sole term of limitation in the insuring agreement of the excess policy. Under *Powerine I*, the term "damages" is limited to "money ordered by a court." *Id.*

The court emphasized that the policy language at issue in the nonstandard excess policy differs in several key respects from the umbrella/excess policies at issue in *Powerine II*. First, the insuring provision of the excess policy does not include the term "expenses" to broaden the coverage beyond that provided by the word "damages." Second, the insuring provision does not purport to more fully define damages and expenses by reference to "ultimate net loss" in the insuring clause itself. Accordingly, the court found that unlike the standard umbrella/excess policies at issue in *Powerine II,* the insuring clause of the non-standard excess policy is substantively the same as the standard CGL policy discussed in *Powerine I. Id.* at 10557.

Consistent with the holding in *Powerine I*, the court therefore concluded that "… costs and expenses associated with responding to administrative orders to clean up and abate soil or groundwater contamination *outside the context of a government-initiated lawsuit seeking such remedial relief,* and property buy-out settlements negotiated with third party claimants outside the context of a court suit, do not fall within the literal and unambiguous coverage terms of the [excess] policy's insuring agreement." *Id.* at 10557-10558.

Conclusion

Policyholders that are burdened with environmental liabilities in California frequently are subject to administrative agency orders requiring remediation and abatement of contamination. Since the California Supreme Court's decision in *Powerine I,* policyholders have been faced with a difficult decision either to comply voluntarily with such orders thereby forfeiting any potential insurance coverage

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under their standard CGL policies, or otherwise to force costly litigation with the agencies in hopes of obtaining coverage.

Powerine II opens the door to policyholders to potentially recover costs of complying with administrative orders under umbrella liability policies without forcing the government to sue. Of course, the fortunes of the policyholder will depend upon the precise language of the policies at issue, compliance with policy terms and conditions, and possibly the application of exclusions. Nonetheless, *Powerine II* provides a possible basis for recovery of administrative costs where none might have existed before.

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