



# CLIENT MEMORANDUM

## California Supreme Court Rules on “Sudden and Accidental” Pollution Exclusion in *State of California v. Allstate Insurance Company*

*March 18, 2009*

On March 9, 2009, the California Supreme Court, in a unanimous decision, held that certain insurers that afforded liability insurance coverage to the State of California may be liable for a portion of the State’s more than \$500 million estimated cost of cleaning up of the Stringfellow “Acid Pits.” The decision addressed two technical but important disputes concerning the application of the “sudden and accidental” pollution exclusion. First, the Supreme Court identified the secondary discharge from the Stringfellow hazardous waste site (rather than the disposal of waste into the site) as the relevant polluting event for the purposes of applying the exception to the “sudden and accidental” pollution exclusion. Second, the Court determined that a policyholder need not prove the quantum of damage resulting from “sudden and accidental” discharges of pollutants when “indivisible” property damage resulted from both excluded and covered causes as long as the insured can show that covered discharges accounted for a “substantial cause” of the injury.

With respect to this latter point, the Court’s decision holding insurers liable for the totality of “indivisible” damage represents a departure from the common understanding that the insured has the burden of proof to establish coverage under a liability policy, including exceptions to exclusions, and the insurer has the burden of proof to establish the applicability of exclusions to coverage.

### **BACKGROUND**

The State of California established the Stringfellow site in 1956 as a Class I hazardous waste site for disposal of the most hazardous liquid wastes. Between 1956 and 1972, more than 30 million gallons of industrial waste were deposited at the site. The State determined that the Stringfellow site was suitable for this purpose based on a geologist’s report that incorrectly concluded that the site overlay an impermeable layer of rock. In fact, the site was underlain by decomposed granite and fractured bedrock, through which ran an underground channel. Also,

contaminants escaped into the environment around the edge of a negligently constructed dam built to contain surface runoff. Moreover, the dam failed to contain wastes during what the Supreme Court termed "two major overflow episodes" during periods of very heavy rains in 1969 and 1978.

The State's underlying liability arose in a somewhat unusual posture to which the result may, in part, be attributable. The State of California actually joined with the federal government as a plaintiff in a cleanup suit against the companies that dumped waste at the Stringfellow site and the companies counterclaimed against the State for negligence. In 1998, the federal district court held the State negligent in establishing and operating the Stringfellow site and rendered the State one hundred percent liable for claims under California law and sixty-five percent liable for claims under federal law for the past and future costs of remediating the contaminated land and groundwater at and around the site.

The Riverside Superior Court in which the State commenced the coverage action granted four excess insurers' motions for summary judgment that their pollution exclusions applied and barred coverage. The Court of Appeal for the Fourth District held that the "sudden and accidental" pollution exclusions in the policies in question did not bar coverage for the State's claims as a matter of law and remanded the case for further proceedings. The insurers then sought review from the Supreme Court.

### **THE RELEVANT DISCHARGE UNDER THE "SUDDEN AND ACCIDENTAL" POLLUTION EXCLUSION**

The "sudden and accidental" pollution exclusion was a feature of liability insurance policies from the 1970's to the mid-1980's. That exclusion typically bars coverage for "discharge, dispersal, release or escape" of pollutants except where such discharges are "sudden and accidental." The California Supreme Court affirmed the Court of Appeal's holding that the relevant discharge was not the routine dumping into the Stringfellow site's evaporation

ponds but rather the accidental release of chemical waste from containment at the site. See *State v. Allstate Ins. Co. ("Stringfellow")*, No. S149988, slip op. at 7 (Cal. Mar. 9, 2009). The Supreme Court engaged in the analysis as to the relevant discharge as a basis for holding that the State satisfied the "accidental" element of the "sudden and accidental" exception to the exclusion. The two flooding events in 1969 and 1978<sup>1</sup> allowed the State to claim that at least some of the pollution was a product of "sudden" discharges.

In the portion of its decision addressing the relevant discharge, the Supreme Court distinguished *Standun, Inc. v. Fireman's Fund Insurance Co.*, 62 Cal. App. 4th 882, 889-90 (2d Dist. 1998), a Court of Appeal decision which held that the insured's initial discharge of wastes into a landfill, rather than the subsequent migration of wastes into the surrounding environment, was the operative discharge for purposes of applying the "sudden and accidental" pollution exclusion. In *Standun*, a case involving the OII landfill in Monterey Park, California, the insured was a responsible party that sent waste to the landfill and settled a contribution action brought by other responsible parties under the CERCLA strict liability scheme. The Court of Appeal concluded that where the insured purposefully gave its liquid industrial waste to transporters that brought the waste to a landfill where it was released directly onto the land, the disposal of the waste and not the subsequent leaching from the site was the relevant discharge. See *id.* at 891. The *Standun* Court stated:

Where hazardous waste material is deposited directly into a landfill, the relevant discharge of pollutants for purposes of the pollution exclusion is the initial release of the hazardous waste into the landfill, not the subsequent release of pollutants

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<sup>1</sup> The Court of Appeal had held that the 1978 release was not accidental as a matter of law because of the State's prior experience with the 1969 overflow and its failure to adopt the requisite measures to avoid another overflow. The Supreme Court reversed this ruling, finding a triable issue of fact as to whether the 1978 discharge was accidental. See slip op. at 15-21.

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from the landfill into the water, air and adjoining land. This discharge of pollutants into or upon the land is to be distinguished from the subsequent contamination of the environment and the condition of the landfill, which constitute the damages arising out of the discharge of pollutants onto the land.

*Id.* (internal citation omitted). The *Standun* Court further held that a landfill cannot be considered a storage container as the insured argued "because the landfill vessel is itself land." *Id.*

By contrast, the Supreme Court deemed significant that in *Stringfellow* the wastes were placed into evaporation ponds and the site was intended to contain liquid wastes. The Supreme Court stated that "the State's liability was based on its having sited, designed, built, and operated the Stringfellow facility in such a negligent manner as to allow hazardous chemicals to escape from the evaporation ponds (by both seepage and overflow) into the surrounding environment." *Stringfellow*, slip op. at 8. Thus, the State's acceptance of wastes into the intended containment ponds was not itself a discharge, dispersal, release or escape within the meaning of the pollution exclusion, and the chemical wastes did not behave as environmental pollutants until they were later discharged from the ponds. *See id.* at 10-11.

The *Stringfellow* Court also reasoned that even assuming that the deposit of chemicals into the evaporation ponds was barred from coverage as intentional discharges under the relevant pollution exclusions, the subsequent escape of those chemicals from the ponds into the surrounding soils and groundwater constituted another set of discharges. *Id.* at 11. In the underlying pollution liability case, the State's liability was based on its negligence in allowing the second set of discharges, not the first. In this context, the Court viewed the seepage and overflow from the ponds as liability-causing events as opposed to simply more property damage. *Id.*

In its opinion, the Supreme Court did not discuss, although it did reference *Travelers Casualty & Surety Co. v. Superior Court*, 63 Cal. App. 4th 1440 (6th Dist. 1998),

another Court of Appeal decision handed down shortly after the *Standun* case, and also involving the OII hazardous waste site. In *Travelers v. Superior Court*, the Court of Appeal applied the "sudden and accidental" pollution exclusion to claims by Lockheed to obtain indemnity for its environmental liability at the site. In reversing the denial of two insurers' summary adjudication motions, the Court of Appeal held:

We find that the insurers met their initial burden of establishing that Lockheed's claim for coverage of the OII site damages is barred by the pollution exclusion. The undisputed facts show that the OII claims concern property damage or personal injury which arose from the routine and intentional disposal of industrial wastes by Lockheed and other manufacturers into the OII landfill. Placement of pollutants into the landfill is, literally, disposal of pollutants onto land. Therefore, a claim for property damage or personal injury arising from the disposal of wastes at the OII site is barred by the plain language of the pollution exclusion.

*Id.* at 1460-61 (internal citations omitted). Like the *Standun* Court, the Court of Appeal in *Travelers v. Superior Court* rejected Lockheed's argument that discharge into the landfill was not the relevant discharge for purposes of applying the pollution exclusion, stating: "At the outset, we reject Lockheed's argument that the OII landfill was a place of containment from which toxic substances suddenly and accidentally escaped, causing damage to the surrounding environment . . . There is no indication the EPA considered the landfill to be a containment vessel from which hazardous substances escaped. Nor has Lockheed presented any other evidence that the OII landfill was a kind of containment vessel for industrial waste." *Id.* at 1461-62 (internal citation and quotation marks omitted). The Court of Appeal deemed other alleged causes of "sudden and accidental" releases cited by Lockheed such as fires, firefighting, and earthquakes to be speculative and Lockheed's claim that heavy rains caused

leaching of the contaminants into the groundwater to be an expected consequence of the dumping and also to constitute further damage as opposed to a relevant discharge. *Id.* at 1462-63.

**SHIFTING THE BURDEN OF PROOF AS TO THE AMOUNT OF HARM CAUSED BY "SUDDEN AND ACCIDENTAL" DISCHARGES OF POLLUTANTS WHEN ONLY A PORTION OF THE HARM DERIVES FROM A COVERED DISCHARGE**

The State admitted that it was unable to differentiate the property damage caused by the 1969 and 1978 releases from the gradual, and thus noncovered, leakage of pollutants from the evaporation ponds, and that it could not differentiate the "work performed to date" to remedy the property damage caused by the various sets of releases. Due to these admissions, the trial court ruled that the State could not recover any of the proceeds from its liability insurance contracts because it could not prove how much of the property damage was caused by covered "sudden and accidental" releases. *See Stringfellow*, slip op. at 21.

The California Supreme Court, adopting the reasoning of the Court of Appeal, rejected this approach based on the insured's normal burden to prove coverage under a liability insurance contract. Instead, the Court focused on a concurrent causation analysis, as expressed in *State Farm Mutual Auto Insurance Co. v. Partridge*, 10 Cal. 3d 94 (1973), a case involving a gunshot injury in an automobile. In *Partridge*, the policyholder's covered negligent act was lightening the trigger pull of his pistol and the policyholder's excluded negligent act was driving his truck off the paved road onto rough terrain, where his truck hit a bump and the gun fired. The Supreme Court held that as in *Partridge*, where harm was indivisible and contributed to by both excluded and nonexcluded causes, the insurer's liability followed the insured's tort liability. Specifically, the Court held that

if the insured proves that multiple acts or events have concurred in causing a single injury (as in *Partridge*) or an indivisible amount of property damage (as may be shown at trial here), such that

one or more of the covered causes would have rendered the insured liable in tort for the entirety of the damages, the insured's inability to allocate the damages by cause does not excuse the insurer from its duty to indemnify.

Slip op. at 32-33. In other words, the *Stringfellow* Court determined that if the insured's nonexcluded negligence suffices to render the insured liable for truly indivisible harm, the insurer is obligated to fully indemnify the policyholder even if other excluded causes contributed to the injury or property damage. In reaching this result, the Court overruled *Golden Eagle Refinery Co. v. Associated International Insurance Co.*, 85 Cal. App. 4th 1300 (2d Dist. 2001), a case involving a petroleum refiner that had polluted its refinery site by discharging petroleum hydrocarbon constituents through both routine and "sudden and accidental" discharges. In *Golden Eagle*, the Court of Appeal, applying a contract rather than tort-based analysis, held that the insured could obtain no recovery under its liability insurance policy where the insured could not carry its burden of proving the amount of damages attributable to non-excluded causes.

**EVALUATION**

The *Stringfellow* case has unique facts since the site in question was actually designed to operate as a containment facility and the underlying liability was for negligence as opposed to statutory strict liability. The Supreme Court cited with approval both *Standun* and *Travelers v. Superior Court*, the Court of Appeal decisions that granted summary dispositions to insurers based on the "sudden and accidental" pollution exclusion where discharges were made directly into a landfill not designed to contain liquid wastes. Accordingly, the *Stringfellow* decision's focus on the escape of pollutants from the site as the relevant discharge may have limited general application and the Court of Appeal holdings that normal leaching of hazardous waste at a dumpsite where there was no legitimate containment is "damage" and not "discharge" should still be viable, particularly in cases involving industrial operators that dispose of their wastes offsite.



The Supreme Court couched in the logic of the *Partridge* decision its ruling that insurers bear the burden to show the amount of harm attributable to excluded causes in cases where damage from excluded and covered causes is "indivisible." However, its holding may be better understood as a part of continued litigation in California on the significance of the "all sums" language typically found in the insuring agreement of general liability insurance contracts. Courts that have adopted an "all sums" approach hold an insurer that issued a liability policy for any period during which a continuous loss occurred liable up to its policy limits for the full extent of loss without regard to whether damage also happened before and/or after its policy period. Courts that do not follow an "all sums" approach rely on policy language that limits a liability insurer's contractual obligation to indemnify solely to the amount of covered property damage that happens during the insurer's policy period. See, e.g., *Consolidated Edison Co. v. Allstate Ins. Co.*, 98 N.Y.2d 208, 221-25 (2002). The *Stringfellow* Court's decision to the effect that a general liability insurer's obligations under its policy follows the tort liability in the underlying cases may telegraph how the "all sums" issue will ultimately be decided in California.<sup>2</sup> However, the Supreme Court's holding on the burden of proof may be grounded less in case law or logic than in the Supreme Court's view that, as a practical matter, insurers should not be absolved from liability in situations where there is concededly substantial covered harm. The Supreme Court may view its ruling as one that incentivizes insurers to prove divisibility of harm so they do not benefit from a muddled record.

Finally, the Supreme Court did acknowledge previously recognized limitations that preclude insureds from reflexively claiming harm from concurrent causes in this context. Citing Court of Appeal decisions, the Supreme Court held that the insured has the burden to show that a covered act or event was actually a *substantial cause* of the property damage for which the insured is liable. *Stringfellow*, slip op. at 32-34. Since the Court of Appeal has previously resolved cases like *Standun* and *Travelers v. Superior Court* favorably to insurers, it remains to be seen the extent to

which the *Stringfellow* case will affect the willingness of trial courts and the Court of Appeal to allow summary judgments in routine "sudden and accidental" pollution exclusion cases where there is no serious dispute as to containment of waste.

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<sup>2</sup> The insurers subject to a recent unfavorable "all sums" ruling in another *Stringfellow*-related coverage appeal, see *State of California v. Continental Insurance Co.*, 170 Cal. App. 4th 160 (4th Dist. 2009), have recently sought review from the Supreme Court.

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