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THE POLLUTION EXCLUSION: IMPLEMENTING THE SOCIAL POLICY OF PREVENTING POLLUTION THROUGH THE INSURANCE POLICY

Erwin E. Adler and Steven A. Broiles***

In recent years, as this country attempts to restore the natural environment following decades of pollution, the insurance industry increasingly has become the focus of environmental litigation. The insurance policy pollution exclusion was designed to implement the social policy of discouraging business practices which harm the environment. However, implementation of this social policy is thwarted when courts nonetheless impose environmental clean-up costs on an active polluter's business insurer.

Recently, various courts have held insurance companies liable for pollution damage under policies of general liability insurance routinely issued to commercial and business entities since the late 1960's. At that time, however, insureds believed that this risk was specifically excluded from coverage; similarly, insurers never charged for that risk when collecting premiums. This mutual understanding between insurers and insureds was consistent with legislation enacted by one state almost two decades ago to create an economic disincentive to pollute by prohibiting insurance coverage for pollution damage.¹ Insurers in that state and others generally cooperated by excluding such coverage from their policies.²

The social policy underlying this legislation and the pollution exclusions clause was to discourage conduct by insureds which might result in environmental pollution. As the scope of these insurance policies is litigated today, however, certain courts are inadvertently rewarding irre-

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1. N.Y. A.B. 6952, 1971-72 Reg. Sess. (1971) (introduced by Assem. Harris) (originally codified at N.Y. INS. LAW § 46) (currently codified as amended at N.Y. INS. LAW § 1113 (McKinney 1985)). See *infra* notes 13-23 and accompanying text.

2. See *infra* notes 7-12 and accompanying text.

sponsible corporate behavior. By failing to consider the pollution exclusion clause's underlying purpose, a disproportionate share of environmental clean-up costs is being imposed on the insurance industry.³ The varying judicial interpretations of the exclusion's applicability and scope illustrate the general lack of appreciation of the underlying social policy issue that led to its inclusion in most insurance contracts.

California, like other states, attempts to protect the environment through an extensive scheme of legislation which imposes the basic cost of pollution upon the entity or entities best able to prevent the pollution.⁴ The pollution exclusion implements that regulatory philosophy by motivating business executives to consider the direct economic costs of environmental damage *before* acting. Thus, the executive, knowing that he cannot shift the cost of the company's socially incompatible behavior to someone else, is much less likely to become a polluter. Furthermore, any costs incurred by a business in eliminating pollution can be passed on to the consumers of its products or services. The marketplace, therefore, determines whether the social benefits and costs of that product or service (including its pollution control) outweigh its utility value to the consumer.

This Article traces the development of the pollution exclusion, examines its underlying social policy, and discusses how the inconsistent judicial interpretations of the exclusion have resulted from the judiciary's failure to recognize or acknowledge this policy. It suggests that consistent judicial recognition of the exclusion's social policy would facilitate responsible corporate decision-making in the environmental context.

I. DEVELOPMENT OF THE POLLUTION EXCLUSION CLAUSE

To understand the judicial treatment of the pollution exclusion clause, it is necessary to review both the historical use of insurance to support regulatory policy goals and to examine the development of the

3. In 1984, property and casualty insurers suffered a net loss of \$3.55 billion, the first net loss for the insurance industry since the San Francisco earthquake in 1906. This loss was due in part to the narrow judicial interpretation of the standard pollution exclusion. As a result of this and other uncertainties arising out of the scope of liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended in scattered sections of 16, 22, 33, 42, 49 U.S.C.), pollution coverage is being withdrawn from the market. See EPA Standards Applicable to Owners and Operators of Hazardous Waste Treatment, Storage, and Disposal Facilities: Liability Coverage, 50 Fed. Reg. 33,902 (1985) (to be codified at 40 C.F.R. pts. 264-265) (proposed Aug. 21, 1985) [hereinafter cited as EPA Proposed Stds. of Liability Coverage].

4. See *infra* note 53 and accompanying text.

exclusion clause in typical forms of insurance policies available during the past fifteen years.

A. *Typical Insurance Coverage*

1. The comprehensive general liability policy

The comprehensive general liability policy (CGL) was first developed in 1966 to replace the earlier "accident" policy form. CGL policies provide insurance coverage for "all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage to which this [insurance] applies, *caused by an occurrence*, and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage"⁵ "Occurrence" is defined as "an accident, including injurious exposure to conditions, which results, during the policy period in *bodily injury or property damage* neither expected nor intended from the standpoint of the insured."⁶

Under the CGL policy, the insurer's duties to defend and indemnify arise when an injury occurs during the policy period. Neither the event causing the injury nor the actual filing of a claim need occur during the policy period.

a. *the CGL pollution exclusion clause*

Beginning in June 1970, insurance companies voluntarily attempted to exclude liability coverage under CGL policies for environmental damage caused by the release of pollutants or hazardous substances, except for "sudden and accidental" pollution.⁷ The insurance industry's efforts paralleled novel legislation enacted in New York,⁸ and initially took the form of an endorsement excluding coverage for:

bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or other pollutants into or upon

5. See *American States Ins. Co. v. Maryland Casualty Co.*, 587 F. Supp. 1549, 1551-52 (E.D. Mich. 1984) (emphasis added). See generally Wilmarth, *Outline of Insurance Developments*, in 21 FED'N INS. COUNS. Q. 23, 23-26 (Summer 1971).

6. See *Steyer v. Westvacs Corp.*, 450 F. Supp. 384, 388 (D. Md. 1978) (emphasis in original). See generally Wilmarth, *supra* note 5, at 23-26.

7. See generally McGeough, *The Applicability of Liability Insurance Coverage to Actions Involving Environmental Damage*, 1971 A.B.A. SEC. INS., NEGL. AND COMPENSATION LAW 312.

8. See *infra* notes 13-23 and accompanying text for a discussion of this New York legislation.

land, the atmosphere or any water course or body of water; but this exclusion does *not* apply if such discharge, dispersal, release or escape is "sudden and accidental"⁹

By 1973, most standard CGL policies included this language as an exclusion.¹⁰ While coverage was intended to apply to liability arising out of a spill or other accident whose effects were known reasonably soon after the occurrence, problems arose when the effects were not known until years after the event or where there was gradual seepage.¹¹ As a result of the unpredictable judicial interpretation of the pollution exclusion clause, the standard CGL policy recently has been revised in an attempt to exclude coverage for all pollution damage claims.¹²

b. history of the pollution exclusion clause

At about the same time insurers were rewriting the CGL to exclude certain pollution hazards, the State of New York began efforts to preclude insurance coverage for polluters. These efforts culminated in 1971 with the passage of legislation prohibiting pollution liability coverage.¹³

9. See Wilmarth, *supra* note 5, at 25-26 (quoting exclusion endorsement clause utilized by Insurance Rating Board).

10. Following the court in *Travelers Indem. Co. v. Dingwell*, 414 A.2d 220, 223 n.2 (Sup. Jud. Ct. Me. 1980), we refer to the general pollution provisions as "exclusions" and to any limitations on the scope of the exclusions as "exceptions."

11. These problems are beyond the scope of this Article. They are briefly considered below, *see infra* notes 118-25 and accompanying text, but warrant separate treatment.

12. The proposed 1986 Insurance Services Office (ISO) Commercial General Liability Policy (Exclusion F) reads:

This insurance shall not apply to:

- (1) "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants:
 - (a) at or from premises you own, rent or occupy;
 - (b) at or from any site or location used by or for you or others for the handling, storage, disposal, processing or treatment of waste;
 - (c) which are at any time transported, handled, stored, treated, disposed of, or processed as waste by or for you or any person or organization for whom you may be legally responsible; or
 - (d) at or from any site or location on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations:
 - (i) if the pollutants are brought on or to the site or location in connection with such operations; or
 - (ii) if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.

Pollutants, means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

The Defense Research Institute, Inc., Course Book No. 85-3, *Environmental and Hazardous Waste Litigation*, at H-27 (Apr. 11-12, 1985) (unpublished reference provided at DRI Defense Practice Seminar in Boston, Mass.).

13. N.Y. A.B. 6952, 1971-72 Reg. Sess. (1971) (introduced by Assem. Harris) (originally

Pollution exclusion clauses most commonly found in insurance policies written between 1973 and 1986 generally follow the form proposed as an amendment¹⁴ to section 46 of New York's Insurance Law.¹⁵

The bill, when introduced, carried Governor Rockefeller's recommendation.¹⁶ His message described New York's great concern for environmental values and also articulated the need to preclude polluters from shifting the consequences of their actions to insurers. His message is applicable to any state concerned with eliminating pollution:

New York state has adopted stringent standards to prohibit despoiling the environment through the discharge of noxious substances into the water and air. These standards, which are the most comprehensive in the Nation, go far beyond merely strengthening and supplementing the common law rules against pollution.

As strict as these laws are, however, their effectiveness could be substantially reduced if polluters were to purchase insurance to protect themselves from having to pay the fines and other liabilities that may be imposed upon them for polluting the environment.

For example, a polluting corporation might continue to pollute the environment if it could buy protection from potential liability for only the small cost of an annual insurance premium, whereas, it might stop polluting, if it had to risk bearing . . . the full penalty for violating the law.¹⁷

The Governor further analyzed the interrelationship between the availability of insurance coverage and the need to place the full burden of pollution costs upon the polluter:

Many insurance companies have voluntarily initiated ac-

codified at N.Y. INS. LAW § 46) (currently codified as amended at N.Y. INS. LAW § 1113 (McKinney 1985)).

14. A.B. 6952 of the 1971-1972 regular session contained a proposed amendment to the definition of "personal injury liability insurance" found in § 46(13) of New York's Insurance Law that read as follows:

Policies issued to commercial or industrial enterprises providing insurance against the legal liabilities specified in this subdivision shall expressly exclude therefrom liability arising out of pollution or contamination caused by the discharge, dispersal, release or escape of any pollutants, irritants or contaminants into or upon land, the atmosphere or any water course or body of water unless such discharge, dispersal, release or escape is sudden and accidental.

15. Section 46 of the New York Insurance Law is now codified at N.Y. INS. LAW § 1113 (McKinney 1985).

16. Governor's Program Bill, Program Bill No. 42, at 1 (1971).

17. *Id.* at 353-54.

tion to protect the environment by refusing to insure against liability arising out of environment pollution.

The bill would help to assure that corporate polluters bear the full burden of their own actions spoiling the environment, and would preclude any insurance company from undermining public policy by offering this type of insurance protection.¹⁸

New York's then recently formed Department of Environmental Conservation supported the bill for similar reasons:

It is the belief of this Department that if polluters are allowed to purchase insurance to protect themselves from paying fines and other liabilities which will be imposed upon them for polluting the environment, that the effectiveness of a strengthen[ed] enforcement program will be diminished. To make a clean environment a reality, corporate polluters must bear the full cost of despoiling the environment.¹⁹

New York's policy of statutorily precluding any type of insurance for environmental damage has not, to our knowledge, been adopted by any other state. But numerous other states have generally followed New York's lead by enacting extremely stringent environmental pollution laws and imposing clean-up costs on the polluter.²⁰ New York's efforts, moreover, did prompt the insurance industry to include the pollution exclusion clause in most CGL policies written at that time.²¹

It is worth noting that while the New York legislature was considering adoption of legislation precluding pollution insurance, the state's

18. *Id.* at 354.

19. Memorandum from Henry L. Diamond, Envt'l Conservation Comm'r, Dep't of Envt'l Conservation to N.Y. Senate (June 18, 1971) (filed with Committee on Rules in support of N.Y. S.B. 7042, 1971-72 Reg. Sess. (1971)).

20. For a thorough summary of state environmental laws, see Office of Domestic Fin., U.S. Dep't of Treasury, No. PB82-188236, Hazardous Substance Liability Insurance, at app. B-2 (Mar. 1982), reprinted in NAT'L TECHNICAL INFORMATION SERV., U.S. DEP'T OF COMMERCE, HAZARDOUS SUBSTANCE LIABILITY INSURANCE, at app. 193-202 (Mar. 1982) [hereinafter cited as HAZARDOUS SUBSTANCE LIABILITY INSURANCE].

21. See *Niagara County v. Utica Mut. Ins. Co.*, 103 Misc. 2d 814, 427 N.Y.S.2d 171, 174 (1980), *aff'd*, 80 A.D.2d 415, 439 N.Y.S.2d 548 (1981). The bill was designed to encourage all insurers not to provide insurance for pollution. Memorandum from Roger W. Tompkins, Deputy Superintendent and Gen. Counsel of the N.Y. Ins. Dep't to Gov. Rockefeller (June 15, 1971) (filed with Committee on Rules in support of N.Y. S.B. 7042, 1971-72 Reg. Sess. (1971)). "[T]he effect of those laws [prohibiting pollution] may be substantially reduced if polluters may purchase insurance to protect themselves from having to pay fines and other liabilities that may be imposed upon them for their actions." *Id.* at 2. Commissioner Tompkins noted that Governor Rockefeller had been urging enactment of such a regulation since 1970 and that although certain insurers had voluntarily agreed to include exclusions for polluters, "[t]his legislation should serve to further motivate all commercial and industrial enterprises to preserve and protect the environment." *Id.*

Commerce Department recognized that neither the state's commercial and industrial businesses nor the state's extensive insurance industry opposed adoption of the legislation.²² In fact, only two power companies—which have long been accused of insensitivity to environmental concerns—filed written opposition to the legislation.²³

In summary, the social policy that underlies the only statute on the subject and the related language of the CGL pollution exclusion clause is directed toward influencing corporate management decisions *before* a business harms the environment. The purpose was to make corporate managers aware that they, and not their insurers, would have to pay for the consequences of their failure to adequately protect the environment. Accordingly, the regulated community would be stimulated to adopt practices protective of the environment while pursuing their business activities rather than ignoring the possible long term environmental consequences of their acts.

2. Environmental impairment liability policies

Another type of currently issued environmental insurance policy is the environmental impairment liability (EIL) policy. EIL policies must be distinguished from CGL policies, which include the pollution exclusion clause. First issued in 1977, EIL policies are issued on a "claims-made" basis rather than on an "occurrence" basis. Under a claims-made basis, the policy covers any claim made for injuries arising from environmental pollution during the period of coverage. Some EIL policies limit the number of years prior to the claim when an occurrence must have happened for the policy to cover the claim. The scope of such limitation clauses, as well as other standard deductible, annual, aggregate and self-insured retention provisions, are subject to negotiation between the carrier and its insured, and vary from policy to policy.

No policy presently written completely matches the liability exposure of a "responsible party" under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).²⁴ CERCLA

22. See Memorandum from Henry J. O'Donald, First Deputy Commissioner to N.Y. Assembly 3 (June 24, 1971) (filed with Committee on Insurance in support of N.Y. A.B. 6952, 1971-72 Reg. Sess. (1971)).

23. See Letter from Edwin J. Walsh, Attorney for Long Island Lighting Co., to Michael Whitman, Counsel to the Governor (June 18, 1971); Letter from Walter J. Barrett, Attorney for Niagara Mohawk Power Corp., to Michael Whitman, Counsel to the Governor (June 17, 1971) (filed with Committee on Insurance in support of N.Y. A.B. 6952, 1971-72 Reg. Sess. (1971)).

24. Comprehensive Environmental Response, Compensation, and Liability Act (CER-

imposes financial liability for "removal" and "remedial" clean-up costs.²⁵ Because of the open-ended nature of such clean-up costs,²⁶ they are not generally covered by insurance. Insurance is, however, generally available to cover exposure under the Resource Conservation and Recovery Act (RCRA)²⁷ and non-intentional tort liability.

Some EIL insurance policies are specifically designed to cover third-party damages caused by pollution. Insurers generally investigate a site and assess the potential environmental impact resulting from a particular business operation before issuing such policies. Absent such a review, no insurance underwriter can hope to quantify the potential risk associated with a particular business enterprise. Of course, if management chooses, in conjunction with its insurer, to decrease the hazards of environmental pollution, the business enterprise saves a portion of the premium it would otherwise have to spend. Conversely, the insurer has decreased the risk it will assume under the insurance policy ultimately issued. The overall benefit to society is, of course, the decreased probability of the degradation of our soil, air and water.

The cost of preparing a written risk assessment or survey upon which the underwriter will accept or reject an applicant for pollution coverage is borne by the applicant. Applicants for EIL policies are limited to the current owner or operator of a site. No insurance is presently available for former owners or operators. All EIL policy forms contain important exclusions and each form must be considered from this standpoint.²⁸ Because the EIL policy is written in conjunction with a site inspection by the insurer, the exclusions which are included in such policies implement the general desire that the risks of environmental pollution are to be borne by the operator.

Most forms of EIL policies exclude liability for claims arising from conduct which the insured, or its directors, officers or responsible employees, actually know does not comply with the law. Some forms exclude loss arising from any condition giving rise to pollution if any director, officer or other management person knew, or could reasonably

CLA) of 1980, Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended in scattered sections of 16, 26, 33, 42, 49 U.S.C.).

25. CERCLA § 101 (23)-(24), 42 U.S.C. § 9601(23)-(24) (1982).

26. Costs imposed under CERCLA include "necessary expenses" of third persons, *id.* § 107, 42 U.S.C. § 9607 (1982), and "natural resource damages" assessed under the direction of federal officials, *id.* §§ 102(16), 111(1), 42 U.S.C. §§ 9602(16), 9611(H)(1) (1982).

27. Resource Conservation and Recovery Act of 1976, Pub. L. No. 94-580, 92 Stat. 2795 (codified as amended in 42 U.S.C.A. §§ 6901-6987 (West 1983 & Supp. 1985)).

28. EIL policy coverages are generally described in HAZARDOUS SUBSTANCE LIABILITY INSURANCE, *supra* note 20, at app. 212-28.

have foreseen, that such a condition would give rise to a claim. The application forms relating to such policies contain much the same type of limitation of liability language.

Some EIL policies may also exclude various types of injury. All policies exclude coverage for nuclear hazards. Some forms exclude coverage for genetic damage. Most forms exclude liability arising under a contract or agreement; whether this would include a contractual indemnification or settlement agreement is an interesting (and unlitigated) question.

There may also be exclusions for the type of relief sought. For example, some EIL policies exclude claims for non-pecuniary, *injunctive* relief. Others accomplish the same result by referring only to *damage* coverage. In a related context, most EIL policies specifically exclude coverage for fines, penalties and punitive damages. Similarly, most forms do not cover damage to property owned or used by the insured.

Finally, almost all forms of EIL policies attempt to preclude coverage for claims broader than environmental impairment. For example, all forms exclude workers' compensation or work-related claims²⁹ and exclude product liability claims.³⁰ The Insurance Services Office (ISO) is preparing a new form of policy covering all pollution incidents, both sudden or gradual, on behalf of major insurance companies.³¹ The 1981 ISO policy form was designed to accommodate the insurance needs of owners and/or operators of facilities which generate, store, treat or process hazardous materials and wastes. It excludes from coverage the cost to clean-up a site owned, operated or used by the insured as well as liability emanating from any site which is no longer in active use.³²

3. The interrelationship of the EIL policy to the CGL policy

The availability of pollution insurance under an EIL policy underscores the intention of insurers to generally exclude pollution coverage from the scope of CGL policies. Indeed, this proposition is supported by the most recent case addressing the issue: "[T]he existence of such [EIL] coverage is enlightening concerning the underwriters' understanding of the scope of coverage in the [CGL] liability policy [the insured] did

29. See Comm. on Business Management Liab. Ins. of the ABA Section of Corp., Banking and Business Law, *Liability Insurance Against Environmental Damage: A Status Report—June 1982*, 38 BUS. LAW. 217, 222-23 (1982) for a discussion of these exclusions.

30. *Id.*

31. See HAZARDOUS SUBSTANCE LIABILITY INSURANCE, *supra* note 20, at app. 231-34.

32. *Id.*

have."³³

A number of other courts, however, in considering the scope of an insurer's duties under CGL policies to defend and indemnify the insured in actions brought by third parties for pollution injuries,³⁴ have erroneously interpreted CGL policy coverage to be as broad as EIL policy coverage.³⁵

II. JUDICIAL INTERPRETATION OF THE POLLUTION EXCLUSION

A. *Judicial Non-recognition of the Exclusion's Underlying Social Policy*

The social policy of influencing the decisions of corporate managers *before* they act generally has not been the central theme of reported decisions construing the pollution exclusion clause.³⁶ Regrettably, few decisions have focused as sharply upon the underlying policy issues as has the most recent decision in this area, *Waste Management of Carolinas v. Peerless Insurance Co.*³⁷

The policy reasons for the pollution exclusion are obvious: if an insured knows that liability incurred by all manner of negligent or careless spills and releases is covered by his liability policy, he is tempted to diminish his precautions and relax his vigilance. Relaxed vigilance is even more likely where the insured knows that the intentional deposit of toxic material in his dumpsters, so long as it is unexpected, affords him coverage. In this case, it pays the insured to keep his head in the sand.

. . . .

In addition, putting the financial responsibility for pollution that may occur over the course of time upon the insured places the responsibility to guard against such occurrences upon the party with the most control over the circumstances

33. *Waste Management of Carolina, Inc. v. Peerless Ins. Co.*, No. 70PA85, slip op. at n.5 (N.C. Sup. Ct. Feb. 18, 1986) (available Mar. 28, 1986 on LEXIS, States library, NC file).

34. *See, e.g., Sellers v. Seligman*, 463 So. 2d 697, 702 (La. Ct. App.), *cert. denied*, 464 So. 2d 1379 (1985) (material issue of fact existed as to whether sandblaster's inhalation of silica dust while performing his duties fell within terms of pollution exclusion clause, precluding summary judgment).

35. *See infra* notes 44-53 and accompanying text.

36. *But cf. Niagara County v. Utica Mut. Ins. Co.*, 103 Misc. 2d 814, 427 N.Y.2d 171 (1980), *aff'd*, 80 A.D.2d 415, 439 N.Y.S.2d 538 (1981).

37. No. 70PA85 (N.C. Sup. Ct. Feb. 18, 1986) (available Mar. 28, 1986, on LEXIS, States library, NC file).

most likely to cause the pollution.³⁸

The policy of affecting corporate decision-makers at the time they act is, of course, related directly to the perceived level of certainty by the public that our legal system will enforce that social policy. The United States Department of the Treasury, in its massive analysis of hazardous substance liability insurance, recognized that the certain unavailability of insurance coverage for active polluters directly impacts the corporate decision-maker.³⁹ In that context, the Treasury Department concluded that:

[The] degree to which liability systems provide incentives to responsible parties for greater levels of care will depend to a certain extent on how easily that liability can be shifted to some other party as guarantor. If liability can be shifted to another party only with great difficulty (for reasons of cost, terms and conditions, or whatever) the more likely it is to serve as a disincentive for participation in the activity at issue and vice-versa.⁴⁰

The corporate "disincentive for participation in the [polluting] activity at issue"⁴¹ is the focal point for analysis of the pollution exclusion clause set forth below.

Unfortunately, most courts that have disregarded the social policy underlying the pollution exclusion clause relied upon maxims of contract construction developed in the interpretation of *automobile* insurance policies or other nonbusiness activities. These courts thus ignored the business sophistication of the insured in addressing the pollution exclusion question. This major issue has been obscured by judicial platitudes such as a "contract of insurance prepared and phrased by the insurer is to be construed liberally in favor of the insured and strictly against the insurer"⁴² Similarly, the disincentive to pollute which motivated the creation of the pollution exclusion, has been ignored by courts looking for a deep pocket to finance environmental clean-up. The imposition of such costs on insurers is justified by the finding of some "doubt" or "ambiguity" in the clause which must be resolved in favor of the insured.⁴³

38. *Id.*

39. HAZARDOUS SUBSTANCE LIABILITY INSURANCE, *supra* note 20, at 14.

40. *Id.*

41. *Id.*

42. *Buckeye Union Ins. v. Liberty Solvent & Chem. Co.*, 477 N.E.2d 1227, 1232 (Ohio Ct. App. 1984).

43. *See, e.g., Waste Management of Carolinas v. Peerless Ins. Co.*, 72 N.C. App. 80, 323 S.E.2d 726 (1984), *review granted*, 313 N.C. 612, 330 S.E.2d 616 (1985), *rev'd*, No. 70PA85, (N.C. Sup. Ct. Feb. 18, 1986) (available Mar. 28, 1986 on LEXIS, States library, NC file).

The judiciary's general failure to focus upon the context in which business decisions are made is to some degree understandable. Society does not challenge most corporate business decisions affecting the environment. The relatively few decisions which are challenged do not often result in litigation; the complaining parties content themselves with a letter to corporate management or, possibly, a local newspaper or chamber of commerce. Few of the business decisions actually challenged in court result in a final judgment, and even fewer of these receive appellate review.

The business decision that may result in environmental pollution is not comparable to conduct which may result in an automobile accident. Automobile usage is generally unaffected by the judicial interpretation of auto insurance policy terms, while corporate decision-making is often influenced by judicial decisions on business matters. The automobile accident therefore does not provide an adequate conceptual basis for analyzing the social necessity of influencing corporate decision-making on environmental issues.

To reach the conclusion that environmental damage is covered under an insurance policy, the courts virtually have ignored the social policy which the pollution exclusion clause implements. Moreover, the courts doing so have held either that the pollution exclusion clause is not involved,⁴⁴ or that the accidental discharge exception to the pollution exclusion clause applies.⁴⁵

The exception provides that the exclusion "does not apply if such discharge, dispersal, release or escape is sudden or accidental."⁴⁶ Several courts maintain that this exception was intended to apply to liability arising out of a discharge which was "accidental" from the viewpoint of the insured and if its effects were known reasonably soon after the event.⁴⁷ Other courts purport to apply the exception where the discharge was intentional although the resulting injury was not,⁴⁸ especially where the

44. See *Molton, Allen & Williams, Inc. v. St. Paul Fire & Marine Ins. Co.*, 347 So. 2d 95 (Ala. 1977) (sand and dirt washed by storm waters on neighboring land not a specified pollutant); *A-1 Sandblasting & Steamcleaning Co. v. Baiden*, 53 Or. App. 890, 632 P.2d 1377 (1981), *aff'd*, 293 Or. 176, 643 P.2d 1260 (1982) (injury to vehicles as a result of overspray while painting bridge not environmental pollution).

45. See *supra* note 10 and accompanying text.

46. See *supra* note 9 and accompanying text.

47. See *Lansco, Inc. v. Department of Env'tl. Protection*, 138 N.J. Super. 275, 350 A.2d 520 (1975) (oil seepage into river due to discharge caused by vandals), *aff'd*, 145 N.J. Super. 433, 368 A.2d 363 (1976), *certif. denied*, 73 N.J. 57, 372 A.2d 322 (1977); *Evans v. Aetna Casualty & Sur. Co.*, 107 Misc. 2d 710, 435 N.Y.S.2d 933 (1981) (discharge of gasoline from above ground tank caused by vandals).

48. See *Travelers Indem. Co. v. Dingwell*, 414 A.2d 220 (Me. 1980) (exception to policy

effects have taken months or years to manifest themselves.⁴⁹

The reasoning typically followed by a court in emasculating the pollution exclusion clause begins with finding the pollution clause ambiguous⁵⁰ in order to construe it in a manner favorable to the insured. The court then interprets the words "sudden and accidental" as requiring the pollution-causing event to happen at a particular point in time.⁵¹ Once the court construes the exception to the pollution exclusion to be as broad as the policy coverage provision, the exclusion disappears. The pollution exclusion clause is thus identical in operation to the intentional injury exclusion⁵²—it is coextensive with the definition of "occurrence."

exclusion was not limited to a "sudden and accidental" release of pollutants, where insured's operation of industrial waste facility led to contamination of plaintiff's well water); *CPS Chem. Co. v. Continental Ins. Co.*, 199 N.J. Super. 558, 489 A.2d 1265 (1984) (coverage extended to generator of illegally dumped toxic waste), *rev'd*, 203 N.J. Super. 15, 495 A.2d 886 (1985); *Jackson Township Mun. Utils. Auth. v. Hartford Accident & Indem. Co.*, 186 N.J. Super. 156, 451 A.2d 990 (1982) (coverage not excluded to site owner/operator for intentional landfill disposal of industrial and municipal waste that eventually contaminated underground water supply); *Buckeye Union Ins. Co. v. Liberty Solvents & Chem. Co.*, 17 Ohio App. 3d 127, 477 N.E.2d 1227 (1984) (duty to defend hazardous waste generator in CERCLA action for clean-up of contaminated disposal site). *Cf.* *General Ins. Co. of Am. v. Town Pump, Inc.*, 692 P.2d 427, 428 (1984) (coverage for gasoline contamination of wells from leaking underground pipe after insured became "aware of potential gasoline leakage"); *Niagara County v. Utica Mut. Ins. Co.*, 80 A.D.2d 415, 439 N.Y.S.2d 538 (1981) (owner of leaking landfill not alleged to have been responsible for disposal of polluting substance). *Contra* *Great Lakes Container Corp. v. National Union Fire Ins. Co.*, 727 F.2d 30 (1st Cir. 1984) (exclusion upheld as to pollution injuries caused by insured's barrel reconditioning operation); *American States Ins. Co. v. Maryland Casualty Co.*, 587 F. Supp. 1549, 1552 (E.D. Mich. 1984) (exclusion upheld where insured produced and disposed of toxic waste as a "natural and usual part of its business").

49. *See* *Reliance Ins. Co. v. Martin*, 126 Ill. App. 3d 94, 467 N.E.2d 287 (1984) (parking garage alleged to have permitted carbon monoxide and soot to regularly enter adjacent condominium unit at diverse times); *Shapiro v. Public Serv. Mut. Ins. Co.*, 19 Mass. App. Ct. 648, 477 N.E.2d 146 (1985) (oil leaked from a progressively corroded underground tank into surrounding waterways); *City of Kimball v. St. Paul Fire & Marine Ins. Co.*, 190 Neb. 152, 206 N.W.2d 632 (1973) (pollution of irrigation well due to seepage from city sewer); *Allstate Ins. Co. v. Klock Oil Co.*, 73 A.D.2d 486, 426 N.Y.S.2d 603 (1980) (gradual discharge of gasoline from storage tank into adjacent property); *United Pac. Ins. Co. v. Van's Westlake Union*, 34 Wash. App. 708, 664 P.2d 1262 (1983) (gasoline leaked from underground pipe over several months).

50. Courts upholding the pollution exclusion clause typically find it not to be ambiguous. *See, e.g.*, *Great Lakes Container Corp. v. National Union Fire Ins. Co.*, 727 F.2d 30, 33 (1st Cir. 1984).

51. *Waste Management of Carolinas, Inc. v. Peerless Ins. Co.*, 82 N.C. App. 80, 323 S.E. 2d 726, 732 (1984), *review granted*, 313 N.C. 612, 339 S.E.2d 616 (1985), *rev'd*, No. 70PA85 (N.C. Sup. Ct. Feb. 18, 1986) (available Mar. 28, 1986, on LEXIS, States Library, NC file).

52. *See* *Grand River Lime Co. v. Ohio Casualty Ins. Co.*, 32 Ohio App. 2d 178, 289 N.E.2d 360 (1972) (coverage denied for air pollution damage from emissions over a period of seven years where insured was aware of damage and failed to correct condition when requested to do so).

Such an interpretation is repugnant to the statutory policy of those states, such as California, which preclude insurance coverage for any willfully inflicted injury.⁵³

B. Defining Key Policy Terms

Although few courts have focused specifically upon the social policy implications of their decisions, a number have been concerned indirectly with this issue in two separate contexts, both relating to standard terms in CGL policies: (1) the definitions of "intent" and "accident" and (2) the definition of "pollutant."

1. The "intent" and "accident" definitions

The courts have engaged in an analysis of "intent" to resolve questions arising under the definition of "occurrence" in the CGL pollution exclusion clause.⁵⁴ To be a covered "occurrence," the event must have been "neither expected nor intended from the standpoint of the insured."⁵⁵ A similar analysis has involved the exception to the pollution exclusion for acts which are "sudden and accidental."⁵⁶

When focusing upon the question of "intent," courts refer occasionally to the social purpose of affecting management decisions. For example, one court, in the context of New York's statutory environmental insurance exclusion, noted:

The clear purpose of the statutorily required exclusion is to strengthen New York's environmental protection standards by imposing the full risk of loss due to personal injury or property damage from pollution upon the commercial or industrial enterprise that does the polluting and by eliminating the enterprise's option of spreading that risk through insurance coverage.⁵⁷

Courts in other states have also referred to the "purpose" of the exclu-

53. See CAL. INS. CODE § 533 (West 1972); CAL. CIV. CODE § 1668 (West 1985). Section 533 of the California Insurance Code provides that: "An insurer is not liable for a loss caused by the willful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agents or others." CAL. INS. CODE § 533. Section 1668 of the Civil Code, in a similar vein, provides that: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." CAL. CIV. CODE § 1668.

54. See *supra* note 6 and accompanying text.

55. See *supra* note 5 and accompanying text.

56. See *supra* note 9 and accompanying text.

57. *Autotronic Sys. v. Aetna Life & Casualty*, 89 A.D.2d 401, 403, 456 N.Y.S.2d 504, 505-06 (1982) (citations omitted).

sion as eliminating protection of the "active polluter."⁵⁸

The distinction between those commercial entities entitled to insurance coverage for their environmentally harmful acts and those not so entitled should be predicated upon social policy. Thus, it is helpful to analyze the meaning of corporate intent in that context rather than mechanical reference to a facile formula derived from the automobile accident context.⁵⁹

The law generally recognizes that intent is a probabilistic analysis. If one pulls the trigger of a loaded gun while aiming it at someone, the law presumes he or she intended the natural consequence of his or her action: the death and/or serious injury of another.⁶⁰ Similarly, if a person picks up a loaded gun and shoots into a crowd, he or she will be held accountable for the foreseeable harm resulting from his or her conduct. In short, criminal defendants will not be heard to say that they did not intend the consequences of their voluntary conduct which, in the ordinary course of events, creates a high probability of serious harm to others.⁶¹ It is, of course, this same probabilistic type of analysis which resulted in the murder convictions of a corporation and its executives for an employee's death resulting from cyanide in the work environment.⁶²

The intent analysis involves a consideration of the foreseeability and probability of harm to others likely to result as a consequence of the person's action. In the environmental context, it is thus helpful to narrow the analytic focus to the following question: When the corporation undertook the action resulting in the pollution complained of, what was the probability of environmental harm resulting to others? If the probability of harm was high, even if it could not be said to be damaging to a complete certainty, coverage for that conduct should be excluded by

58. See, e.g., *Molton, Allen & Williams, Inc. v. St. Paul Fire & Marine Ins. Co.*, 347 So. 2d 95 (Ala. 1977); *Jackson Township Mun. Utils. Auth. v. Hartford Accident & Indem. Co.*, 186 N.J. Super. 156, 451 A.2d 990, 993-99 (1982); *Lansco, Inc. v. Department of Env'tl. Protection*, 138 N.J. Super. 275, 350 A.2d 520 (1975), *aff'd*, 145 N.J. Super. 433, 368 A.2d 363 (1976), *certif. denied*, 73 N.J. 57, 372 A.2d 322 (1977).

59. See *infra* text preceding note 87.

60. See, e.g., CAL. EVID. CODE § 665 (West 1966), which provides that "[a] person is presumed to intend the ordinary consequences of his voluntary act."

61. See, e.g., *Letner v. State*, 156 Tenn. 68, 299 S.W. 1049 (1927) (defendant convicted of manslaughter for shooting into water next to boat causing an occupant to leap overboard, upset boat, and thereby cause other occupants to drown).

62. *People v. Film Recovery Sys.*, Nos. 83-11091, 84-5064 (Cook County Cir. Ct. of Ill. June 14, 1985) (three executives found guilty of murder and sentenced to serve up to 25 years in prison and to pay over \$50,000 in fines). The trial court's decision is discussed in Spiegel, *The Liability of Corporate Officers*, A.B.A. J., Nov. 1985, at 48, and Note, *Corporations Can Kill Too: After Film Recovery Are Individuals Accountable for Corporate Crimes?*, 19 LOY. L.A.L. REV. — (1986) (included in this issue of the *Loyola of Los Angeles Law Review*).

the pollution exclusion clause.⁶³ If the probability of harm was low, the event should be insurable.

Although the dispositive language of the reported decisions has not been consistent,⁶⁴ a number of decisions clearly indicate the courts' implicit adoption of this probabilistic type of analysis. In considering whether a claim was insurable, the courts have considered whether a particular event was the result of corporate action which had a high or low probability of causing environmental damage. Two examples are helpful in illuminating the probabilistic analysis.

*Case No. 1: In Lansco, Inc. v. Department of Environmental Protection,*⁶⁵ oil spilled from Lansco's tanks into the Hackensack River, damaging it and adjacent bodies of water. The spill was caused by the intentional acts of vandals, not by the failure of corporate management to provide appropriate environmental safeguards.⁶⁶ Under these facts, the court properly determined that the pollution exclusion was inapplicable. It explained that "[w]hether the occurrence is accidental must be viewed from the standpoint of the insured, and since the oil spill was neither expected nor intended by Lansco, it follows that the spill was sudden and accidental under the exclusion *even if caused by the deliberate act of a third party.*"⁶⁷

*Case No. 2: In Barmet of Indiana, Inc. v. Security Insurance Group,*⁶⁸ an aluminum recycler mixed aluminum dross, a by-product of its primary aluminum product, with rock salt and heated the mixture to the boiling point. The process created a gaseous fog. Although the manufacturer used a "bag house" pollution control system to filter the gas, the system frequently malfunctioned. Four years after the manufacturer had begun receiving complaints, one such cloud of gaseous fog obscured a nearby highway. The driver of an automobile was killed as a result. The court held that under these circumstances, the emission of gases was

63. See *Ashland Oil Inc. v. Miller Oil Purchasing Co.*, 678 F.2d 1293 (5th Cir. 1982) (coverage excluded for fire and contamination of refinery crude oil stock as a result of injecting hazardous waste into a crude oil pipeline).

64. Some courts distinguished between "intent" in tort law and "intent" under contracts of indemnity where the specific damage needed to be "intended." See, e.g., *Aetna Casualty & Surety Co. v. Martin Bros. Container & Timber Prods. Corp.*, 256 F. Supp. 145 (D.C. Or. 1966); *Atlantic Cement Co. v. Fidelity & Casualty Co.*, 91 A.D.2d 412, 459 N.Y.S.2d 425 (1983), *aff'd*, 63 N.Y.2d 798, 481 N.Y.S.2d 329, 471 N.E.2d 142 (1984).

65. 138 N.J. Super. 275, 350 A.2d 520 (1975), *aff'd*, 145 N.J. Super. 433, 368 A.2d 363 (1976), *certif. denied*, 73 N.J. 57, 372 A.2d 322 (1977).

66. *Id.* at 278-79, 350 A.2d at 521-22.

67. *Id.* at 282, 350 A.2d at 524 (emphasis added).

68. 425 N.E.2d 201 (Ind. Ct. App. 1981).

not "sudden and accidental."⁶⁹

Although *Barnet* [the recycler] could not predict exactly when its pollution control system would malfunction, it was shown that *Barnet's* system malfunctioned on a regular and frequent basis, ranging from daily to occasional. *Barnet* was aware of this problem and had received numerous complaints. With this factual background, we cannot accept *Barnet's* contention that the discharge of the emissions was sudden and accidental within the meaning of the policy.⁷⁰

The *Barnet* court also adopted a probabilistic analysis and held that the emissions, under these facts, could not be described as unintentional.

Although *Barnet* may not have intended for the emissions to obstruct the visibility and thus perhaps, contribute to the accident, this problem was certainly foreseeable because *Barnet* had received numerous complaints regarding their emissions. *Barnet may have been unable to predict the exact time when the emissions would be discharged, but they certainly knew the emissions would continue as a part of their business operations.* We remain unpersuaded that the accident was unforeseeable and unpredictable.⁷¹

The same type of probabilistic analysis has been applied to the continuous emission of an allegedly carcinogenic and noxious vapor which injured employees,⁷² to the dumping of toxic wastes which injured the dump's underlying aquifer,⁷³ and to the general discharge of caustic wastes which damaged a municipal sewer system.⁷⁴

We recognize that like numerous other issues, intent may, in a particular setting, require a factual rather than legal analysis. The factual averments of a pleading often will be insufficient to enable a court to determine the issue. But even the summary judgment mechanism may be inadequate to determine the issue of intent. The following example demonstrates that the intent analysis necessary for determining the indemnification issue requires a thorough factual inquiry. In *Reliance In-*

69. *Id.* at 202.

70. *Id.* at 203.

71. *Id.* (emphasis added).

72. *Stockdale v. Agrico Chem. Co.*, 340 F. Supp. 244 (N.D. Iowa 1972); *National Standard Ins. Co. v. Continental Ins. Co.*, No. CA-3-81-1015D (N.D. Tex. Oct. 4, 1983).

73. *Waste Management of Carolina, Inc. v. Peerless Ins. Co.*, No. 70PA85 (N.C. Sup. Ct. Feb. 18, 1986) (available Mar. 28, 1986, on LEXIS, States library, NC file); *American States Ins. Co. v. Maryland Casualty Co.*, 587 F. Supp. 1549 (E.D. Mich. 1984).

74. *Transamerica Ins. Co. v. Sunnes*, 77 Or. App. 136, 711 P.2d 212 (1985).

urance Co. of Illinois v. Martin,⁷⁵ a parking lot structure was located next to a residential condominium structure. The plaintiff complained that carbon monoxide "regularly" entered her condominium unit and that soot entered the unit at "diverse times through the ventilating grates, walls or floors."⁷⁶ In her pleading, however, she did not allege information necessary to determine the indemnification issue, such as the number of occurrences, whether such soot or carbon monoxide invaded other condominium units, whether she or other residents had ever complained of the situation, or how the parking lot operator could have been expected to know that such fumes could be blown into the condominium unit.

Under these circumstances, the court held that a summary judgment had been improperly entered.⁷⁷ It indicated that the question of intent should be resolved at a plenary trial, stating that "[t]he relevant question is not the time frame involved but whether Martin Co., the insured, could have intended or expected carbon monoxide and soot to enter the plaintiff's condominium unit."⁷⁸

Regrettably, the judicial analysis of intent has become a confused welter of legal formulas more likely to obscure analysis than to aid it. Certain courts have stated that "coverage will not be provided for intended results of intentional acts but will be provided for the unintended results of an intentional act."⁷⁹ While this formulation has aesthetic virtue, it fails to consider the link between cause and effect. This simplistic formula, applied to the three example cases, would result in coverage for the polluting aluminum recycler even though its management intentionally failed to adopt reasonable environmental safeguards. The intentional polluter would be able to escape the consequences of its acts although, on an objective basis, it should have recognized the high probability that further emission of gaseous vapors would result in personal injury or environmental harm. Like the person who shoots into a crowd, the corporate manager should not be rewarded for his subjective failure to appreciate the gravity of his action or inaction.

75. 126 Ill. App. 3d 94, 467 N.E.2d 287 (1984).

76. *Id.* at 95, 467 N.E.2d at 288.

77. *Id.* at 98, 467 N.E.2d at 290.

78. *Id.*

79. *Jackson Township Mun. Utils. Auth. v. Hartford Accident & Indem. Co.*, 186 N.J. Super. 156, 451 A.2d 990, 994 (1982). *Accord* *Buckeye Union Ins. Co. v. Liberty Solvent & Chem. Co.*, 477 N.E.2d 1227, 1233 (Ohio Ct. App. 1984); *Allstate Ins. Co. v. Klock Oil Co.*, 73 A.D.2d 486, 488-89, 426 N.Y.S.2d 603, 605 (1980).

2. The "pollutants" definition

The probabilistic analysis set forth above also has been followed by certain courts in defining whether various activities are "pollutants" or the cause of "pollutants,"⁸⁰ and thus subject to the pollution exclusion. In one such case, a plaintiff, claiming injury as a result of exposure to toxic substances in gasoline, sued the company which had designed and constructed a self-serve gasoline station.⁸¹ The mere possibility that such a service station could be improperly operated was not, the court held, a basis for applying the pollution exclusion to the designer.⁸² The designer's management decision was not focused upon pollution-causing activities: "The pollution causing commercial activity that is the subject of the underlying tort action is the day-to-day operation of the gasoline filling station, an activity in which plaintiff was not involved, directly or indirectly."⁸³ Thus, the court held that the designer-contractor was entitled to a defense from its insurance carrier.⁸⁴

Similarly, another court considered a claim by a company engaged in the business of cleaning and painting bridges.⁸⁵ There, errant spray from a bridge-painting job damaged passing vehicles. In his affidavit, the painter stated that although he took precautions, a certain amount of over-spraying was inevitable in such operations. The insurer did not controvert this assertion. Furthermore, when accepting the risk, the insurer was aware of the nature of plaintiff's business and knew that plaintiff had previously received over-spray complaints. The court accordingly determined that the claim "was not for pollution damage"⁸⁶ and, thus, covered under the painter's insurance policy.

C. Analytic Confusion Leads to Inconsistent Results

The interpretational analysis we have suggested above rests on the proposition that the pollution exclusion clause should be interpreted consistently with its underlying social policy. The rote application of legal principles pertinent in the auto accident policy coverage context is insufficient in the environmental context. Utilization of the auto accident

80. See *supra* note 8 and accompanying text.

81. *Autotronic Sys. v. Aetna Life & Casualty*, 89 A.D.2d 401, 403, 456 N.Y.S.2d 504, 506 (1982).

82. *Id.*

83. *Id.* at 404, 456 N.Y.S.2d at 506.

84. *Id.*

85. *A-1 Sandblasting & Steamcleaning Co. v. Baiden*, 53 Or. App. 890, 632 P.2d 1377 (1981).

86. *Id.* at 895-96, 632 P.2d at 1380. Cf. *Pepper Indus. v. Home Ins. Co.*, 67 Cal. App. 3d 1012, 134 Cal. Rptr. 904 (1977).

model has not led to principled court decisions in pollution insurance coverage cases, cases which could potentially facilitate responsible corporate decision-making having significant environmental consequences.

Several cases involving virtually the identical factual situation illustrate the confusion which exists among various courts. In each case, the insured claimed that it was entitled to insurance coverage for environmental damage it caused to a dump site's underlying aquifer resulting from its dumping of polluting materials. At each dump site, the polluter continuously dumped improper substances without considering the effect on the environment.

In *American States Insurance Co. v. Maryland Casualty Co.*,⁸⁷ the court held that the polluter was precluded from recovery.⁸⁸ The court reasoned that the dumping had occurred over a period of time, and that dumping, by its nature, is integrally involved with the business of the dump site. In addition to denying the insured's indemnification claim, the court held that the polluter was not entitled to a legal defense from its insurer.⁸⁹ The court focused upon "the policy behind the pollution exclusion clause [which is] to prevent industries from seeking insurance coverage rather than stop polluting the environment."⁹⁰ Because of the social policy involved, the court concluded that "[t]he pollution exclusion clause was not intended to exclude coverage previously provided, but was intended to eliminate any doubt that may have existed concerning coverage for damages caused by the emission of pollutants as a regular or continuous part of the insured's business."⁹¹

Conversely, in a virtually identical situation, the court in *Jackson Township Municipal Utilities Authority v. Hartford Accident & Indemnity Co.*,⁹² recognized but would not resolve the social policy issue presented. The court did acknowledge, however, that the pollution clause was intended to deprive an "active polluter" of coverage.⁹³

In *Jackson Township*, the landfill operator failed to design and maintain the fill properly. Pollutants dumped onto the property seeped into an aquifer. The court first referenced the familiar rule of interpreting a

87. 587 F. Supp. 1549 (E.D. Mich. 1984).

88. *Id.* at 1553.

89. *Id.*

90. *Id.* (citing *Niagara County v. Utica Mut. Ins. Co.*, 80 A.D.2d 415, 439 N.Y.S.2d 538 (1981)). *Accord* *Waste Management of Carolinas v. Peerless Ins. Co.*, No. 70PA85 (N.C. Sup. Ct. Feb. 18, 1986) (available Mar. 28, 1986, on LEXIS, States library, NC file); *see supra* text accompanying note 38.

91. *American States*, 587 F. Supp. at 1553.

92. 186 N.J. Super. 156, 451 A.2d 990 (1982).

93. *Id.* at 164, 451 A.2d at 994.

policy against the insurer and in favor of the reasonable expectations of an insured.⁹⁴ It then properly attempted to distinguish between intended and unintended results of intentional acts:

The chemical manufacturer or industrial enterprise who discharges, disburses or deposits hazardous waste material knowing, or who may have been expected to know, that it would pollute, will be excluded from coverage by the clause. The industry, for example, which is put on notice that its emissions are a potential hazard to the environment and who continues those emissions is an active polluter excluded from coverage.⁹⁵

The court determined, however, that a landfill operator who collected liquid waste and dumped it on property designated to accept that waste, was carrying out its public function.⁹⁶ Thus, it concluded that the landfill operator's ignorance of the probable consequences of its acts could be ignored: "[I]t was never expected or intended that the waste would seep into the aquifer resulting in damage and injury to others."⁹⁷

The court in *Jackson Township* never focused upon the need to assess the responsibility of the corporate decision-maker for his action in designing and operating the dumpsite. In the closing years of the twentieth century, however, it is too late to contend that environmental protection is not an issue of general public concern. In attempting to satisfy that public concern, both public and private entities which have an effect on the environment must be forced to recognize their social obligations. Hence, it is necessary that those commercial decision-makers consider the consequences of their acts *before* a polluting incident occurs rather than later in the litigation context.

The *Jackson Township* court's failure to consider the dump operator's refusal to protect the environment, either by designing or operating his landfill properly, promotes a social dereliction. The very essence of a landfill operator's responsibilities is to accept waste materials and to prevent resulting environmental damage. To permit such operators to escape the adverse consequences of their acts does nothing for the environment except create the possibility that, on an occasional basis, the responsibilities of the polluter (or more specifically, the adverse environmental consequences which result from his irresponsibility) will be passed on to his hapless insurance carrier. In essence, the court's conclu-

94. *Id.* at 161, 451 A.2d at 992.

95. *Id.* at 164, 451 A.2d at 994.

96. *Id.*

97. *Id.*

sion in *Jackson Township* disregards the social policy of causing the decision-maker to consider environmental effects *before* acting.

The foregoing analysis is somewhat complicated, to be sure, by the insurer's obligation to defend. Most states indicate that an insurer has an obligation to defend its insureds separate and apart from its duty to indemnify them. Moreover, the scope of the insurer's duty to defend is much broader than the scope of its duty to indemnify.⁹⁸ In addition, as we have discussed, there will be cases involving the applicability of the pollution exclusion in which consideration of the social policy underlying the exclusion may not be relevant.⁹⁹ More specifically, in a case involving a particular industry, it may be necessary to examine in detail the probability of harm resulting from the polluter's actions as well as the gravity of that harm. Presumably, the court may also consider the social utility of the actions undertaken. Prevailing industrial and commercial practices may also have to be considered. Whether a summary judgment or a plenary declaratory trial action is appropriate will be for the court to determine. In any event, the guiding consideration should be an objective focus upon the ability of a polluter to foresee the risk of environmental damage created by his or her actions.

In any subsequent declaratory action for interpretation of the rights and obligations under the insurance policy, the basic focus should be upon the measures taken by the polluter from the outset to recognize and prevent pollution. In this respect, it may be helpful to contrast the result in *Reliance Insurance Co. of Ill. v. Martin*,¹⁰⁰ the parking lot operator case, with another decision which discussed a relatively similar issue outside the scope of the pollution insurance exclusion.

In *Luthringer v. Moore*,¹⁰¹ the court considered a claim for personal injuries resulting from plaintiff's inhalation of hydrocyanic acid gas. The defendant was retained to exterminate cockroaches and other vermin in the basement under a restaurant in a commercial building in Sacramento, California. Although the fumigation operation was confined to the basement, gas unexpectedly penetrated the pharmacy on the first floor, injuring plaintiff.¹⁰² The trial court considered the operator's efforts to confine the gas, the failure of various witnesses to detect any gas odor in the locations reached, the possibility of air currents blowing the gas in

98. See, e.g., *CNA Casualty of Cal. v. Seaboard Surety Co.*, 176 Cal. App. 3d 598, 605, 222 Cal. Rptr. 276, 279 (1986).

99. See *infra* notes 109-17 and accompanying text.

100. 126 Ill. App. 3d 94, 457 N.E.2d 287 (1984).

101. 31 Cal. 2d 489, 190 P.2d 1 (1948).

102. *Id.* at 492-93, 190 P.2d at 3-4.

various directions, the efforts of the operator to seal all cracks around doors and windows and other receptacles permitting penetration, the defendant's efforts to vacate adjoining space, and other safety measures, including the defendant's posting of warning signs.¹⁰³

Similar factors should be considered in determining whether an alleged polluter will be able to shift liability for the environmental damage he causes to another. In the garage case, for example, what reasonable safety precautions should the parking lot operator have taken in designing and operating the structure when viewed against the magnitude of environmental harm likely to result if his activities miscarried?

The analysis of the applicability of the pollution exclusion clause is similar to the California judiciary's treatment of punitive damages. Punitive damages may be enforced against a corporation although no individual in the corporation specifically intended to hurt or maim a particular person.¹⁰⁴ Nonetheless, as evidenced by the well-known decision involving the Ford Pinto automobile, such corporate decisions are subject to punitive damage liability.¹⁰⁵ This is so even though only mid-level corporate management was aware of the potential of harm to others and there was no corporate "intention" to hurt any particular individual.¹⁰⁶ The financial consequences of such inappropriate actions are borne by the corporate wrongdoer, not the insurance carrier.¹⁰⁷ Otherwise, corporate entities would not be deterred from undertaking reprehensible conduct. If punitive damage liability were insurable, the imposition of punitive damages would not serve as a deterrent.¹⁰⁸

This California public policy analysis is directly applicable to judicial interpretation of the pollution exclusion clause in California. California courts have refused to argue social policy in the two cases involving the pollution exclusion clause with which they have dealt.

In the first such case, *Pepper Industries v. Home Insurance Co.*,¹⁰⁹ the pollution exclusion clause was, from a social policy perspective, totally irrelevant to the problem presented. The insured made a single discharge of 5000 gallons of gasoline into a city's sewer system.

103. *Id.* at 492-94, 190 P.2d at 3-4.

104. *See, e.g., Grimshaw v. Ford Motor Co.*, 119 Cal. App. 3d 757, 174 Cal. Rptr. 348 (1981).

105. *Id.* at 819-20, 174 Cal. Rptr. at 385-87.

106. *Id.* at 814-17, 174 Cal. Rptr. at 385-87.

107. *Ford Motor Co. v. Home Ins. Co.*, 116 Cal. App. 3d 374, 380, 172 Cal. Rptr. 59, 63 (1981).

108. *Id.* at 380-81, 172 Cal. Rptr. at 62-63.

109. 67 Cal. App. 3d 1012, 134 Cal. Rptr. 904 (1977).

Subsequently, an explosion and fire resulted from the discharge.¹¹⁰ The insurer's contention of nonliability for fire suppression costs and property damage was rejected.¹¹¹ The court concluded that because the insured's misconduct did not result in environmental harm, the pollution exclusion clause was not applicable:

A fair reading of the endorsement leads to the conclusion it was intended to exclude insurance coverage resulting from pollution and contamination of the environment, be it land, water or the atmosphere. Although the City's sewer and pumping station may reasonably be said to fit into one or more of these categories, the fact remains the City is not claiming [that] its facilities *were polluted or contaminated* but rather that they were destroyed or damaged by an explosion and fire.¹¹²

In the other pollution exclusion case involving California law, *Healy Tibbitts Construction Co. v. Foremost Insurance Co.*,¹¹³ a federal district court considered a discharge of oil in the context of a sinking barge. The barge had a hole in its hull. As the barge removed piling and other debris, it began to list as water entered the hole. Although it was moved into shallow water, it continued to take on additional water until it sank. As the barge submerged, oil escaped into the water from an open vent in the fuel tank which had supplied the boiler. The barge operator apparently made no attempt to contain the oil.¹¹⁴ Consistent with the social policy analysis we have set forth above, the court refused to mechanically apply general contract principles related to the construction of insurance policies.¹¹⁵ It rejected the applicability of the rule that where two perils cause a loss, one which is insured against and the other which is excepted, an insured is entitled to coverage.¹¹⁶

If such an argument were accepted—given the fact that oil can never escape from a barge without the intervention of some other factor—[an insured] could claim that Section 6 makes [the insurer] liable whenever there is an oil spill. In such circumstances, [an insured] could always contend that the intervening factor is a “covered” peril which “caused” the excepted peril of oil pollution. This would be tantamount to reading the

110. *Id.* at 1014, 134 Cal. Rptr. at 905.

111. *Id.* at 1019-20, 134 Cal. Rptr. at 908.

112. *Id.* at 1019, 134 Cal. Rptr. at 908 (emphasis added).

113. 482 F. Supp. 830 (N.D. Cal. 1979).

114. *Id.* at 833.

115. *Id.* at 836.

116. *Id.* at 836-37.

Pollution Exclusion Clause out of the policy altogether.¹¹⁷

Although the court ultimately refused to read the pollution exclusion clause out of the policy, it did not rely on social policy in reaching its decision.

D. The Pollution Exclusion and the Insurer's and Insured's Obligation of Good Faith and Fair Dealing

That portion of the CGL policy containing the pollution exclusion is a small but very important part of a greater whole. The social policy underlying the pollution exclusion, of course, cannot be implemented in a vacuum. Environmental pollution is only one of many problems which is dealt with in the insurance policy. Numerous decisions have considered the long-standing environmental damage resulting from continuing occurrences.¹¹⁸ However, a consideration of the various conflicting theories upon which those decisions are predicated would not add to our discussion of the pollution exclusion.

Moreover, the implementation of the pollution exclusion cannot be extricated from the general principle that the *insured* owes its *insurer* a duty of good faith just as much as the reverse.¹¹⁹ The rule requiring good faith by the insured to the insurer gains special significance in the context of the pollution exclusion. The definition of good faith is generally stated to be that "[i]n every contract, including policies of insurance, there is an implied covenant of good faith and fair dealing. Broadly stated, that covenant require[s] that neither party do anything which will deprive the other of the benefits of the agreement."¹²⁰

Where an occurrence extending over a number of years results in environmental harm, it is self-evident that a number of insurance policies issued by different insurers may be involved. Furthermore, the insured may have chosen to carry a large portion of the risk itself. In the commercial context, it is common for an insured to retain a very large deductible, generally known as a Self-Insured Retention (SIR). In effect, the business entity assumes the status of insurer as well as insured, with an attendant good faith obligation. A primary insurance policy is issued

117. *Id.*

118. *See, e.g.,* CPS Chem. Co. v. Continental Ins. Co., 199 N.J. Super. 558, 489 A.2d 1265 (1984), *rev'd*, 203 N.J. Super. 15, 495 A.2d 886 (1985).

119. *See, e.g.,* Commercial Union Assurance Cos. v. Safeway Stores, Inc., 26 Cal. 3d 912, 920, 610 P.2d 1038, 1041, 164 Cal. Rptr. 709, 713-14 (1980); Kaiser Found. Hosps. v. North Star Reinsurance Corp., 90 Cal. App. 3d 786, 792, 153 Cal. Rptr. 678, 682 (1979); Liberty Mut. Ins. Co. v. Altfillisch Constr. Co., 70 Cal. App. 3d 787, 789, 139 Cal. Rptr. 91, 95 (1977).

120. Seamen's Direct Buying Serv. v. Standard Oil Co. of Cal., 36 Cal. 3d 752, 768, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984) (emphasis omitted) (citation omitted).

to provide the first layer of insurance benefits above the insured's SIR. The business then may obtain insurance from one or more excess carriers in the layers above the primary insurance policy. A typical insurance program, for example, might contain a \$500,000 SIR by the insured, a \$2,000,000 insurance policy by a primary carrier, a first layer excess policy of \$5,000,000 and a second layer excess policy of an additional \$5,000,000. The liability limits of such policies and the net coverage in relation to the SIR of the insured are matters of business judgment.

In the context of environmental damage such insurance programs take on heightened significance. First, the inclusion of a SIR assumes that the insured will be called upon to pay the initial retained amount over each such year. In return for a lower premium, the insured, in effect, elects to assume the insuring obligation itself. Under these circumstances, the insured has an obligation to pay those amounts before it can call upon the insurer to pay any excess.¹²¹ Although the pollution may have extended over a number of years requiring the attention of numerous insurers, again, it is self-evident that the insured obtains a benefit from the insurer. In return for the insured's assumption of a large SIR, it pays lower premiums to its insurance company. Hence, in assuming coverage for the act of pollution, the insured must pay for the consequences of its decision to accept the SIR.

Second, the election by a corporate entity to have a large SIR in return for a low insurance premium interacts with the insured's recognizable desire to avoid the consequences of that decision when it has caused pollution damage over a period of time. An insured currently holding a large SIR might be tempted to claim its losses incurred prior to the assumption of its own insurance liability. The thrust of California authority, however, precludes an insured from shifting the date of injury so as to increase the burden upon a particular insurer.

In one case, for example, an insured received various claims during two successive years.¹²² The insured, in conjunction with its current insurer, claimed that all of the losses had occurred in the prior year. Thus, a greater liability was imposed on the predecessor insurer than the predecessor's policy required. The court held the insured and the successor insurer liable for breach of the duty of good faith each owed the predecessor carrier.¹²³ The same reasoning would apply to an insured who

121. *Nabisco, Inc. v. Transport Indem. Co.*, 143 Cal. App. 3d 831, 836, 192 Cal. Rptr. 207, 209 (1983).

122. *Kaiser Found. Hosps. v. North Star Reinsurance Corp.*, 90 Cal. App. 3d 786, 792, 153 Cal. Rptr. 678, 682 (1979).

123. *Id.*

fails to pay the amount of various SIR's in order to shift the costs to a particular carrier. It should not be able to shift these costs by claiming that all of the losses should be paid in a single policy period when, in fact, multiple years are involved.

These principles are equally applicable to the relationship existing between a primary insurer and the excess insurer. Unless the primary insurer exhausts the limits of its liability, there is no obligation of the excess carrier to pay any sums.¹²⁴ If the primary carrier fails to act in good faith toward the excess carrier in settling the claim, it similarly can be held liable for the consequences of its acts.¹²⁵

IV. CONCLUSION

At bottom, the insurance pollution exclusion implements society's decision that corporate decision-makers bear the burden for adverse consequences resulting from their decisions to degrade the environment. Because corporate business decisions are rarely challenged, society's only hope for preventing initial decisions with pollution consequences is to impact the decision-maker directly. By eliminating insurance coverage for an active polluter's refusal to adopt appropriate safety measures, society can create cleaner air, purer water and a healthier environment. Concerns that arise while cleaning up the previously avoidable consequences are plainly too late: the environment already has been harmed.

124. See *Continental Casualty Co. v. United States Fidelity & Guar. Co.*, 516 F. Supp. 384, 389-90 (N.D. Cal. 1981); *Olympic Ins. Co. v. Employer Surplus Lines Ins. Co.*, 126 Cal. App. 3d 593, 598, 178 Cal. Rptr. 908, 910 (1981).

125. *Valentine v. Aetna Ins. Co.*, 564 F.2d 292 (9th Cir. 1977); *Continental Casualty Co. v. United States Fidelity & Guar. Co.*, 516 F. Supp. 384, 387 (N.D. Cal. 1981). *But see* *United States Fire Ins. Co. v. Royal Ins. Co.*, 759 F.2d 306 (3d Cir. 1985).

