INSURANCE LAW

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Since our last edition, our intermediate and high courts have been preoccupied with many issues in which insurance was not at the centerpiece. In this edition, we discuss two recent decisions which apply both the clear language of the insurance policies and common sense – two concepts which have not always been mutually compatible.

METHYLENE CHLORIDE WHICH HAD BEEN DISCHARGED INTO PUBLIC SEWER SYSTEM BY INSURED WAS "POLLUTANT" WITHIN MEANING OF POLLUTION EXCLUSION OF COMPREHENSIVE GENERAL LIABILITY POLICY WHICH DEFINED POLLUTANTS AS INCLUDING, INTER ALIA, CHEMICALS. In American Casualty Co. of Reading, PA. v. Miller (2008) 159 Cal.App.4th 501, 71 Cal.Rptr.3d 571, the California Court of Appeal for the Second District held that a pollution exclusion clause of a furniture stripper's comprehensive general liability (CGL) policy barred coverage for injuries sustained by a sewer worker who was exposed to methylene chloride discharged into public sewer system by the insured. Michael Miller (Miller) owned a furniture stripping business called Stripper Herk located in Santa Monica, California. As part of the business, Stripper Herk generated wastewaters containing solvents, including methylene chloride, and generated hazardous wastes that accumulated in drums on the premises. The City of Santa Monica issued Stripper Herk an "Industrial Wastewater Permit-Manufacturing Facility." The permit allowed Stripper Herk to discharge wastewater from its premises into the City's sewer. The permit, however, prohibited the discharge of any solvents, including methylene chloride, into the sewer.

American Casualty Company of Redding, PA. (American Casualty), provided Miller, doing business as Stripper Herk, with a CGL policy. Under Coverage A, the policy provided coverage for "those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' " caused by an occurrence during the policy period. The policy also obligated American Casualty "to defend the insured against any 'suit' seeking damages." The CGL policy contained a pollution exclusion clause which provided in pertinent part that Coverage A did not apply to: "(1) 'Bodily Injury' or 'property damage' arising out of the actual, alleged, or threatened discharge, dispersal, seepage, migration, release or escape of 'pollutants': [¶] (a) At or from any premises, site, or location which is or was at any time owned or occupied by, or rented or loaned to, any insured." The CGL policy defined "pollutants" as follows: "[A]ny 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."

On the morning of March 26, 2003, a private contractor hired by the City of Santa Monica was working in the City's sewer lines, which were downstream of the premises of Stripper Herk. Valenzuela, an employee of the private contractor, was repairing a 36-inch sewer line in front of and approximately 20 feet below Stripper Herk. Valenzuela noticed wastewaters discharging from a drain outlet into the sewer. The wastewaters soaked Valenzuela's clothing and caused him to lose consciousness. Monitors that measure the presence of dangerous chemicals sounded. Valenzuela sustained serious bodily injuries.

Later that day, inspectors from the City of Santa Monica Environmental and Public Works Management, Industrial Waste Section, inspected Stripper Herk. The investigators discovered organic solvents, including methylene chloride, discharging into Stripper Herk's floor sump and into the City's sewer system. The investigators conducted a dye test, which confirmed that Stripper Herk's industrial waste sump was tied into the sewer leading into the section of sewer line where Valenzuela was working at the time of the incident. The investigation resulted in federal criminal proceedings against Miller. The federal proceedings concluded with Miller entering a plea agreement with the United States Attorney's Office for the Central District of California. There, Miller pled guilty to: (1) negligent discharge of pollutants into a publicly-owned treatment works in violation of a permit; and (2) storage of hazardous wastes without a permit. In the plea agreement, Miller and the United State Attorney stipulated to the following: "[Miller] and his employees allowed such wastewaters to flow into a sump located on the floor of [Stripper Herk's] premises. Located in the sump was a pipe connected to the [sewer]. The pipe was not properly sealed, which negligently allowed some of the wastewaters that accumulated in the sump to flow into the pipe and thereafter discharge into the [sewer]." Neither party presented any evidence as to how long methylene chloride wastewaters had escaped into the sewer.

On June 16, 2003, Zurich American Insurance Company (Zurich) sued Stripper Herk for reimbursement of workers' compensation benefits paid to Valenzuela following the incident. There, Zurich alleged that Stripper Herk caused or permitted toxic compounds to enter the sewer and injure Valenzuela. Zurich also alleged that Stripper Herk retained sufficient control over its premises to owe Valenzuela a duty of care to avoid exposing him to an unreasonable risk of harm. Zurich alleged that the release of wastewaters breached the duty of care. Miller notified American Casualty of the Zurich action, and that Zurich was seeking reimbursement of workers' compensation benefits it had paid and would pay to Valenzuela. American Casualty denied the claim based on the pollution exclusion clause, and refused to defend or indemnify Miller with respect to the claim.

In February 2004, Valenzuela filed suit against Miller and Stripper Herk. Valenzuela alleged eight causes of action, including: negligence, negligence per se, premises liability, strict liability, battery, assault and negligent and intentional infliction of emotional distress (the Valenzuela action). Valenzuela alleged, inter alia, that Miller and Stripper Herk breached a duty of care by discharging wastewaters containing methylene chloride. In May 2004, Miller tendered the Valenzuela

action and re-tendered the Zurich action to American Casualty. On May 28, 2004, American Casualty refused to defend or indemnify Miller with respect to the lawsuits. In January and February 2005, Miller again requested that American Casualty defend and indemnify him for damages resulting from Valenzuela's injuries. American Casualty again refused.

In June 2005, the parties settled the Valenzuela action against Miller and Stripper Herk. As part of the settlement agreement, Miller assigned his rights under the CGL insurance policy to Valenzuela. Valenzuela made a policy limit demand on American Casualty of $1 million. American Casualty declined the demand. On June 7, 2005, American Casualty filed a complaint for declaratory relief against Miller, doing business as Stripper Herk, and Valenzuela. American Casualty alleged that pursuant to the CGL insurance policy, it had no duty to defend or indemnify Miller in either the Valenzuela or Zurich action. Defendants answered and filed a cross-complaint.

On April 26, 2006, the trial court granted summary judgment in favor of American Casualty. The trial court found that under the pollution exclusion clause, quoted above, American Casualty was not required to defend or indemnify Miller, doing business as Stripper Herk, and thus had no liability to Valenzuela for his injuries from the methylene chloride. Defendants timely filed a notice of appeal. In affirming the lower court, the appellate court relied upon the case of MacKinnon v. Truck Ins. Exchange (2003) 31 Cal.4th 635, 3 Cal.Rptr.3d 228. In MacKinnon, the California Supreme Court addressed the meaning and scope of a pollution exclusion clause in a CGL policy. There, the Supreme Court found the pollution exclusion clause was intended to exclude coverage for injuries resulting from events commonly thought as environmental pollution. Applying the MacKinnon rationale, this court found that the injured worker's injuries arose from an event commonly thought of as environmental pollution and that an ordinary insured would reasonably expect that the release of methylene chloride into a public sewer is environmental pollution and affirmed the grant of summary judgment.

THE EXHAUSTION CLAUSE PRECLUDED AN EXCESS INSURER'S LIABILITY WHEN THE INSURED'S SETTLEMENT WITH ITS PRIMARY INSURER IS FOR LESS THAN THE POLICY LIMITS. In Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London (2008) 161 Cal.App.4th 184, 73 Cal.Rptr.3d 770, the California Court of Appeal for the Fourth District (in San Diego) held that the exhaustion clause in an excess director and officer liability policy, providing that the excess insurer "shall be liable only after the insurers under each of the Underlying Policies have paid or have been held liable to pay the full amount of the Underlying Limit of Liability," unambiguously precluded that excess insurer's liability for its insured's losses in excess of the primary policy's limit after the insured settled with its primary insurer for less than the primary policy limit. In so ruling the court noted that taking into account the nature of the excess insurance policy, an objectively reasonable expectation of the insured would be that the primary insurance policy would have to be exhausted before the excess insurance would attach.

In May 1999, certain Qualcomm employees filed a class action lawsuit related to their asserted right to unvested company stock options. Other Qualcomm employees and former employees followed with separate lawsuits. With one apparent exception in which it prevailed on summary judgment, Qualcomm settled these lawsuits, incurring approximately $3.6 million in unreimbursed defense expenses for the class action and unreimbursed expenses in connection with settlement of the other litigation in an estimated amount of over $9 million. Qualcomm tendered those litigation matters to its director and officer (D & O) liability insurers, including National Union Fire Insurance Company of Pittsburgh, P.A. (National) and Certain Underwriters at Lloyd's, London (Underwriters). National had issued Qualcomm a primary D & O insurance policy, with a liability limit of $20 million. The National policy insured Qualcomm and its directors and officers for a " 'Loss' " including " 'damages, judgments, settlements and Defense Costs,' arising from a 'Claim' " including a civil lawsuit. Underwriters had issued Qualcomm a first layer excess "following form" D & O reimbursement policy for the same time period (the excess policy), providing $20 million in coverage for losses in excess of the underlying $20 million primary policy limit. The excess policy contained a "Maintenance of Underlying Policies" clause. Incorporating its definitions, that clause provided: "This Policy provides excess coverage only. It is a condition precedent to the coverage afforded under this Policy that [Qualcomm] maintain [the National policy] with retentions/deductibles, and limits of liability (subject to reduction or exhaustion as a result of loss payments) . . . . This Policy does not provide coverage for any loss not covered by the [National policy] except and to the extent that such loss is not paid under the [National policy] solely by reason of the reduction or exhaustion of the Underlying Limit of Liability through payments of loss thereunder.

In the event [National] fails to pay loss in connection with any claim as a result of the insolvency, bankruptcy or liquidation of said insurer, then those insured hereunder shall be deemed self-insured for the amount of the Limit of Liability of said insurer which is not paid as a result of such insolvency, bankruptcy or liquidation." In a "Limit of Liability" section, the excess policy also contained a clause (referred to by the parties as the exhaustion clause) providing that "Underwriters shall be liable only after the insurers under each of the Underlying Policies [the National policy] have paid or have been held liable to pay the full amount of the Underlying Limit of Liability."

In April 2004, Qualcomm, National and Underwriters participated in a mediation concerning coverage for the litigation. Qualcomm thereafter settled with National under an agreement providing it would release National from all future obligations under the National policy in exchange for National's commitment to reimburse Qualcomm for additional settlement payments and defense expenses for the non-class action litigation, bringing National's total payment under its policy to $16 million. In October 2006, Qualcomm sued Underwriters for breach of contract and declaratory relief. It sought compensatory damages as well as a judicial declaration that Underwriters were obligated to indemnify Qualcomm under the excess policy for more than $9 million in unreimbursed expenses Qualcomm had incurred in connection with the defense and settlement of the non-class action litigation, "provided that Qualcomm, [National], or other third parties paid at least $20 million in defense and indemnity of Qualcomm for [the litigation matters]." Qualcomm also alleged it had "paid the required premiums in full and has satisfied all other conditions to coverage, or is otherwise excused from doing so."

The appellate court held that the excess language in question unambiguously stated that the excess carrier's obligation should only arise after the primary insurer had paid the limits of his coverage or after the insured had been held liable to pay the full amount of the underlying limits of liability. The court ruled that the phrase "had paid the full amount of limits of liability" could only reasonably be interpreted as meaning the actual payment of no less than $20 million, particularly when considered in the overall context of the policy in which it was included. Further, the court held that the clause that the insured "had been liable to pay the full amount of the underlying limit of liability" was not susceptible of contrary meanings and could only reasonably be understood as only requiring coverage where a court order or judgment had entered declaring the insured's liability to pay more than the underlying limits.

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