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Insurance/Reinsurance and Litigation Alert:California Supreme Court Holds That Escape of Pollutants — Not Deposit — is the Relevant Discharge for Application of the Pollution Exclusion, and that Insurer Can be Liable for Indivisible Damages

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In an important decision further clarifying the application of the "sudden and accidental" pollution exclusion and the absolute pollution exclusion as it applies to pollution of a "watercourse or body of water," the California Supreme Court recently held in *State of California v. Allstate Insurance Company, et al.*[1] that the pollution exclusion applies to the escape of pollutants from the site and not to the initial deposit of wastes at the site.

The case arises from the State of California's ("the State") efforts to obtain insurance coverage for property damage liability as a result of discharges from the well-known "Stringfellow Acid Pits," a State-operated class I hazardous waste disposal facility in Riverside County.

In the 1950's, the State selected, designed, and constructed the Stringfellow site near the community of Glen Avon on the floor of a canyon drained by Pyrite Creek. Based on an expert geologist's inspection in 1955, the State concluded that the site was suitable for liquid industrial waste disposal because of what it thought was an impermeable layer of rock, and no water, beneath the site. The expert prepared a report concluding that, if there were a watertight barrier dam across the canyon and adequate measures to divert water runoff, the site would not pose a threat of environmental pollution. In fact, the site was formed by decomposed granite and fractured bedrock under which ran a channel leading to groundwater.[2]

The hazardous waste disposal facility opened in 1956 and more than 30 million gallons of liquid industrial waste were deposited in the evaporation ponds. By 1960, a State expert found that chemical pollution was leaking through the fractured rock and around the barrier dam into the groundwater. In March 1969, heavy rainfall caused the waste ponds to overflow and send polluted water down the canyon. In March 1978, due to heavy rainfall causing an overflow and failure of the dam, the State made a series of controlled discharges from the ponds to keep the dam from breaking, releasing about one million gallons of diluted waste down the Pyrite Creek channel.[3]

The United States sued the State of California in federal court and the court found the State responsible for causing the releases from the site. [4] The State requested coverage from its insurers for the liability imposed in the federal action. Four of the insurers denied coverage based on the pollution exclusion in each of its comprehensive general liability policies. Three of the policies contained a standard "sudden and accidental"exclusion as to pollution to land or air, but absolute as to pollution to a watercourse and body of water. The other policy contained a pollution exclusion which applied the "sudden and accidental" exception to both pollution of land and air, and watercourses and bodies of water.[5]

The State brought this action for declaratory relief, breach of contract, and bad faith denial of coverage. The trial court granted the insurers summary judgment based on the application of the pollution exclusions to the State's initial disposal of waste into the ponds. The Court of Appeal reversed summary judgment, but agreed with the insurers that the 1978 release, as well as the gradual underground leakage, were not sudden and accidental events covered under the policies. The California Supreme Court granted the insurers' petitions for review, which challenged the Court of Appeal's holdings on the relevant release for application of the pollution exclusions, whether the 1969 overflow was within the watercourse pollution exclusion, and the burden of allocating costs between covered and excluded causes. The State challenged the appellate court's ruling that the 1978 release was not accidental as a matter of law.[6]

To determine the relevant polluting event or discharge to which the pollution exclusion applied, the California Supreme Court looked to the State's liability for property damage in the underlying federal action. In the federal action, the State was not held liable for disposing of waste in the evaporation ponds, which were intended to hold the liquid wastes, but for polluting the land and groundwater outside the ponds when the ponds leaked and overflowed. In finding that the initial deposit of wastes into the evaporation ponds was not a "discharge, dispersal, release or escape," the Court held that the focus of the analysis here is on discharges from the ponds, rather than deposits to them.[7]

The Court also concluded that triable issues of fact exist as to whether the entirety of the 1969 overflow was limited to a watercourse, *i.e.* the Pyrite Creek bed; whether the 1978 release was "accidental;" and whether sudden and accidental discharges were a substantial factor in causing indivisible property damage, precluding summary judgment and summary adjudication on any one of these issues.[8]

In addressing the issue of the State's burden to allocate costs between covered and excluded releases, the Court overruled *Golden Eagle Refinery Co. v. Associated International Insurance Co.*,[9] to the extent it held that an insured cannot recover insurance proceeds if it cannot prove how much of the property damage was caused by sudden and accidental releases.[10] Relying on *State Farm Mut. Auto. Ins. Co. v. Partridge*,[11] the Court applied a tort analysis to property damage caused by undifferentiated covered and uncovered releases (whether a covered cause was a "substantial factor" in causing contamination) rather than the contract analysis (quantifiable allocation) applied in *Golden Eagle*.[12] Accordingly, liability coverage exists "whenever an insured risk constitutes a proximate cause of an accident, even if an excluded risk is a concurrent proximate cause."[13]

In a decision rife with the application of tort principles to a contract, this decision reiterates how difficult it is, under California law, for insurers to obtain summary judgment based on the sudden and accidental pollution exclusion. For an insurer to prevail on the "sudden and accidental" pollution exclusion on summary judgment, the Court has indicated that, with respect to the "accidental" prong, the evidence must show the insured was aware of a risk so great that no reasonable person could find the insured did not expect the event. Equally troubling, the Court stated that, even if the insured intentionally releases pollutants to prevent a greater accidental release, as occurred in the 1978 release, the sudden and accidental pollution exclusion does not bar coverage. However, the insured still has the burden of proving a covered act or event was a substantial cause of the property damage for which the insured is liable, but if its damages are indivisible, the insured's inability to allocate the damages by cause does not excuse the insurer from its duty to indemnify. In so ruling, the Court did acknowledge that an insured's speculation about sudden and accidental events, and any trivial impact on property damage arising therefrom, would not result in coverage. Simply stated, this decision will have a significant impact on coverage litigation for environmental claims in California.

Endnotes

[1] 2009 Cal. LEXIS 1640 (March 9, 2009).

[2] *See Id.* at 6-7.

[3] *See Id.* at 7-8.

[4] *United States v. Stringfellow*, 1995 WL 450856 (C.D. Cal. 1995).

[5] *State of California v. Allstate*, 2009 Cal. LEXIS 1640 at 8-9.

[6] *See Id.* at 10

[7] *See Id.* at 18.

[8] *See Id.* at 4.

[9] 85 Cal.App.4th 1300 (2001).

[10] *See Id.* at p. 1316-1317.

[11] 10 Cal.3d 94 (1973).

[12] *State of California* at 53-57.

[13] *Partridge* at p. 105, fn. 11.

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