Stay Out Of This Domain: Court of Appeal Rejects Insured's Suit Against Insurer For Failure To Defend Condemnation Action Charging Property Owner With Environmental Clean-Up Costs

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Public agencies throughout the State are permitted to deduct environmental clean-up costs from their determination of the just compensation offered to private property owners whose properties are being acquired through eminent domain. This is precisely what happened to Janet Block when the Redevelopment Agency of the City of Long Beach sought to condemn two of her lots that sat atop an abandoned oil well for amounts representing a set-off in the amount of the estimated clean-up costs. Block tendered the defense of the eminent domain action to three liability insurers, all of whom rejected the tender outright. While Mrs. Block ultimately settled with the City, she sued her insurers for breach of the covenant of good faith and fair dealing and for breach of contract based on their failure to defend her in the condemnation suit. The Second District Court of Appeal affirmed the trial court's grant of summary judgment in the insurer's favor in Block v. Golden Eagle Insurance Company (2004) 121 Cal.App.4th 186.

In October 1999, the City Redevelopment Agency filed its complaint in eminent domain against Mrs. Block after offering her just $92,000 for both lots. This offer amount reflected an appraised value of $159,000, reduced by $67,250, the estimated cost to remediate the contamination on the parcels. Ultimately, the City increased its offer to a total of $126,000. Mrs. Block claimed that the parcels were worth a total of $375,000, plus well improvements and oil, mineral and drilling rights worth between $40,000 and $60,000. On June 25, 2001, Mrs. Block settled the condemnation action with the City in the amount $475,000, several thousand dollars in excess of her demand. These facts are provided not because they necessarily add to the legal analysis, but because it is hard to believe that the Court's decision was not motivated, at least in part, by the favorable settlement to Mrs. Block.

While defending and settling the condemnation action, Mrs. Block tendered defense of the eminent domain action to three insurers who insured, through her homeowners' policy, all vacant land she owned. Block believed that the agency's reduced offer to buy the property reflecting an amount equal to the estimated cost to remediate environmental damages constituted a claim for "damages" by the agency against Block. Each of the three insurers denied Block's tender on the same general grounds – that the agency's claim against Block was not a claim for "damages." On July 1, 2002, Block filed her second amended cross-complaint naming the three insurers as defendants. On September 11, 2002, the parties filed cross-motions for summary judgment on the issue of the insurers duty to defend Block in the eminent domain action.

The trial court ruled in favor of the insurers finding that the reduced compensation offered by the City was not a claim for damages under the various insurance policies, reasoning that no governmental entity was seeking to impose clean-up costs upon Block, nor was any such agency seeking to recover from Block remediation costs expended by the agency. Since Block was not subject to a claim for any "damages", there was no duty to defend or indemnify.

The Court of Appeal first embarks, appropriately, on an analysis of California insurance law as it relates to the duty to defend government imposed clean-up costs on private insureds. The Court takes us through Montrose Chemical Corp. v. Superior Court (1993) 6 Cal.4th 287 and AIU Ins. Co. v. Superior Court (1990) 51 Cal.3d 807 in order to explain the established rule that "an insured's obligation to reimburse agencies for response costs constituted damages because such costs constituted losses or detriment by the agencies and the insured's reimbursement constituted monetary compensation for such losses."

The Court's expanded discussion of these earlier Supreme Court rulings seems somewhat inconsistent with their refusal to find a duty to defend. It describes AIU as further holding that "although environmental injunctions requiring remedial and mitigative action do not readily fit into the…definition of "damages" because they do not involve monetary compensation of a loss or a detriment, they nevertheless result in costs that constitute 'damages' under [the] policies, because they are equivalent or alternative remedies to response costs (i.e., the property owner is required to clean-up the property itself rather than reimbursing the government for its clean-up costs) and an insured would reasonably expect equal

coverage for such equivalent or alternative remedies." At first blush, it would seem as if AIU would apply here. The condemnation action is an alternative to the agency first requiring clean-up and then acquiring the property, and is equivalent to the agency doing the clean-up and seeking reimbursement.

The Court of Appeal distinguishes AIU by reasoning that the insured in AIU was "legally obligated to compensate the agencies in money for a loss or detriment," thus implying that Mrs. Block was not so obligated. Certainly to some, this will appear to be an unfair elevation of form over substance. The insured should not be denied the opportunity to seek a defense under its liability policy simply because the agency chooses eminent domain as the procedural vehicle for collecting the cost of remediation from the property owner. Why should an insured be punished because the claim for clean-up costs arose in the context of condemnation action instead of a direct clean up?

On the other hand, the Court of Appeal seems concerned that a result other than the one it reached would convert liability insurance policies into policies insuring against the loss of value. This is a valid concern, but one which may be able to be addressed by limiting the holding to condemnation actions and not all suits involving diminution in property value Here, we have the government acting and the government seeking the remediation costs, just like in AIU. While the Court is correct to be concerned about issuing a ruling which would seemingly permit a homeowner to tender a claim when they learn during the sale of their home that it has depreciated, that extreme set of facts was not before it.

The point here is that had there been no condemnation, Mrs. Block would not have been the subject of claim for the cost to remediate the property. In fact, it is the agency decision of how to use the property that apparently drove the need to clean it up. According to Mrs. Block, the property was more valuable as an oil well than as redevelopment property. If the eminent domain action against Block is not a suit for damages, as that term is liberally construed in AIU and similar cases, than what is?

This brings us back to the early indication that the actual dollars received by Block may have colored the Court of Appeal's perspective. In the end, based on the settlement, it did not appear that Mrs. Block suffered any damage because of the reduction. The law is clear however that the duty to defend arises if there is a possibility of coverage. At the time the eminent domain action was filed, there was no way to know whether Mrs. Block was ultimately going to be damaged but the possibility of her receiving reduced compensation reflecting clean-up costs was a real possibility. Perhaps another case will come along where the damage is more obvious (i.e., where the condemning agency offers no or nominal compensation because of environmental problems) and the Court will be more sympathetic to the obvious damage to a property owner being sued by the government. It will also be interesting to see if the Supreme Court will choose to revisit this case and reverse the Court of Appeal. If AIU is liberally construed then it may control the day. On the other hand, the Court may have legitimate concerns over expansion of the risks that a liability policy covers which may be reason enough to leave Block alone. As a practitioner, you may want to consider tendering despite the Block holding, especially if your case involves contamination so severe that its remediation if more costly than the value of the property.