

California Supreme Court Ruling Impacts Organizations Subject to Environmental Cleanup Orders

In a ruling that impacts organizations subject to environmental cleanup orders – and that could lead to increased litigation over environmental cleanup costs – the California Supreme Court ruled in early February that insurers who issued standard comprehensive general liability ("CGL") policies are not required to pay for expenses incurred by their insureds pursuant to administrative cleanup orders. In *Certain Underwriters at Lloyd's London v. Superior Court (Powerine)*, 24 Cal. 4th 945 (2001), the Court held that a CGL insurer's duty to indemnify does not extend to expenses required by an administrative agency pursuant to an environmental cleanup statute. The Court therefore found that an insurer is only obligated to pay for cleanup costs if the costs result from a lawsuit.

The ruling in *Powerine* was an extension of the Court's ruling in a 1998 case, *Foster-Gardner, Inc. v. National Union Fire Ins. Co.*, 18 Cal. 4th 857 (1998). In the *Foster-Gardner* decision, the Court had concluded that a CGL's insurer's duty to defend was limited to civil actions prosecuted in court, and that the duty to defend did not extend to the defense of a proceeding before an administrative agency pursuant to an environmental statute. *Foster-Gardner* left open the question whether an insurer's duty to indemnify – to pay a settlement or other claim – was similarly limited to the payment of damages arising out of a civil lawsuit.

In *Powerine*, the EPA and a - agency had instituted proceedings against Powerine Oil Company for the abatement of contamination of certain sites in California. The agencies' proceedings required Powerine to expend funds for abatement and cleanup of the polluted sites. Thus, in the insurance coverage action, Powerine sought an order requiring its insurers to indemnify it for the expenses it incurred in responding to the administrative agencies' cleanup orders.

The California Supreme Court ruled in favor of the insurers, and held that an insurer's duty to indemnify the insured for "all sums that the insured becomes legally obligated to pay as damages," as set forth in a standard CGL policy, is limited to monetary payments ordered by a court. The Court reasoned that a CGL policy links the term "damages" to a "suit," which the Court found to be only "a civil action prosecuted in a court." The Court also rejected the argument that the public policy in favor of minimizing litigation would be furthered by a broader construction of the term "damages," noting that "we do not rewrite any provision of any contract, including the standard policy underlying any individual policy, for any purpose."

The California Supreme Court acknowledged that "numerous" courts in other states had reached contrary results, but declined to follow those decisions. California is the first state

to issue such a ruling from its highest court, and courts in other states will have to decide whether they will look to California for guidance on the issue. Because the *Powerine* decision makes California law in this area particularly unfavorable to policyholders, choice of law will undoubtedly continue to be a major consideration where coverage is at issue for environmental matters. The ultimate impact of *Powerine* may be to increase the likelihood of litigation where there is a possibility of insurance recovery for environmental cleanup costs - at least where California law applies.

The long-term effect of the *Powerine* on environmental matters is not known, but the decision does make clear that policyholders need to consider insurance implications and strategies as early as possible when they are subject to administrative cleanup orders. To make certain that insurance issues are fully explored, our lawyers with expertise in insurance coverage and environmental matters may be contacted for advice and strategy regarding the issues presented by the *Powerine* case.

If you would like more information, please contact **Grace Carter** in our San Francisco office at (415) 835-1600, or via e-mail at gracecarter@paulhastings.com; or **Eve Coddon** in our Los Angeles office at (213) 683-6000, or via e-mail at evccoddon@paulhastings.com.

Client Alert is published solely for the interest of friends and clients of Paul, Hastings, Janofsky & Walker LLP and should in no way be relied upon or construed as legal advice. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. Paul, Hastings, Janofsky & Walker LLP is a limited liability partnership.