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The Pollution-Exclusion Conspiracy: A Newly Recognized Basis for Recovery

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I. Introduction

Did liability insurance companies conspire to introduce an ambiguous pollution exclusion in their standard-form policies at the advent of the federal environmental regulatory framework in the early 1970s? The drafting and regulatory approval history of the pollution-exclusion clause, as well as court decisions that analyze the circumstances and history of the exclusion's development, indicate that the answer is yes. The New Jersey Supreme Court found that the introduction of the pollution exclusion was deceptive and perhaps even fraudulent in the seminal case, *Morton Int'l, Inc. v. General Accident Ins. Co.*[1] More recently, the United States District Court for the Eastern District of Pennsylvania recognized the legal viability of causes of action against insurance companies for misrepresentation, insurance industry-wide conspiracy to defraud, and bad faith, based on the drafting, regulatory history and the use of the pollution-exclusion clause.[2] The court held that such claims should survive a motion to dismiss.[3]

In 1970, the Insurance Rating Board (IRB) and the Mutual Insurance Rating Bureau (MIRB), trade organizations representing liability insurance companies, represented to state insurance regulators throughout the country, the in-

* The author wishes to acknowledge the assistance of Steven J. Dolmanisth, Esq. in the development of some of the ideas and information presented herein.

1. Morton Int'l, Inc. v. General Accident Ins. Co., 629 A.2d 831 (N.J. 1993).

2. Continental Casualty Co. v. Diversified Indus., Inc., 884 F. Supp. 937 (E.D. Pa. 1995).

3. *Id.* at 965.

sured, and the public that they were "clarifying" current coverage by introducing a pollution exclusion.[4] The clarification was purportedly designed to ensure that policyholders knew that their standard-form liability policies did not cover intentional pollution, but only covered "unexpected and unintended" pollution.[5] State insurance regulators approved the use of the exclusion based on these representations.[6] Moreover, because the exclusion was presented as merely a clarification of the then-existing coverage, insurance companies were permitted to add the exclusion to their policies without a premium discount.[7]

Subsequently however, when environmental liabilities increased dramatically, especially after the enactment of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980[8] (CERCLA), insurance companies disavowed their earlier representations and treated the exclusion not as a clarification, but as a significant restriction of coverage.[9] Since the early 1980s, insurers have routinely relied on the exclusion to deny coverage for pollution-related li-

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4. *See Morton*, 629 A.2d at 851. *See also* Joy Tech. v. Liberty Mut. Ins. Co., 421 S.E.2d 493, 499 (W. Va. 1992).

5. *See Morton*, 629 A.2d at 851. *See also* Kelly J. Sosnow, *Insurance Industry Misrepresentation and the Pollution-Exclusion Clause - Morton International Inc. v. General Accident Insurance Co. of America, 629 A.2d 831 (N.J. 1993)*, 18 HARV. ENVTL. L. REV. 249, 251 (1994) [hereinafter Sosnow].

6. Sosnow, *supra* note 5, at 251.

7. *See Morton*, 629 A.2d at 851-53.

8. Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) §§ 101-405, 42 U.S.C. §§ 9601-9675 (1988 & Supp. 1989), *as amended by* Act of Nov. 5, 1990, CERCLA § 111, 42 U.S.C. § 9611 (1988 & Supp. 1993). CERCLA was amended by the Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, 100 Stat. 1613 (1986) (codified as amended at 42 U.S.C. §§ 9601-9674 (1988)). CERCLA provides the U.S. Environmental Protection Agency (EPA) with the authority to respond to releases of hazardous substances into the environment and to seek reimbursement for cleanup costs incurred from responsible parties. CERCLA § 104(a)(1), 42 U.S.C. § 9604(a)(1) (1988). Alternatively, EPA may require potentially responsible parties (PRPs) to undertake such cleanup pursuant to CERCLA § 106(a). CERCLA § 106(a), 42 U.S.C. § 9606(a) (1988). Liability for cleanup-related costs is joint and several pursuant to CERCLA § 107, in that a responsible party can be found liable for all of the costs incurred by EPA in responding to or removing the release or threatened release of hazardous substances. CERCLA § 107, 42 U.S.C. § 9607 (1988).

9. *See Morton*, 629 A.2d at 852-53.

abilities unless the pollution was the result of an abrupt or instantaneous event.[10] This interpretation introduces a temporal requirement[11] relating to the cause or source of pollution that did not exist before the introduction of the exclusion. Further, it was not included in the insurance industry's original regulatory filings concerning the scope and intent of the exclusion.[12]

This "revised" interpretation enabled insurance companies to decline coverage for millions of dollars of environmental liabilities; costs the policyholders then had to incur without the aid of the "all risk" insurance for which they had paid substantially. Moreover, this "bait and switch" tactic has contributed to the extraordinary sums that both policyholders and insurance companies have paid in transaction costs concerning environmental liabilities.[13]

The controversy regarding the scope of the pollution exclusion has spawned hundreds of insurance coverage cases.[14] Recently, several state appellate courts, upon a determination of ambiguity in the language of the policy, have reviewed the drafting and the regulatory history of the exclusion and uncovered compelling evidence that the insurance companies conspired to knowingly create the ambiguity.[15] Insurance

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10. *Id.* at 852.

11. Waste Management of Carolinas, Inc. v. Peerless Ins. Co., 340 S.E.2d 374, 382-83 (N.C. 1986), *reh'g denied*, 346 S.E.2d 134 (N.C. 1986) (the first state supreme court case holding that the use of the word "sudden" in policies only covers abrupt or precipitant pollution events and is not simply to be construed as requiring that the pollution for which coverage is sought be unexpected or unintended). *See* Sosnow, *supra* note 5, at 254.

12. *Morton*, 629 A.2d at 851-53.

13. *See* J. Acton and L. Dixon, Superfund and Transaction Costs: The Experience of Insurers and Very Large Industrial Firms, Rand Study, The Institute for Civil Justice (1991). The Rand Study "found that insurance companies faced with environmental claims spent 88% of their money — or $410 million — on transaction costs, including insurance coverage litigation against their policyholders." *Id.* at 26.

14. *See* Pepper's Steel & Alloys, Inc. v. United States Fidelity & Guar. Co., 668 F. Supp. 1541, 1549 (S.D. Fla. 1987) (referring to a "plethora of authority" regarding the pollution exclusion "from jurisdictions throughout the United States").

15. *See, e.g.*, Just v. Land Reclamation, Ltd., 456 N.W.2d 570 (Wis. 1990); *Morton*, 629 A.2d at 852-54; *Joy Tech.*, 421 S.E.2d at 499.

companies introduced the pollution exclusion which denied coverage for liability from unexpected and unintended pollution without a commensurate reduction in the premium.[16]

Evidence surrounding the introduction of the pollution exclusion has been an important element of litigation concerning the allocation of environmental remediation costs between business, government, individuals, and the insurance industry. Recent evidence which reveals an intent to deceive the regulators of the insurance industry, as well as insurance purchasers, will likely focus more attention on the introduction of the pollution exclusion. The existence of a conspiracy and the facts surrounding the introduction of the pollution exclusion support a cause of action for misrepresentation and possibly even intentional fraud. At a minimum, insurers who engaged in such activities should be equitably estopped from taking advantage of the ambiguity and confusion that they themselves created, and from denying coverage on grounds that a pollution incident was not sufficiently abrupt to be construed as "sudden".

Moreover, claims of misrepresentation, conspiracy to defraud, and bad faith on the part of the insurance industry sound in tort and not in contract. Therefore, a finding of ambiguity in the insurance contract language is not a prerequisite for a court to inquire into the drafting and introduction history of the pollution exclusion. The recent recognition in federal court of such causes of action represents an important legal development, particularly in states that previously found the pollution exclusion unambiguous and upheld the requirement that pollution be abrupt or sudden in order for coverage to exist.[17] Further, the conspiracy issue has important implications as the nation wrestles with CERCLA reauthorization and federal and state legislative efforts to allocate remediation costs.

This paper begins with a brief review of the drafting and regulatory approval history of the pollution exclusion and the

16. *Morton*, 629 A.2d at 853.

17. Continental Casualty Co. v. Diversified Indus., Inc., 884 F. Supp. 937 (E.D. Pa. 1995).

case law that has applied and interpreted it. The paper then addresses the argument that the insurance industry should be estopped from denying coverage for unexpected and unintended gradually occurring pollution based on its prior misrepresentations to state regulators. The paper then specifically addresses whether the insurance industry intentionally deceived both the regulators and the public alike as to the extent and scope of the exclusion. The paper concludes that the evidence strongly suggests that there was a conspiracy designed to mislead state regulators and policyholders regarding the changes wrought by the insertion of the pollution-exclusion clause into comprehensive general liability policies.

II. Background

In the late 1960s and 1970s, the public became aware of pollution and the potential impact of toxic chemicals on human health and the environment. Previously, common waste handling and disposal practices were found to have caused unexpected and unintended harm.[18] However, significant groundwater contamination has been documented even at landfills that historically received only household waste.[19] As a result, while fulfilling their basic public functions, local municipal governments are being subjected to increasing environmental liability.

Under current state and federal strict liability environmental laws, local governments, businesses, and even indi-

18. *See, e.g., Joy Tech.*, 421 S.E.2d at 498 (discussing the evidence that the disposal practices used by Joy Technologies which caused pollution were common in the industry at the time, and that no evidence was presented indicating that Joy Technologies intended to harm the environment). *See also* Steven Ferrey, *The Toxic Time Bomb: Municipal Liability for the Cleanup of Hazardous Waste*, 57 GEO. WASH. L. REV. 197 (1988) [hereinafter Ferrey]. Operation of the Charles George Landfill resulted in contamination of the public water supply in the late 1970s. However, the landfill operated under a state-issued permit from approximately 1973 to 1976, and did not stop receiving waste until 1983. *Id.* at 217-19.

19. Ferrey, *supra* note 18, at 208-10. Estimates of the proportion of hazardous waste in a typical municipal waste stream are generally less than 0.1% by weight. *Id.*

viduals face substantial claims for cleanup costs of landfills.[20] Such claims often result in complex litigation and enforcement actions between federal and state regulatory agencies and potentially liable parties, as well as extensive litigation by potentially liable parties seeking contribution from other parties.[21]

When faced with such regulatory actions and litigation, parties turn to their liability insurance for protection. Comprehensive general liability (CGL) insurance policies are, as the name suggests, designed to provide policyholders, including governments and businesses, with comprehensive protection against all forms of unexpected and unintended liability, including environmental property damage.[22] Such protection generally charges the insurance company with two duties: the duty to defend and the duty to indemnify. Under its duty to defend, the insurance company promises to defend the policyholder from all suits brought against the policyholder for potentially covered damages.[23] Under its duty to indemnify, the insurance company promises to pay all covered damages that the policyholder legally incurs.[24] The policy language contained in most of the CGL insurance policies sold in the United States is drafted by insurance industry trade associa-

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20. The United States Court of Appeals for the Second Circuit held that CERCLA can potentially impose liability on municipalities which dispose of municipal solid waste. B.F. Goodrich Co. v. Murtha, 958 F.2d 1192 (2d Cir. 1992). This is also consistent with current EPA policy whereby municipal wastes which contain hazardous substances, as defined in CERCLA § 101(14), potentially fall within the liability framework of CERCLA. CERCLA § 101(14), 42 U.S.C. § 9601(14) (1988); 54 Fed. Reg. 51,071, 51,074 (1989).

21. Under CERCLA's liability provisions, any person, which includes municipalities and corporations, can be held liable for cleanup-related costs simply for arranging for the disposal of materials containing hazardous substances. CERCLA § 107(a)(3), 42 U.S.C. § 9607(a)(3) (1988). Municipalities and businesses can therefore be sued by previously-identified responsible parties seeking to compel contribution for their share of costs associated with cleanup activities. *Id.*

22. Nancy Ballard & Peter Manus, *Clearing Muddy Waters: Anatomy of the Comprehensive General Liability Pollution Exclusion*, 75 CORNELL L. REV. 610, 620-21 (1990).

23. Sue C. Jacobs, *The Duty to Defend*, 539 PRACTICING L. INST. 489 (1995).

24. Nicholas P. Alexander, *Developments in Indemnity Law: Express, Implied, Contractual, Tort-based and Statutory*, 79 MASS. L. REV. 50, 52 (1994).

tions.[25] These associations have the responsibility to submit the policy forms on behalf of their "subscriber" insurance companies to state regulators for approval.[26] From 1973 to 1985, the following pollution-exclusion language was inserted into the standard CGL insurance policy form used by most insurance companies in the United States:

> This insurance does not apply . . . (f) to bodily injury or property damage arising out of the dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon the 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 or accidental.[27]

III. Pollution-Exclusion Language History

Prior to the mid-1960s, standard-form CGL insurance policies provided coverage for property damage associated with an "accident".[28] Although such policies did not typically define an "accident," courts historically recognized that the term "accident" did not have a temporal element. Instead, courts have interpreted it as meaning "an unexpected, unforeseen, or undesigned happening or consequence from either a known or an unknown cause."[29] By the late 1960s, the term "accident" was consistently interpreted as "an unexpected happening without intention or design."[30] As a result, property damage associated with the unexpected and unin-

25. Ballard & Manus, *supra* note 22, at 625.

26. *Id.* at 621.

27. *Id.* at 613.

28. *Morton*, 629 A.2d at 849.

29. *See, e.g.*, Hauenstein v. Saint Paul-Mercury Indem. Co., 65 N.W.2d 122, 126 (Minn. 1954); *accord* Canadian Radium & Uranium Corp. v. Indem. Ins. Co., 104 N.E.2d 250, 254 (Ill. 1952).

30. Beacon Textiles Corp. v. Employers Mut. Liab. Ins. Co., 246 N.E.2d 671, 673 (Mass. 1969). *See also* Sharon M. Murphy, *The "Sudden and Accidental" Exception to the Pollution-Exclusion Clause in Comprehensive General Liability Insurance Policies: The Gordian Knot of Environmental Liability*, 45 VAND. L. REV. 161, 165 (1992).

tended gradual accumulation of pollutants was held to trigger coverage under CGL insurance policies.[31]

In 1966, representatives of the insurance industry jointly revised the standard-form policy language to provide coverage for damages caused by the happening of an "occurrence" as opposed to an "accident".[32] This ostensibly eliminated the potential confusion regarding a temporal requirement and extended coverage to include the gradual accumulation of pollutants.[33]

In 1970, the insurance industry presented the pollution exclusion as a *clarification* of the "neither expected nor intended" language in the definition of an "occurrence" rather than as a change in existing coverage.[34] This clause was drafted in response to concerns that the language of existing CGL policies could be construed too broadly, thereby conceivably covering any pollution incident, and included the express intent to deny coverage for pollution incidents resulting from intentional discharge or disposal.[35]

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31. *See, e.g.*, Steyer v. Westvaco Corp., 450 F. Supp. 384, 390 (D. Md. 1978) (damage to trees caused by discharges of pollutants over four-year period); Grand River Lime Co. v. Ohio Casualty Ins. Co., 289 N.E.2d 360, 361-62 (Ohio Ct. App. 1972) (property damage caused by emissions from insured's operations over seven-year period); Aetna Casualty & Sur. Co. v. Martin Bros. Container & Timber Prod. Corp., 256 F. Supp. 145, 149 (D. Or. 1966) (emission of fly ash from insured's plant over a period of several months).

32. Ballard & Manus, *supra* note 22, at 624. The standard-form definition of an "occurrence" that resulted from the 1966 revision provides that an "occurrence" means "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." *Id.*

33. *See, e.g.*, New Castle County v. Hartford Accident & Indem. Co., 933 F.2d 1162, 1197 (3d Cir. 1991); *Morton*, 629 A.2d at 847-48 (holding that the 1966 standard-form CGL policy was drafted with the intent to cover property damage resulting from gradual exposure to conditions, including pollution, as long as the policyholder neither expected nor intended the resulting damage).

34. *Morton*, 629 A.2d at 847-48. *See also* Sosnow, *supra* note 5, at 250-51; *Just*, 456 N.W.2d at 575 (contemporaneous representations by the insurance industry confirm that the drafting committee, in creating the exclusionary clause, clarified but did not reduce the scope of coverage).

35. *See Morton*, 629 A.2d at 849-50 (citing James A. Hourihan, *Insurance Coverage for Environmental Damage Claims*, 15 FORUM 551, 553 (1980) and Thomas Reiter, *The Pollution Exclusion Under Ohio Law: Staying the Course*, 59 U. CIN. L. REV. 1165, 1195-96 (1991)).

In reviewing evidence regarding the history of the pollution exclusion, the *Morton* court quoted the President of the Insurance Company of North America (INA), a defendant in the action, as saying that "INA will continue to cover pollution which results from an accidental discharge of effluents — the sort of thing that can occur when equipment breaks down. We will no longer insure the company which knowingly dumps its wastes."[36] Moreover, as the West Virginia Supreme Court of Appeals found in the record:

> [A]t the time Liberty Mutual adopted this standard-form for the commercial general liability policy, a memorandum entitled "Summary of Broadened Coverage Under New GL Policies With Necessary Limitations to Make This Broadening Possible," was circulated internally within the company. That memorandum indicated that the policies covered liabilities including:
>
> > Coverage for gradual BI [bodily injury] or gradual PD [property damage] resulting over a period of time from exposure to the insured's *waste disposal*. Examples would be gradual adverse effect of smoke, fumes, air or stream pollution, contamination of water supply or vegetation. We are all aware of cases such as contamination of oyster beds, lint in the water intake of down stream industrial sites, the Donora Pa. atmospheric contamination, and the like.[37]

The "sudden and accidental" language appearing at the end of the pollution exclusion had been used and interpreted before. That language used a term of art that had appeared in boiler and machinery policies since the 1950s. This language had been repeatedly construed as providing coverage for events which did not happen *instantaneously*, but rather occurred *unexpectedly*.[38]

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36. *Morton*, 629 A.2d at 850 (citing Charles K. Cox, *Liability Insurance in the Era of the Consumer, Address Before the Annual Conference of the American Society of Insurance Management* (Apr. 9, 1970), *quoted in* Robert S. Soderstrom, *The Role of Insurance in Environmental Litigation*, 11 FORUM 762, 767 (1976)).

37. *Joy Tech.*, 421 S.E.2d at 498.

38. *See, e.g.*, New Castle County v. Hartford Accident & Indem. Co., 933 F.2d 1162, 1197 (3d Cir. 1991); Anderson & Middleton Lumber Co. v. Lumber-

This construction of the "sudden and accidental" language had been so clearly established that, by 1963, one of the leading insurance treatises concluded that "the word 'sudden' should be given its primary meaning as a happening without previous notice, or as something coming or occurring unexpectedly, as unforeseen or unprepared for. That is, 'sudden' is not to be construed as synonymous with instantaneous."[39]

Since the insurance industry had already litigated the construction of "sudden and accidental" in boiler and machinery policies, and moreover, since that phrase had been uniformly interpreted by the courts to mean "unexpected and unintended," it therefore follows that the insurance-industry drafters intended the exclusion to have that identical meaning as the "sudden and accidental" language they chose in 1970.[40]

Usually, these courts have focused exclusively on the literal language of the exclusion, rejecting assertions that the language is ambiguous, and thereby refusing to review the derivation of the pollution exclusion, and the representations of the insurance industry associated with its regulatory approval.[41] However, because any of these cases arose from irresponsible waste management or disposal practices, similar

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men's Mut. Casualty Co., 333 P.2d 938, 941 (Wash. 1959); New England Gas & Elec. Ass'n v. Ocean Accident & Guar. Corp., 116 N.E.2d 671, 679 (Mass. 1953); 10A GEORGE J. COUCH, COUCH ON INSURANCE 2D, § 42:396 (perm. ed. rev. vol. 2d ed. 1982).

39. 11 GEORGE J. COUCH, COUCH ON INSURANCE, § 42:383 (1963) (footnotes omitted). The identical language appears in the most recent edition of the treatise. 10A, GEORGE J. COUCH, COUCH ON INSURANCE 2D, § 42:396 (perm. ed. rev. vol. 2d ed. 1982). *See also* Sutton Drilling Co. v. Universal Ins. Co., 335 F.2d 820, 824 (5th Cir. 1964) (in action on policy insuring oil well drilling rig, sudden meant "happening without previous notice or with very brief notice; unforeseen; rapid. It does not mean instantaneously"); Picchetti v. Pittsburgh Plate Glass Co., 153 N.E.2d 209, 213 (Ohio App. 1957) (sudden "does not mean instantaneous"); Lovell v. Williams Bros., Inc., 50 S.W.2d 710, 713 (Mo. App. 1932) ("[I]t is obvious that happening suddenly does not mean happening instantaneously").

40. "The judicial construction placed upon particular words or phrases made prior to the issuance of a policy employing them will be presumed to have been the construction intended to be adopted by the parties." 2 GEORGE J. COUCH, COUCH ON INSURANCE 2D, § 15:20 (1984).

41. *Id.* at 862.

legal outcomes could have been based on the fact that the pollution was expected from such activity, or even that they may have been intended.[42]

Numerous state and federal courts have denied insurance coverage on the basis of interpreting "sudden" as requiring a temporal attribute.[43] Other cases have recognized that "sudden" can mean "unexpected" without a temporal element and therefore, held that the exclusion is ambiguous.[44] Accordingly, these courts have held that pollution damage resulting from gradual discharges of pollutants is covered under policies containing the pollution exclusion.[45]

It has been suggested that these differing outcomes also reflect differing policy considerations.[46] Arguably, insurance policies should not be used as tools to indemnify intentional polluters. However, extending the interpretation of the pollution exclusion to deny coverage to those who might be unwittingly liable for gradual pollution that was neither expected nor intended serves both to frustrate and to defeat the purpose of CGL insurance, and is, therefore, unwarranted.[47]

IV. Regulatory Approval History of Pollution Exclusion

The contemporaneous statements by insurance industry officials, the drafting and regulatory history of the pollution exclusion, and the reasoning of those courts which have examined these statements and history, serve as compelling

42. *Id.* *See also* Sosnow, *supra* note 5, at 257-58.

43. *See Morton*, 629 A.2d at 857-62.

44. *See, e.g.*, Claussen v. Aetna Casualty & Sur. Co., 380 S.E.2d 686 (Ga. 1989); Queen City Farms, Inc. v. Central Nat'l Ins. Co., 827 P.2d 1024 and *New Castle*, 933 F.2d 1162. Some cases have held that the fact that so many cases have interpreted "sudden" differently alone is evidence that the exclusion is ambiguous. *See, e.g.*, *Id.* at 1196.

45. *Id.* at 857.

46. Sosnow, *supra* note 5, at 257-58.

47. "[O]ne fact emerges clearly from the drafting history . . . [the pollution exclusion] . . . when it was approved, both insurers and regulatory officials focused on intent as the factor that would determine whether coverage would be provided . . . . No one suggested that the exclusion . . . was drafted or approved in order to limit coverage to accidental releases of short duration." Ballard & Manus, *supra* note 22, at 627.

support for the conclusion: pollution exclusion represents a clarification of the "occurrence" language, and allows coverage where the resulting pollution damage was "neither expected nor intended from the standpoint of the insured."[48]

In 1970, the insurance industry, represented by the IRB, submitted the pollution exclusion with a standard-form explanatory memorandum to state insurance commissioners throughout the country for approval.[49] The insurance industry specifically represented to these state insurance commissioners that the pollution exclusion was intended to be merely a clarification of the "occurrence" definition, and, therefore, that pollution insurance coverage was to be denied only in cases of intentional pollution:

> Coverage for pollution or contamination is not provided in most cases under present policies because the damages can be said to be expected or intended and thus are excluded by the definition of occurrence. The above exclusion clarifies this situation so as to avoid any question of intent. Coverage is continued for pollution or contamination caused injuries when the pollution or contamination results from an accident . . . .[50]

The *Morton* court concluded the following regarding the statements in this memorandum: "The first sentence is simply untrue."[51] "The second sentence is even more misleading

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48. *Id.* at 624.

49. *New Castle*, 933 F.2d at 1198.

50. Insurance Rating Board, Submission to Ins. Comm'r of W. Va. (May 18, 1970), *reprinted in* Ballard & Manus, *supra* note 22, at 626. This explanatory memorandum was submitted to various state insurance commissioners in conjunction with the regulatory approval process. Insurance companies wishing to sell insurance policies in a particular state generally must file their policy and endorsement forms for approval with state insurance regulators. *Id.*

51. *Morton*, 629 A.2d at 852. Pollution coverage was explicitly provided for prior to 1970. *Id.* The statement in the explanation "is not only astonishing but inaccurate and misleading as well." *Id.*; *accord* Claussen v. Aetna Casualty & Sur. Co., 676 F. Supp. 1571, 1573 n.4 (S.D. Ga. 1987). "The Court finds dishonesty in the representation made to the Georgia Insurance Department in 1970 that the pollution exclusion clause would have little effect on preexisting coverage." *Id.* In fact, many cases have held that pre-1970 "occurrence" policies were "tailor-made" to cover most pollution liability. *See, e.g.*, Aetna Casualty & Sur. Co. v. Martin Bros. Container & Timber Prods. Corp., 256 F. Supp. 145 (D. Or.

than the first."[52] "The succeeding sentence of the explanatory memorandum continued to camouflage the literal effect of the pollution-exclusion clause."[53] "[T]he conclusion is virtually inescapable that the memorandum's lack of clarity was deliberate."[54] Additionally, according to *Morton*, the insurance industry's explanatory memorandum expressly states that although coverage "is continued" for accidents, it does not contain any indication that there is an overall reduction of coverage or that insurance rates should therefore fall.[55]

Other courts have reviewed and addressed the insurance industry's regulatory and public representations regarding the pollution exclusion and have reached similar conclusions.[56] In *Claussen*, the Georgia Supreme Court reviewed the standard state filing documents and found that "[d]ocuments presented by the Insurance Rating Board . . . to the Insurance Commissioner when the 'pollution exclusion' was first adopted suggest that the clause was intended to exclude only intentional polluters."[57]

1966); City of Kimball v. St. Paul Fire & Marine Ins. Co., 206 N.W.2d 632 (Neb. 1973).

52. *Morton*, 629 A.2d at 852. "[T]o characterize so monumental a reduction in coverage [as the exclusion is construed today by the insurance industry] as one that 'clarifies this situation' simply is indefensible." *Id.* at 852-53.

53. *Id.* at 853. In asserting that "coverage is continued," the explanation invites the regulators and policyholders to rely on the belief that no further restriction in coverage is provided by the introduction of the exclusion. *Id.*

54. *Id.* The insurance industry's other contemporaneous representations regarding the intent and scope of the exclusion, including representations to their insurance agents responsible for selling the policies, were identical, or at least similar, to the representations contained in the explanatory memorandum. *Morton*, 629 A.2d at 848-55.

55. *Id.* at 853.

56. *See, e.g.*, *Joy Tech.*, 421 S.E.2d at 499 (although the court applied Virginia law, it noted that under Pennsylvania law, the defendant insurance company's current interpretation of the exclusion would be "inconsistent" with the "studied, unambiguous, official and affirmative representations," and accordingly, against public policy). *Id.* at 497.

57. *Claussen*, 380 S.E.2d 686 at 689. The Insurance Rating Board specifically represented to the Georgia Insurance Commissioner: "Coverage for expected or intended pollution is not now present as it is excluded by the definition of occurrence. Coverage for accidental mishaps is continued." Claussen v. Aetna Casualty & Sur. Co., 676 F. Supp. 1571, 1583 (S.D. Ga. 1987).

Similarly, the Wisconsin Supreme Court agreed that "[c]ontemporaneous representations by the insurance industry confirm that the drafting committee, in creating the exclusionary clause, clarified but did not reduce the scope of coverage."[58] The holding of the *Just* court underscores the proposition that it was the intent expressed to the insurance regulators in the filing statements that is relevant to the interpretation of the pollution exclusion, regardless of the underlying intent of the insurance industry. "This expressed intent was also the interpretation relied upon by insurance regulators in approving the exclusionary clause."[59] Policyholders as well have a right to rely on the expressed intent of the insurance industry.

The insurance industry denies that it never expressed any intent to reduce coverage in the pollution exclusion. These and other insurance industry arguments appear to be false. First, the insurance companies' position is contradicted by the fact that most insurance commissioners approved the exclusion as a mere clarification of coverage.[60] The West Virginia Insurance Commissioner who approved the pollution exclusion stated in an affidavit that:

> The insurers stated in pre-hearing submissions, at the hearing, and in posthearing submissions that the proposed [pollution-exclusion] endorsement forms did not limit or narrow coverage and were not intended to do so. Based upon those representations, *I concluded that the pollution endorsement forms did not narrow or limit coverage and,*

58. *Just*, 456 N.W.2d at 584.

59. *Id.* at 575. The insurance industry has argued that internal industry documents demonstrate the industry's "true" intent in the introduction of the "polluter's exclusion." However, as the *Just* court stated, it is what the industry agents *actually* represented to the insurance regulators that is dispositive, not what the industry agents intended. *Id.* at 575, 578-79.

60. Despite the clear definition in the "occurrence" policy that an "accident includ[es] injurious exposure to conditions . . .," the insurance industry's position appears to be that everyone in the *insurance world* knew that a hypertechnical meaning is included in the term "accident" and that meaning includes a "boom" requirement. *Morton*, 629 A.2d at 849. That requirement, however, had been rejected by courts and insurance companies well before 1970. No such requirement was represented to the regulators or the public. *Id.* at 852-53.

> *instead, were mere clarifications of existing coverage as defined and limited by the definition of the term "occurrence."* Accordingly, I approved the endorsement forms IRB 335 and MIRB MB G008 submitted respectively by the Insurance Rating Board and the Mutual Insurance Rating Bureau.[61]

This testimony is additionally significant because several states held hearings on pollution exclusion, or required the submission of supplemental explanatory information.[62] Thus, if the insurance industry did actually intend to restrict the "occurrence" coverage, rather than to merely clarify it, the industry had ample opportunity to make sure that the insurance commissioners understood this intended distinction. Instead, the insurance industry reiterated that the pollution exclusion did not further restrict coverage, but that it merely clarified "existing coverage as defined and limited by the definition of the term 'occurrence'."[63] As the West Virginia Supreme Court of Appeals concluded:

> [I]n view of the fact that in the present case the insurance . . . [rating board] . . . representing [the insurance company] unambiguously and officially represented to the . . . [i]nsurance [c]ommission that the exclusion in question did not alter coverage under the policies involved, . . . this Court must conclude that the policies . . . covered pollution damage, even if it resulted over a period of time and was gradual, so long as it was not expected or intended.[64]

Second, if the insurance industry had wanted to restrict coverage for gradual pollution or limit coverage to damage arising out of "bloom" incidents, the insurance industry could have put such language in its exclusion. It did not. Instead, the insurance industry utilized the "sudden and accidental" language which had been interpreted to *not* include a temporal element.

At a minimum, the insurance industry could have explicitly informed the insurance regulators and the public

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61. *Joy Tech.*, 421 S.E.2d at 499 (emphasis added).
62. *Morton*, 629 A.2d at 853-54.
63. *Joy Tech.*, 421 S.E.2d at 499.
64. *Id.* at 499-500.

that the exclusion was intended to exclude gradual pollution. It did not. The insurance companies certainly had the opportunity to explain that the exclusion was intended to exclude gradual pollution in their explanatory memorandum and in responding to the many state regulators who questioned whether the exclusion was only a clarification of coverage. In response to such questions, the insurance companies only reiterated that the exclusion was merely a clarification. In fact, the insurance companies' public representations and conduct was directly to the contrary.

Third, the insurance companies' use of the term "clarification" when explaining the intent of the exclusion was not happenstance. When filing explanatory memoranda, the insurance industry organizations responsible for such filings use specific terms of art to describe the effect of the exclusion. The terms "clarification" and "restriction" are two such terms of art. The former secretary of the Mutual Insurance Rating Bureau, one of the organizations involved in developing the exclusion and filing it with state insurance regulators, has acknowledged the use of the term "clarification" in the explanatory memorandum was intentional and meant to inform the regulators that the exclusion was not a further restriction in coverage.[65]

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65. See Affidavit of David E. Kuizenga, former Assistant Secretary and Secretary of MIRB where he was employed from 1950 to May, 1973, sworn on November 30, 1993. "In my underwriting positions and as Assistant Secretary I had the responsibility for issues involving general liability insurance and participated in the MIRB's General Liability Rating Committee and Policy Forms Committee and the Joint General Liability Rating and Policy Forms Committees of the MIRB and the Insurance Rating Board (the 'IRB'). Those committees were responsible for drafting general liability form insurance policy provisions.

"In 1970, the MIRB submitted provision nos. MB G008 and MB G009 to insurance departments in all states, including Mississippi. Provision no. MB G008 was entitled 'Exclusion (Contamination or Pollution).' Provision no. MB G009 was entitled 'Supplementary Exclusion (Contamination or Pollution-Described Operations).'

"The manual for provisions nos. MB G008 and MG G009 contains a section with the heading 'Explanation.' The second sentence of that section includes the sentence: 'the above language clarifies this so as to avoid any question of intent.' That sentence, or substantively similar language, appeared in the manuals for numerous proposed changes to standard form insurance policy language which were submitted to state regulators by the MIRB and IRB. That

V. Equitable Estoppel

Where the scope of the pollution exclusion is at issue in future litigation, courts should follow *Morton* in equitably estopping the insurance industry from asserting a temporal requirement. This approach will prevent the insurance industry from denying insurance coverage by taking unfair advantage of any ambiguity in the pollution-exclusion language and of their inaccurate, or at least misleading, statements to the state insurance regulators, and the public as to the intent of the exclusion.

Representations made by the insurance industry's agents, the IRB and the MIRB, during the state regulatory approval process are at the heart of the equitable estoppel claim. Regardless of whether or not these were misrepresentations at the time they were made, they are cause for precluding the industry's subsequent disavowal of coverage for gradually occurring pollution. The public policy purpose served by regulatory approval is to provide an official explanatory opportunity whereby state regulators, acting as agents for current and future policyholders, can fully and accurately evaluate the implications of all proposed changes to the insurance policy language. The critical assumption underlying this policy is that the insurance industry be unequivocally, and accurately clear, complete and honest in all its representations. Any lack of clarity, or deviation from absolute hon-

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language, as used in the manual for provision no. MB G008 and other state filings, signifies that the coverage intended by the drafters of a policy term was not as broad as was subsequently thought by courts or others, and that the proposed provision clarifies the intent of the drafters of the provision as to the scope of coverage.

"The *Explanation* section of the manual for provision nos. MB G008 and MB G009 explains that MB G008 is a clarification of coverage intended under 'occurrence' based liability insurance policies. That section does not indicate that MB G008 is a return to "accident" based coverage for contamination or pollution claims.

"During my tenure at MIRB, when the MIRB and IRB sought to reduce the scope of standard form liability insurance coverage, they would include a justification for the reduction in coverage in the manual submitted to the state regulators concerning the proposed change. The *Explanation* section of the manual for provision nos. MB G008 and MB G009 states that provision no. MB G009 is an exclusion of coverage." *Id.*

esty, effectively serves to circumvent safeguards provided by this review process.

The insurance industry should be held responsible for intentional misrepresentations, regardless of whether or not a conspiracy existed, or even for inadvertent, inaccurate, or misleading representations. The most appropriate remedy to address the insurance industry's representations concerning the pollution exclusion is to estop the insurance industry from denying coverage under the pollution exclusion for gradual, unintended and unexpected pollution.

The holding of the Third Circuit Court of Appeals in *New Castle* confirms both the correctness and the reasonableness of the court holding that the insurance industry should be estopped from repudiating the assertions it made during the regulatory review process.[66] In *New Castle* the Third Circuit supported its holding for coverage after extensively analyzing the history surrounding the pollution exclusion, including its drafting history, its adoption by state regulators, and its judicial treatment.[67] The *New Castle* court found that "insurance company executives stated that the language of the clause was a mere clarification of the 'occurrence' definition, excluding coverage *only for expected and intended pollution.*"[68] In light of the pollution exclusion's history, the Third Circuit determined that the term "sudden" within the exclusion was ambiguous.[69] Based on its factual findings, the court could have arrived at the same result using estoppel.

Recent case law from the highest courts of several states also supports estoppel claims.[70] The most recent and compelling decision with regard to the estoppel alternative is the holding by the New Jersey Supreme Court in *Morton*. After an exhaustive review of the insurance industry's representa-

66. *New Castle*, 933 F.2d at 1196-98.

67. *Id.* at 1192-98.

68. *Id.* at 1197-98 (emphasis added).

69. *Id.* at 1198. It further determined that giving "sudden" a non-temporal meaning did not render "accidental" superfluous because "sudden means unexpected, and accidental means unintended." *New Castle*, 933 F.2d at 1194.

70. *See,e.g.*, *Morton*, 629 A.2d 831; *Joy Tech.*, 421 S.E.2d 493; *Just*, 456 N.W.2d 570.

tions to insurance regulators and the public as to the underwriting intent and meaning of the exclusion, the court held that the insurance industry was estopped from asserting that the pollution exclusion precludes coverage for anything but intentional discharges of known pollutants.[71] The court found that even though it believed the term "sudden" was ambiguous, the insurance companies should not be able to refuse coverage for gradual pollution because of the insurance industry's misrepresentations made in filing the exclusion with state insurance regulators. The court found that the regulatory and public representations by the insurance industry were "paradigms of understatement," "misleading," "inaccurate," "indefensible," "camouflage," "lacking in candor," and "not straightforward."[72] In sum, the *Morton* court refused to "condone the industry's misrepresentations to regulators in New Jersey and other states concerning the effect of the clause."[73]

The *Morton* holding is not an anomaly. It is consistent with the numerous decisions of other appellate courts that have considered the facts surrounding the pollution exclusion.[74] For example, the Wisconsin Supreme Court held that in presenting the pollution exclusion to state regulators for approval and in selling it to policyholders, the insurance industry expressly and unequivocally represented that the exclusion was intended only to "clarify" existing coverage.[75]

In light of these compelling authorities, the insurance industry should be estopped from interpreting the pollution-exclusion clause in any manner that is inconsistent with its previous representations to insurance regulators and the public. Equitable estoppel is available when: (1) promises or inducements were made; (2) plaintiffs reasonably relied upon the promises or inducements; and (3) plaintiffs will be

71. *Morton*, 629 A.2d at 848.

72. *Id.* at 852-54.

73. *Id.* at 848.

74. *See Joy Tech.*, 421 S.E.2d 493; *Just*, 456 N.W.2d 570; *Queen City*, 827 P.2d 1024; *Claussen*, 380 S.E.2d 686; *New Castle*, 933 F.2d 1162.

75. *Just*, 456 N.W.2d at 574.

harmed if the claim of estoppel is not allowed.[76] It is a doctrine of fundamental fairness that binds a party to its prior position as evidenced by its prior representations or conduct. It enables courts to adjust the relative rights of parties in accordance with the parties' duties of good faith and fair dealing.[77]

Under equitable estoppel, a policyholder may hold an insurance company to representations of broad coverage that were advanced in various contexts during the insurance policy's development, regulatory approval, or marketing process.[78] In *Morton*, the New Jersey Supreme Court held that "equity and fairness" require that the insurance industry be bound by the pre-coverage representations it advanced regarding the pollution exclusion.[79] The *Morton* court explained that it is "appropriate and compelling" to apply equitable estoppel to bind insurance companies to their representations of the early 1970s because:

> Not only did the insurance industry fail to disclose the intended effect of this significant exclusionary clause, it knowingly misstated [the clause's] intended effect in the industry's submission of the clause to state Departments of Insurance. Having profited from that nondisclosure by maintaining pre-existing rates for substantially reduced coverage, the insurance industry should be required to bear the burden of its omission by providing coverage at a

76. Hydra-Mac, Inc. v. Onan Corp., 450 N.W.2d 913, 919 (Minn. 1990).

77. Northern Petrochemical Co. v. U.S. Fire Ins. Co., 277 N.W.2d 408, 410 (Minn. 1979) (holding that estoppel is intended to prevent a party from taking unconscionable advantage of his own wrong by asserting his strict legal rights).

78. The issue here is not an expansion of coverage. Instead, coverage that existed at the time policies were purchased and that was represented to exist by the insurance industry to the insurance regulators, the insured, and the public should be provided. In addition, policyholders would not be unjustly enriched by obtaining coverage that they did not pay for because they did, in fact, pay for it. The insurance companies did not provide a premium reduction when they introduced the pollution exclusion as they should have done if the exclusion was a reduction in coverage. "[H]ad the industry acknowledged the true scope of the proposed reduction in coverage, regulators would have been obligated to consider imposing a correlative reduction in rates." *Morton*, 629 A.2d at 853.

79. *Id.* at 874.

> level consistent with its representations to regulatory authorities.[80]

Significantly, the New Jersey Supreme Court reached this conclusion without any evidence of direct communication between the parties of the action, and instead found privity of the parties, and reasonable and detrimental reliance on the part of state insurance commissioners and policyholders.[81] First, the court found that the IRB was the insurance industry's "designated agent, in presenting the pollution-exclusion clause to state regulators."[82] Second, the court found that insurance commissioners are, in effect, the agents of their state's policyholders because they are charged by statute "'to protect the interests of policyholders' and to assure that 'insurance companies provide reasonable, equitable and fair treatment to the insuring public.'"[83]

Moreover, when the insurance commissioners approved the exclusion, they relied on the industry's misrepresentations, and were, thereby, deprived of the opportunity to make informed judgments about the premium and coverage issues that resulted from the exclusion. Accordingly, policyholders were lulled from acting "either directly or through intervention by state regulatory authorities, to encourage the industry to provide broader coverage for pollution damage, even at increased rates, perhaps avoiding the litigation explosion that the . . . clause ha[d] precipitated."[84] The court explained: "The proposition [that the insurance company is estopped to deny coverage] is one of elementary and simple justice. By justifiably relying on the insurer's superior knowledge, the

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80. *Id.* at 876.

81. *Id.* at 875. "We are fully persuaded that the 'reasonable expectations' of the New Jersey regulatory authorities should be imputed to those insured" to whom policies were issued containing the approved pollution exclusion clause. *Id.*

82. *Id.* at 874.

83. *Morton*, 629 A.2d at 874.

84. *Id.* at 876.

insured has been prevented from procuring the desired coverage elsewhere."[85]

VI. Conspiracy

The Supreme Court addressed claims of a conspiracy and its related causes of action of intentional fraud and misrepresentation in the context of the tobacco industry's efforts to refute evidence of the health effects of smoking.[86] The Court rejected the tobacco industry's arguments that such claims were preempted by federal regulation of cigarette labeling and advertising because they were "predicated on a duty 'based on smoking and health.'"[87] The Court further recognized that these claims were predicated on a general duty to neither deceive nor conspire to commit fraud.[88] It reviewed, as well, the elements of an intentional fraud and misrepresentation claim under the applicable New Jersey state law as presented by the District Court.[89] The Supreme Court stated that such a claim "consists of the following elements: 1) a material misrepresentation of . . . fact [by false statement or concealment]; 2) knowledge of the falsity . . . ; 3) intent that the misrepresentation be relied upon; 4) justifiable reliance . . . ; [and] 5) resultant damage."[90]

Appendix A, on file with Pace Environmental Law Review, is an internal memorandum from Aetna Casualty & Surety Company which discusses the potential implications of the clarifying language of the pollution exclusion for use by the IRB.[91] The IRB was the insurance industry organization

85. *Id.* at 873 (quoting Harr v. Allstate Ins. Co., 255 A.2d 208 (N.J. 1969) (citations omitted).

86. *See* Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992).

87. *Id.* at 529.

88. *Id.*

89. *Id.* at 528 n.25. *See* Cipollone v. Liggett Group, Inc., 683 F. Supp. 1487, 1499 (N.J. 1988).

90. *Cipollone*, 505 U.S. at 528 n.25.

91. *See* Appendix A (on file with Pace Environmental Law Review). This memorandum only came to light inadvertently. First, Aetna unsuccessfully attempted to limit its availability through a claim of privilege and then by asserting that it was subject to a protective order. Aetna was forced to release it publicly in *Morton*, however, when the company faced a potentially embarrassing motion that would have questioned Aetna's representations to various

which convened a committee to draft the exclusion language.[92] This memorandum, now known as the "Guiney memorandum", involved Francis Bruton, a high-level officer of Aetna and one of the principle members of the committee that drafted the pollution exclusion, and was involved with its filing with the state insurance regulators. The memorandum addresses the potential public relations issue that the pollution exclusion appeared to reduce coverage without reducing insurance premiums.[93]

The importance of this memorandum is that it documents a contemporaneous scheme by the insurance companies to deceive the state regulators and the public as to the impact of the pollution exclusion. First, the document shows that insurance industry representatives were aware that inserting the pollution exclusion into existing insurance policies could be perceived, and later used, as a reduction in coverage.[94] This knowledge contradicts the industry's representation to the insurance regulators, the insured, and the public that the exclusion was a mere clarification of coverage. Second, the document helps explain why the insurance industry did not directly draft the exclusion to exclude gradual pollution or directly inform state insurance regulators or the public that the exclusion was a restriction of coverage. The substance of the internal memorandum is evidence that the insurance industry conspired to conceal its true purpose for the pollution exclusion: to reduce potential future liability by limiting the scope of coverage.

The insurance companies recognized "public policy" implications and knew that such a restriction would only be approved in conjunction with a premium rebate. Moreover, by conspiring to keep the actual and intended impact of the pollution exclusion from the insurance regulators, the insured, and the public, the industry avoided admitting that gradual pollution was currently covered by existing policies.

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courts that its version of the drafting history of the pollution exclusion was the complete and accurate version.

92. Ballard & Manus, *supra* note 21, at 625.

93. *See* Appendix A (on file with Pace Environmental Law Review).

94. *Id.*

All the necessary elements of intentional fraud and misrepresentation are present in the case of the insurance industry's "clarification" of coverage.[95] The industry knowingly misrepresented the impact of the pollution-exclusion language in statements to state insurance regulators, acting as agents for the policyholders, with the intent that such misrepresentations be relied upon. The states and policyholders justifiably relied on those statements and incurred damages for litigation costs and denials of coverage related to the restrictions imposed as a result of the pollution-exclusion language.

The history of the development of the pollution exclusion provides ample evidence of an insurance industry-wide conspiracy to misrepresent the exclusion's scope and effect. Recently, the United States District Court for the Eastern District of Pennsylvania denied an insurance company's motion to dismiss claims of a conspiracy to misrepresent the facts and bad faith regarding the development of the pollution exclusion.[96] This holding recognizes conspiracy as a viable cause of action.[97] Judicial recognition of such causes of action has already spawned additional cases using the same legal theory.[98] Such causes of action may prove crucial in overcoming state law precedent where the pollution exclusion has been held unambiguous and the term "sudden" has been interpreted to mean abrupt or instantaneous, thereby introducing a temporal requirement into insurance coverage for pollution events.[99]

VII. Conclusion

At issue is the scope of the pollution exclusion as the industry represented it to the insurance regulators, policyholders, and the public in the early 1970s. Numerous businesses

95. *See Cipollone*, 505 U.S. at 504 n.25 and accompanying text.

96. *See* Continental Casualty Co. v. Diversified Indus., Inc., 884 F. Supp. 937, 959 (E.D. Pa. 1995).

97. *Id.*

98. *See, e.g.*, Hyde Athletic Indus., Inc. & Saucony Shoe Mfg. Co., v. Continental Ins. Co. et al, C.A. No. 95-5822 (E.D. Pa. 1995).

99. *See supra* notes 35-38 and accompanying text.

and municipalities face substantial liability from unexpected, unintended, and gradually occurring pollution. Entities that purchased CGL insurance policies in reliance on the representations of the insurance industry and the subsequent approval of the "clarifying" language by insurance regulators are entitled to insurance coverage for such liability. At a minimum, the insurance industry should be estopped from denying the same protection that the insurance companies sold, as represented to state insurance regulators, policyholders, and the public.

Evidence that a conspiracy existed within the insurance industry surrounding the development of the pollution exclusion goes beyond the issues of intentional misrepresentation and estoppel, and clears the way for tort claims for punitive damages. The viability of a conspiracy claim and the judicial recognition of associated causes of action represent a powerful tool to force the insurance industry to shoulder its fair share of environmental liability. Moreover, such causes of action will likely force states that have previously ruled against CGL insurance policyholders to take a second look at precedents interpreting insurance contracts containing the pollution exclusion and the circumstances surrounding its development.

The added cost to society of the litigation spawned by this controversy must also be considered, particularly as the legislatures of several states and Congress consider legislation to reallocate the burdens of environmental liability between the insurance industry, government, and policyholders. The highly publicized "insurance crisis" should be evaluated in the context of the behavior of the insurance industry regarding the pollution exclusion before any such legislation is enacted.