December 2011

Idaho Federal Court Rules That Environmental Administrative Proceedings Constitute "Suits" Under Contracts For General Liability Insurance

In *Wells Cargo, Inc. v. Transport Insurance Co.*, 2011 WL 5080143 (D. Idaho Oct. 26, 2011), an Idaho federal court held that a CERCLA administrative proceeding constitutes a "suit" under Idaho law and, therefore, the costs of responding to such proceedings qualify as covered defense costs under contracts for general liability insurance. The district court also held that, under conflict of laws principles, Idaho is the principal location of the insured risk and, thus, Idaho law governs the substantive insurance issues even though the policies were drafted elsewhere and the additional insureds at issue were located outside the state.

Background

In *Wells Cargo*, the United States Department of Agriculture Forest Service ("U.S. Forest Service") brought a Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") action arising out of environmental pollution and contamination at the North Maybe Mine in southeast Idaho. Since Wells Cargo Inc. ("Wells Cargo") conducted mining operations at the mine from 1965 to 1967, the U.S. Forest Service identified Wells Cargo as a potentially responsible party ("PRP") for cleanup costs.

Wells Cargo was insured by Transport Insurance Company ("Transport"). After Wells Cargo was forced to defend itself in the action, Wells Cargo filed a declaratory judgment action, seeking a declaration that Transport was required to defend and indemnify Wells Cargo for the CERCLA action under its insurance policies. Wells Cargo also sought damages for breach of contract.

The parties cross moved for summary judgment concerning: 1) whether the CERCLA action constitutes a "suit" under the insurance policies; 2) even if the CERCLA action constitutes a suit, whether costs associated with and paid in connection with the Remedial Investigation/Feasibility Study ("RI/FS costs") constitute defense or indemnity costs under the insurance policies; and 3) what substantive state law should control the outcome of these issues.

Holding

After determining that Idaho law applies, the district court granted partial summary judgment in favor of Wells Cargo, finding that CERCLA administrative proceedings initiated by PRP letters constitute "suits." The district court also held that RI/FS costs, generally, are defense costs that may be covered by insurance, although an evidentiary hearing may be necessary before specific findings on the issue of costs can be made.

As a threshold matter, the district court addressed which law will apply under Idaho's conflict of laws principles. Under Idaho law, Section 193 of the Restatement (Second) of Conflict of Laws resolves conflict of laws issues involving insurance coverage. Pursuant to Section 193, "the law of the state which is the principal location of the insured risk will be applied unless with respect to the particular issue, some other state has a more significant relationship … to the transaction and the parties."

Transport argued that, regardless of the principal location of the insured risk, California law should apply because California has the most significant relationship to the parties and the policies. Transport noted that the policies were drafted in California, that Wells Cargo's former president attended board meetings in California and that the policies identified additional insureds in California. But, the district court rejected Transport's arguments, finding that Transport ignored the clear presumption created by Section 193 in favor of the location of the insured risk. And, where the insured risk was the environmental cleanup of an Idaho mining project, the principal location of the insured risk was clearly Idaho.

Next, the court addressed whether Transport had a duty to defend Wells Cargo in the CERCLA action. Although the parties agreed that Transport had a duty to defend Wells Cargo against "suits" generally, the parties disagreed about whether CERCLA administrative proceedings initiated by PRP letters, as here, constitute "suits" under the policies.

The district court looked at the plain meaning of the policy language and followed the Ninth Circuit's decision in *Aetna Casualty & Surety Co. Inc. v. Pintlar Corp.*, 948 F.2d 1507, 1517 (9th Cir. 1991), to determine that a "PRP letter is similar to a complaint, and is therefore the effective commencement of a 'suit' which triggers the duty to defend." In so holding, the district court relied on *Pintlar* and found that "coverage should not depend on whether the [governmental agency] chose to proceed with its administrative remedies or go directly to litigation." Rather, the focus should be on the underlying purpose of the insurer's duty to defend — to protect the policyholder when its rights are potentially in jeopardy — not "on the formalistic rituals." Thus, here, where the filing of an administrative claim is a "clear signal that legal action is at hand," the district court held that the CERCLA administrative proceeding initiated by a PRP letter must constitute a "suit."

After concluding that the CERCLA action was a suit under the policies, the district court held that Transport had a duty to defend Wells Cargo, finding there to be several instances where the U.S. Forest Service asserted allegations that, if found true, would create the potential for liability for property damage covered by the Transport policies. And, because there was a potential for coverage under the insurance policies, Transport's duty to defend was triggered.

Finally, the court addressed whether the RI/FS costs are defense costs covered by insurance. Transport argued that, although RI/FS costs may be covered as indemnity costs, they are not covered as defense costs. Wells Cargo argued that the costs are defense costs because, by conducting the RI/FS, Wells Cargo is investigating and defending the CERCLA action in the same manner it would defend an environmental lawsuit.

The district court agreed with Wells Cargo, finding that Wells Cargo must conduct the RI/FS study to determine the most cost-effective remedy for minimizing or absolving itself of liability and that doing so was necessary to its defense. The court concluded, therefore, that Wells Cargo "prudently participated in the RI/FS process as a means of defending the CERCLA action." Accordingly, the court held that the RI/FS costs could qualify as defense costs under the policies.[1]

Implications

Wells Cargo is a significant decision for policyholders because it recognizes that administrative proceedings under CERCLA, and the costs of responding to such proceedings, may qualify as defense costs under contracts for general liability insurance. Such a recognition carries particular significance in today's economic environment where policyholders are increasingly being required to respond to governmental and regulatory investigations to ascertain compliance with a wide variety of legal and

[1] The district court further held that the court may need to conduct an evidentiary hearing before specific findings on the issue of costs are made.

administrative constraints. Where a failure to adhere to those constraints may subject the policyholder to liability, the cost of responding to the investigation may be covered, and the investigation may merit a defense.

Contacts

Walter J. Andrews
wandrews@hunton.com

Lon A. Berk
lberk@hunton.com

Lawrence J. Bracken II
lbracken@hunton.com

John C. Eichman
jeichman@hunton.com

Robert J. Morrow
rmorrow@hunton.com

Curtis D. Porterfield
cporterfield@hunton.com

Syed S. Ahmad
sahmad@hunton.com

Michael S. Levine
mlevine@hunton.com

Sergio F. Oehninger
soehninger@hunton.com

William T. Um
wum@hunton.com