Monday, May 12, 2008

THE DAILY RECORD

WESTERN NEW YORK'S SOURCE FOR LAW, REAL ESTATE, FINANCE AND GENERAL INTELLIGENCE SINCE 1908

Can coverage exist despite the pollution exclusion?

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Many insureds believe that it is a fait accompli that any insurance coverage for a pollution event is completely barred if the policy has a pollution exclusion.

The recent Third Department case of City of Kingston v. Harco National Insurance Co., 2007 NY Slip Op 10458; 46 A.D.3d 1320; 848 N.Y.S.2d 455, 2007 N.Y. App. Div. LEXIS 13228 demonstrates the danger of that assumption and the necessity of conducting a thorough review of the policy terms, the facts surrounding the precipitating event, and any disclaimer notice received from the carrier.

The case arose because of a sewer main break in January 2004. Many residents of the city of Kingston were forced from their homes when the ruptured main released a flood of water and raw sewage into their neighborhood.

Some residents then sued the city in Supreme Court, Ulster County, for property damage, personal injury, emotional distress and other claims.

The city sought indemnity and defense from its insurer, Harco National Insurance Co.

In a letter citing the total pollution exclusion contained in its policy, Harco disclaimed coverage for claims that "would not have occurred in whole or in part but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants at any time." City of Kingston v. Harco National Insurance Co. at 1321.

"Pollutants," as defined in the policy, were "any solid, liquid, gaseous, or thermal irritant or contaminant including but not limited to, smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." Id. at 1321.

Kingston brought an action seeking a declaratory judgment that Harco was required to defend and indemnify it. Harco sought summary judgment, and the city cross-moved for summary judgment as well. The supreme court denied Harco's motion and partially granted that of the city, holding that Harco was required to defend the City against the residents.

Harco appealed.

The Appellate Division affirmed the lower court's decision holding that Harco did have a duty to defend Kingston but left the issue of the duty to indemnify for proof at trial.

The court cited The Town of Massena v Healthcare Underwriters Mut. Ins. Co., 98 NY2d 435, 443 which said, "[i]f any of the claims against [an] insured arguably arise from covered events, the insurer is required to defend the entire action." City of Kingston v. Harco National Insurance Co. at 1321-1322.

The court reasoned that it is the insurance company's burden to prove: (1) that the exclusion covers all of the allegations made in the pleadings; (2) that there is no other interpretation of the exclusion that can be reasonably made; and (3) that no provision in the policy provides a legal or factual basis to create a right of indemnity.

In its analysis, the Third Department assumed, but did not decide, that raw sewage was a contaminant falling within the pollution exclusion in the policy. After reviewing the complaints and the testimony of some defendants before trial, the Court concluded that this extrinsic evidence could be used to determine that some of the damage had occurred because of the enormous flood of water.

Therefore, Harco had failed to show that there was no "possible factual or legal basis upon which it ultimately could be obligated to indemnify [the] plaintiff." Id. at 1322.

The Appellate Division also dispensed with Harco's argument that "the fungi or bacterial exclusion in the policy provided an alternate basis for denying coverage." Id. at 1321.

Harco failed to refer to that exclusion in its disclaimer letter, and insurance case law (Maroney v New York Cent. Mut. Fire Ins. Co., 10 AD3d 778, 780-781, 782 N.Y.S.2d 287 [2004], affd 5 NY3d 467, 839 N.E.2d 886, 805 N.Y.S.2d 533 [2005]) firmly supports the principle that "an insurer's disclaimer is strictly limited to those grounds stated in the notice of disclaimer, which disclaimer must clearly apprise the insured of the grounds on which the disclaimer is based." Id. at 1321.

No reference to the fungi/bacterial exclusion in the disclaimer letter = no basis for disclaiming coverage.

Although Harco subsequently made a motion for leave to appeal to the Court of Appeals in this case, that court dismissed the motion without a published opinion on the ground that the order to be appealed from did not finally determine the action pursuant to the Constitution. City of Kingston v. Harco Nat'l Ins. Co., 2008 N.Y. LEXIS 1028 (2008).

This case, like many other insurance disputes, highlights the importance of reading and understanding the terms of the policy at issue, the facts surrounding an event and the rationale of any insurance disclaimer received. For plaintiffs' lawyers it is a reminder; for insurers it is a lesson.

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