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# Non-Disclosed Exercise Of Governmental Powers, However Negligent, Constitutes Neither A "Willful Act" Nor "Concealment"

By Robert Y. Chung

On May 16, 2005, a Riverside County, California jury rejected arguments by insurance companies that the State of California should be denied coverage under its general liability policies because of the State's mistakes in exercising its regulatory powers during the selection, design, and construction of the Stringfellow Acid Pits, a Class I toxic waste site. The jury found that the insurance companies, including CNA, Wausau, Yosemite, Horace Mann (ACE), and Stonebridge Life Insurance Company, breached their insurance contracts with the State, rejected all coverage defenses, and found that those policies provided coverage for the cleanup of the Stringfellow site.

During the 1950s, the State of California worked with the owner of the Stringfellow site for the purpose of establishing a site at the Stringfellow quarry so that industries in Southern California had a central location to remove their toxic waste. As a result of the negligent selection, design, and construction of the Stringfellow site, third party property damage, as defined in the State's general liability policies, resulted continuously during the years including 1963 through 1976. Although two overflows of contamination were discovered and acted upon in 1969 and 1978, by 1981 the Stringfellow site was found to be leaking. A federal action was brought against the State of California and other potentially responsible parties pursuant to CERCLA (Comprehensive Environmental Response, Compensation and Liability Act of 1980) for damages in connection with property damage arising out of the Stringfellow Site. By then, remediation of the site was well underway by the State. In September of 1998, judgment was entered against the State. The State sough the benefits of its liability insurance policies for the environmental liabilities. The State's liability insurance claims were denied.

During the six week jury trial, the insurance companies attempted to frame the State's acts in connection with the selection, design, and operation of the Stringfellow waste site as (1) a "willful act" as to which the State expected that damage was highly likely or substantially certain to result from a deliberate, liability producing act, thus violating Section 533 of the California Insurance Code and (2) a "material fact" which the State intentionally concealed from the insurance companies. Additionally, Stonebridge tried a "lost policy" defense. Each insurance company argument was rejected by the jury.

*"Every underwriter is presumed to be acquainted with the practice of the trade he insures..."*
*—Lord Mansfield*

All policyholders, including governmental entities, can draw the following basic lessons from this case when confronted with insurance companies who overreach in asserting similar defenses.

First, the insurance companies incorrectly asserted a defense that the State's "willful acts" precluded coverage. Insurance companies similarly generally incorrectly assert defenses of no "fortuity" or that damage or injury was "expected or intended". In California, Insurance Code Section 533 states that:

> "An insurer is not liable for a loss caused by the willful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agents or others."

Section 533's purpose is twofold:

1. to permit coverage for any form of negligence and,
2. to preclude coverage only for willful

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wrongs.

Section 533 is a public policy exclusion designed to discourage acts that are against public policy.

Here, the State's activities in connection with the selection, construction, and operation of the Stringfellow site did not result in a "loss caused by the willful acts of the insured", but were in furtherance of public policy and were not the types of egregious activities contemplated by Section 533. At trial, the State demonstrated that those acts, no matter how negligent, did not rise to the level of an intentional act which would constitute a violation of Section 533 or void coverage.

Second, the Insurance Companies incorrectly asserted a defense of concealment of risk in the policy application process. This also is a common defense raised by the insurance companies to turn the spot-light on the policyholder's behavior rather than the insurance companies' improper denial of the claim. California has codified the insurance defense of concealment under Section 332 of the California Insurance Code:

> "Each party to a contract of insurance shall communicate to the other, in good faith, all facts within his knowledge which are or which he believes to be material to the contract and as to which he make no warranty, and which the other has not the means of ascertaining."

Consistent with the general custom and practice in the insurance industry, however, the Code also contains numerous statutory exceptions. Primarily, under Section 333: "Neither party to a contract of insurance is bound to communicate information of the matters following, except in answer to the inquiries of the other:

1. Those which the other knows.
2. Those which, in the exercise of ordinary care, the other ought to know, and of which the party has no reason to suppose him ignorant.
3. Those of which the other waives communication." Each of these factors defeat an insurance company's allegations of concealment.

There also is no need for a party to an insurance contract to disclose all "the general causes which are open to his inquiry equally with that of the other, and which may affect either the political or material perils contemplated" or "the general usages of

*"Non-Disclosed Exercise" continued p3*


"As the Texas Supreme Court has said, the object of insurance is to insure."

*Answer on page 3*

*"Non-Disclosed Exercise" continued from p2*

trade," since each party is "bound to know" such matters. Cal. Ins. Code § 335. Nor is a policyholder required to speculate about the likelihood and likely results of future proceedings. A policyholder is required only to disclose its actual knowledge, not matters of opinion. "Neither party to a contract of insurance is bound to communicate, even upon inquiry, information of his own judgment upon the matters in question." Cal. Ins. Code § 339.

There is no reason the State or any other policyholder should forfeit its coverage for failure to anticipate the changes in the law (e.g., enactment of CERCLA in 1980) which ultimately led to its environmental liabilities. A policyholder only is required to disclose material facts "within his knowledge" when procuring insurance. If the applicant for insurance has no present knowledge of the facts sought, or failed to appreciate the significance of information related to the policyholder, the policyholder's incorrect or incomplete responses would not constitute grounds for rescission. The extent of such knowledge is tested by the policyholder's good faith belief at the time of application, and subsequent events proving it to be unfounded or false do not void the policy. There must first be actual knowledge of the fact alleged to be concealed. Like the standard for materiality of such facts, the test should be a subjective one.

As explained long ago by Lord Mansfield, the father of common law and insurance law: "Every under-writer is presumed to be acquainted with the practice of the trade he insures, and that whether it is recently established, or not. If he does not know it, he ought to inform himself." *Noble v. Kennoway*, 2 Doug. 511 (K.B. 1780).

Indeed, during discovery we found out that some of the very same insurance companies involved, including the lead underwriter, sold policies to the owner of the site specifically providing coverage for toxic waste disposal at the Stringfellow site. At the same time, those insurance company defendants invoked "post-loss underwriting" by denying any claim under its general liability policies in connection with any undisclosed activities in which the policyholder was engaged at the time the policies were sold, regardless of whether the policyholder was aware it could be held liable for damages.

The State of California presently is pursuing its bad faith claims against any non-settling insurance company defendants.

Bob Horkovich, Robert Chung, and Cort Malone from Anderson Kill & Olick in New York represented the State of California along with Lead Supervising Deputy Attorney General Darryl L. Doke from Sacramento, Deputy Attorney General Don Robinson from Los Angeles, Roger Simpson from Cotkin Collins & Ginsburg in Los Angeles, and Dan Schultz from Tempe, Arizona.

**Robert Y. Chung** is an attorney in the New York office of Anderson Kill & Olick, P.C. Mr. Chung has extensive experience in insurance recovery litigation. Mr. Chung can be reached at (212) 278-1039 or rchung@andersonkill.com.

## Announcement

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announce that

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A Managing Partner of the
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in insurance coverage disputes.

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**a WHO SAID WHAT?**

**CNA Insurance Companies and Columbia Casualty Company,** Plaintiff's Reply to Columbia's and CNA's Response to Plaintiff's Motion for Partial Summary Judgment at 7, dated June 18, 1992, *National Union Fire Insurance Co. of Pittsburgh, PA v. CNA Insurance Cos.*, No. L-90-55-CA (E.D. Tex).

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