ENVIRONMENTAL LOSSES: THE SUPREME COURT CHANGES THE RULES ON CONTRIBUTION CLAIMS

COOPER INDUSTRIES, INC. VS. AVIALL SERVICES, INC

The Supreme Court opinion in *Cooper Industries, Inc. vs. Aviall Services, Inc.*, 543 U.S. 157, 125 S.Ct. 577 (2004) (*Aviall*) dramatically changed how environmental losses are handled by requiring a lawsuit to be filed against a contaminating party before that party can seek contribution from other responsible parties. The significance of the *Aviall* decision cannot be underestimated, as it altered well-established law decided years earlier in *Key Tronic Corp. vs. U.S.*, 511 U.S. 809, 818, 114 S.Ct. 1960 (1994) (*Key Tronic*). This article examines the impact of *Aviall* on environmental losses and suggests mechanisms which may avoid its impact.

The *Aviall* case involved four contaminated aircraft engine maintenance sites in Texas. Cooper Industries owned and operated the sites until 1981, when they were sold to Aviall Services. Aviall subsequently discovered that Cooper had contaminated the ground and ground water with petroleum and other hazardous substances leaking from underground storage tanks and spilled on the surface.

Aviall notified the Texas Natural Resource Conservation Commission of the contamination. The Commission directed Aviall to clean up the site and threatened to sue if Aviall failed to do so.

Neither the Commission nor the EPA ever took judicial or administrative measures to compel clean up. Aviall began cleaning up the properties in 1984. It later sold the properties to third parties, but remained contractually liable for clean-up expenses up to $5,000,000. Aviall then sued Cooper in federal court, seeking to recover those clean-up costs. The Complaint was based on the Comprehensive Environmental

Continued on page 2

CERCLA allows persons who have undertaken efforts to clean up properties contaminated by hazardous substances to seek contribution from other parties responsible for the contamination. The issue before the Supreme Court in Aviall was when a party, who participated in contaminating property/groundwater, can sue another potentially-responsible party (PRP) who contributed to the contamination pursuant to Section 113(f)(1) of CERCLA. The Supreme Court in a 5 to 2 decision answered: only after the party has itself been subjected to suit under Section 106 or 107(a) of CERCLA. Absent an environmental lawsuit brought against it, Aviall could not sue Cooper Industries, even though Cooper likely had far more responsible for the contamination at the site based on its length of occupancy of the property.

**WHAT ARE THE IMPACTS OF THE COOPER INDUSTRIES OPINION?**

Prior to Aviall, courts regularly permitted a party involved in the voluntary clean up of contaminated property to sue another PRP for contribution to the costs of cleaning up the contamination. Courts reasoned the original party could sue a PRP because it assisted in getting a contamination clean up, citing the earlier Supreme Court decision in Key Tronic. One impact of Aviall is to increase the number of lawsuits which will be filed in environmental cleanups. Now parties who need to sue other PRP’s will require government agencies to sue so they can bring in other parties. This increases costs for all parties and insurers involved. It does not make a significant difference on the actual clean up, because regulatory agencies were already involved in setting clean up standards at the contaminated property before Aviall.

**FEDERAL DECISIONS AFTER AVIALL**

The Aviall decision left open the issue of whether parties who voluntarily clean up environmental contamination can bring a contribution claim based on Section 107(a) of CERCLA. Several federal courts had previously held that a contribution right was “implied” in Section 107(a).

Public policy should support permitting a party, who cleaned up contamination without being sued, to seek contribution. Otherwise, the law discourages clean ups before agencies file suit. In theory, the law should encourage a PRP to work voluntarily with a governmental agency rather than requiring a suit solely to permit recovery of clean up costs against another PRP. However, a number of district courts have disagreed on this public policy issue debate. For example, a California federal district court has applied the public policy argument to permit contribution after Aviall, even though no suit had been filed against the party bringing the action. Adobe Lumber vs. Taeker, 2005 W.L. 1367065. (E.D. Cal. 2005) District courts in Texas and Illinois have issued similar rulings. Vine Street LLC v. Keeling, 362 F.Supp.2d 754 (E.D., Texas, 2005); Metropolitan Water Reclamation District of Chicago v. Lake River Corp., 365 F.Supp.2d, 913 (N.D. 111, 2005). In Virginia, one district court found there could be no implied right of contribution, rejecting the public policy argument, Mercury Mall Associates, Inc., vs. Nick’s Market, Inc. (2005) 368 F.Supp.2d 513. (E.D. Va., 2005). The Virginia court has been joined by district courts in New York, New Jersey, and Wisconsin in rejecting an implied contribution right. Element is
Another potential pitfall in environmental claims is the statute of limitation. Section 113 actions under CERCLA have a three-year statute of limitation. Section 107(a) actions under CERCLA have a six-year statute of limitations. These statutes of limitations can easily run if no agency has brought suit against the potentially-responsible party.

ALTERNATIVES TO EVALUATE POST-AVIALL

If contribution is barred, other causes of action should be considered. For example, a claim for injunctive relief under Section 7002 of the Resource Conservation Recovery Act (42 U.S.C. § 6972), can force other PRP’s to participate in the response action. That action would be limited to injunctive relief.

State law causes of action may also exist against non-governmental defendants, e.g., California Health and Safety Code Section 25363. Moreover, in California, a nuisance cause of action should be considered under Sections 3479 or 3480 of the Civil Code, or other common law causes of action such as trespass, waste, etc.

Care must be taken in evaluating how to handle environmental contamination claims post-Aviall. Considerable litigation will likely ensue until the Supreme Court resolves this issue conclusively. The issue left unresolved by the Supreme Court in the Aviall opinion is whether there is an implied right to contribution under Section 107 of CERCLA. We are waiting to see how the Supreme Court answers that question.

NEW SUBROGATION CASES

OWNER MAY BE LIABLE FOR FAILING TO PROVIDE FIRE EXTINGUISHERS

In Barclay vs. Jesse M. Lange Distributors, Inc. 129 Cal.App.4th 281, 28 Cal.Rptr.3d 242 (2005), plaintiff Randell Barclay was injured by an explosion while working for his employer (nonparty Chico Drain Oil) cleaning above-ground fuel storage tanks on land owned by defendant Jesse M. Lange Distributor, Inc. (Lange). Plaintiff filed suit against Lange and others, alleging negligence and premises liability. The trial court entered summary judgment in favor of Lange under the doctrine of Privette vs. Superior Court (1993) 5 Cal.4th 689, 21 Cal.Rptr.2d 72, 854 P.2d 721 (1993) and its progeny, pursuant to which a non-negligent property owner is generally not liable for injuries to an employee of an independent contractor hired to perform hazardous work on the property. Plaintiff appealed.

The California Court of Appeals reversed, ruling that Lange could be liable for the plaintiff’s injury based upon Lange’s breach of its own regulatory duties, regardless of whether or not Lange voluntarily retained control or actively participated in the project. The court cited trial court testimony that, contrary to the California Fire Code, Lange did not maintain a fire extinguisher within 75 feet of the tank. The Court further cited testimony that the plaintiff’s injury would have been much less severe had a fire extinguisher been available within 75 feet of the tank. (A fire extinguisher located over 150 feet away was used to douse the tank fire.) The court held that the violation of the Fire Code by Lange overcame the general doctrine that property owners are not liable for injuries on their property suffered by the employees of independent contractors.

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CONTRACTORS UNLICENSED AT THE COMMENCEMENT OF PERFORMANCE MAY NOT RECOVER COMPENSATION FOR ANY WORK PERFORMED

In MW Erectors, Inc. vs. Niederhauser Ornamental and Metalworks Company, Inc., 36 Cal.4th 412 (2005), the California Supreme Court held that, if a contractor is not properly licensed at the commencement of a job, the contractor cannot recover compensation for any work performed, including work performed after the contractor has obtained a proper license. However, if a contractor obtains a license prior to commencing work, the contractor is entitled to be paid even though the contractor was unlicensed when it successfully bid on the job.

Niederhauser Metalworks Company (Niederhauser) was a metal works subcontractor for construction of Disneyland’s Grand California Hotel. Niederhauser entered into two contracts with MW Erectors, Inc., one for structural steel work and the other for ornamental metals works. After several months of performance, Niederhauser terminated MW Erectors and MW Erectors sued Niederhauser for more than $1 million due on the two contracts. Niederhauser moved for summary judgment on the basis that MW Erectors did not have the required licenses for the first 18 days of performance on the first contract or at any time when work on the second contract was performed, so both contracts were thereby illegal and void at inception.

With regard to the first structural steel work contract, the Court looked at Business and Professions Code section 7031(a), which generally prohibits a contractor from maintaining an action to recover compensation for work performed unless it is properly licensed for the duration of the project. California appellate courts had issued several decisions in the past reducing the severity of licensing laws in order to protect contractors, one of which allowed compensation for that part of the job performed while the contractor was licensed. The California Supreme Court eliminated this exception, concluding that if a subcontractor performed any work while it was unlicensed, it could not sustain an action to recover any compensation for work performed on the project.

With regard to the second ornamental metal works contract, the Court recognized that although MW Erectors did not have a license when the contract was executed, it did have a Class C-51 structural steel contractor license when it commenced the work on the second contract. The Court rejected Niederhauser’s contention that the contract was illegal and void at inception because MW Erectors was not properly licensed when the contract was executed and because the C-51 license was not a proper license. The Court held that 7031(a) does not preclude recovery where a contractor is unlicensed at contract execution, but is licensed at all times during contract performance. The Court remanded the case to the trial court to determine whether a C-51 license was sufficient to perform ornamental metal type work.

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INSURER NOT SUBJECT TO BAD FAITH CLAIM FOR SUBROGATING AGAINST INSURED WITH NO COVERAGE FOR CLAIM

In general, insurers are not permitted to subrogate against their own insureds. For example, a tenant may be deemed to be an implied co-insured or the landlord’s first-party property policy if the lease provides that the landlord will maintain such insurance, barring a subrogation claim against the tenant for damaging the landlord’s property. Similar restrictions apply to subrogation claims against defendants covered by liability policies issued by the subrogating insurer. However, this doctrine applies only if the subrogation claim is actually covered by the liability policy issued by the subrogating insurer, as shown by McKinley vs. XL Specialty Insurance Co., 131 Cal.App.4th. 1572, 33 Cal.Rptr.3d 98 (2005).
In *McKinley*, the court held that the renter of an aircraft could not pursue a bad faith claim against the insurer of the aircraft who had unsuccessfully pursued a subrogation action against the renter for damage to the plane, even though the renter was an additional insured under the liability coverage provided for the plane by the subrogating insurer. The pilot rented the plane from a flight school and signed a rental agreement which stated that the pilot renting the aircraft assumed full financial responsibility for any loss, theft, casualty or damage caused to the aircraft.

Although the flight went smoothly, the landing did not, causing damage to the aircraft’s hull. The insurer of the aircraft paid for the damage to the plane, and then brought a subrogation action against the renter. The matter went to arbitration, where the renter was found not liable for the damages. The renter then filed a bad faith action against the insurer claiming she was an insured under the liability coverage provided by the policy, so the insurer should not have sued her in subrogation.

The court held that, if the policy did not cover the renter for the loss or liability which was the basis for the subrogation action, a subrogation against the pilot would be proper. The court found that the pilot could be provided insurance under policy for third party claims. However, the court noted that the coverage for the damage to the aircraft was provided under the first party property damage coverage, not the third party liability coverage, so the pilot was not an insured with respect to the damages arising out of the incident. The court reasoned that the damage to the aircraft did not involve damage to a third party’s property, so the liability coverage did not apply.

The court also noted that the rental agreement did not create an “insured” relationship between the renter and the insurer with respect to first-party property coverage. The rental agreement included a statement that the pilot was strongly encouraged to take out renter’s insurance, and that the pilot assumed full financial responsibility for any loss, casualty or damage caused to the aircraft. Thus, the court held that the insurer, who had paid a claim for damage to rented equipment, could not be said to have acted in bad faith in seeking subrogation from a renter reasonably believed to have caused the damages to the aircraft.

This case provides assistance in pursuing claims against renters claiming to be an “implied insured” under a rental agreement, when the terms of agreement indicate otherwise. It may also be of assistance in overcoming the “anti-subrogation rule,” when a party claims that, because the insurer provides some coverage on its behalf, the insurer is prevented from pursuing subrogation against the “insured” for damages, even though the damages were caused by circumstances outside the coverage of the policy.

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**NEW COVERAGE CASES**

**INSURER ENTITLED TO RETROACTIVE REIMBURSEMENT OF DEFENSE COSTS WHERE INSURER IS SUCCESSFUL IN OBTAINING JUDICIAL DETERMINATION OF LACK OF COVERAGE AS A MATTER OF LAW**

In *Blue Ridge Insurance Co. vs. Jacobsen* 25 Cal.4th 489, 106 Cal.Rptr.2d 535 (2001), the California Supreme Court held that an insurer, having properly reserved its rights to dispute coverage, may settle a third party action within the policy limits, even over the insured’s objection, then obtain reimbursement of its settlement payments from the insured upon a later judicial determination that the underlying claims were not covered. In *Buss v. Superior Court* 16 Cal.4th 35, 65 Cal.Rptr.2d 366 (1997), the California Supreme Court held that an insurer with a duty to defend must pay for the defense of uncovered as well as covered claims, subject to a right of reimbursement for

Continued on page 6
defense costs solely allocable to uncovered claims. In its new decision in *Scottsdale Insurance Company vs. MV Transportation* 36 Cal.4th 643 (2005), the California Supreme Court has upheld the insurer’s right to reimbursement to all defense costs paid under reservation of rights after a court finds, as a matter of law, there never was a duty to defend. *MV Transportation* holds that an insurer, under a standard commercial general liability (CGL) policy, which specifically reserves its rights to do so, may advance sums to defend its insured against a third-party lawsuit and thereafter obtain reimbursement of all defense costs from the insured if it is determined that no duty to defend ever existed, because, as a matter of law, the policy never afforded any potential coverage.

After hiring employees of a major competitor, MV was sued by the competitor for trade secret theft and related claims. The competitor alleged that MV had used proprietary information in preparing competitive bids for specific contracts. MV tendered defense to Scottsdale under the advertising injury coverage of its CGL policy. Asserting that the competitor’s claim was not covered as advertising injury, Scottsdale accepted the tender with a reservation of “[t]he right to seek reimbursement of defense fees paid toward defending causes of action which raise no potential for coverage.”

Scottsdale filed a declaratory relief action against MV and moved for summary judgment. Scottsdale’s motion was denied. Two years later, the Supreme Court held in *Hameid vs. Nat’l Fire Ins. Of Hartford* 31 Cal.App.4th 15, 1 Cal.Rptr.3d 401 (2003) that “advertising injury” as used in a similar CGL policy meant “widespread promotional activities usually directed to the public at large.” Relying upon *Hameid*, the Court of Appeal reversed the trial court’s denial of summary judgment and held that the competitor’s claim concerning bidding improprieties directed at specific contracts could not possibly be covered under the advertising injury coverage of the MV policy. The court of appeal held, however, that, once it began paying for MV’s defense, Scottsdale’s defense duty to MV was not “extinguished” until there had been a judicial determination that no potential for coverage existed. The court held that Scottsdale could have limited its defense obligation by either: 1) denying MV’s tender (thus risking a bad faith suit by MV); or 2) accepting the tender and seeking a prompt declaration of its rights and duties while the third-party suit was proceeding. Having failed to do either, Scottsdale could not recoup defense fees already advanced.

The Supreme Court reversed, holding that Scottsdale properly reserved its rights and was entitled to reimbursement of all defense costs, because, as a matter of law, a duty to defend never arose. The Supreme Court expressly approved such reimbursement in cases where the law on the existence of coverage is unsettled at the time of tender, and the lack of the possibility of coverage can only be determined with certainty later, with the benefit of “hindsight.” The Supreme Court stated: “[a]n insurer facing unsettled law concerning its policies’ potential coverage of the third party’s claims should not be forced either to deny a defense outright, and risk a bad faith suit by the insured, or to provide a defense where it owes none without any recourse against the insured for costs thus expended. The insurer should be free, in an abundance of caution, to afford the insured a defense under a reservation of rights, with the understanding that reimbursement is available if it is later established, as a matter of law, that no duty to defend ever arose.” *Id.*, 36 Cal.4th at 660. However, the Supreme Court confirmed that a factual dispute over the existence of coverage bars reimbursement of defense costs prior to termination of the duty to defend by a judicial determination of non-coverage. If there is a disputed issue of fact governing the existence of coverage, the insurer must obtain a judicial determination that there is no coverage to terminate the duty to defend, and defense costs incurred prior to that determination will not be reimbursable.
The lesson of this case is that where an insurer is uncertain if coverage exists, especially where the law is unsettled, and the insurer under takes the defense of its insured, the insurer should expressly reserve the right to seek reimbursement of all defense payments, should it later be judicially determined that no duty to defend ever existed.

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