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Is There A Hidden Omission In Your E&O Policy?

Law360, New York (December 16, 2008) -- To err is human, to insure against errors is prudent. Therefore, cautious professionals cloak themselves with the protective mantle of Professional Liability Errors and Omissions (E & O) coverage.

Even very careful professionals do so, for in a society as litigious as ours, perfect, negligence-free performance of your professional duties cannot eliminate the risk of a suit for damages based on an alleged failure to perform as promised.

Professionals thus sleep a little more easily when they have E & O coverage to insure against their own errors and those of their employees. A recent federal appellate decision, however, is bound to cause some sleepless nights both for such professionals and for their clients.

In a case of first impression, the Court of Appeals for the Eleventh Circuit created an immense gap in E & O coverage when it determined that a pollution exclusion clause precluded coverage for the errors of an environmental consultant in its conduct of a Phase I investigation. James River Insurance Company v. Ground Down Engineering Inc., 540 F.3d 1270 (11th Cir. 2008).

The facts of the case are typical of site cleanups. A predecessor of Priority Development LP (Priority), a prospective purchaser of property, wished to qualify for a liability defense found in the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).

The defense insulates purchasers from CERCLA's onerous liability regime, which normally covers owners of contaminated sites even if they did nothing to create the contamination, if they satisfy several statutory requirements, including appropriate pre-acquisition due diligence. 42 U.S.C. §§ 9601(40), 9607(r); 40 C.F.R. pt. 312.

Priority hired Ground Down Engineering Inc. (Ground Down) to conduct the required pre-acquisition environmental inquiries.

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Specifically, Ground Down was hired to determine whether there were indications of an existing release, a past release or a material threat of a release of hazardous substances or petroleum products on the property, referred to as "Recognized Environmental Conditions." 540 F.3d. at 1272.

In its assessment report, Ground Down reported that it had not found any recognized environmental conditions, and relying on that report, Priority purchased the property.

Subsequently, when developing the property, it discovered construction debris, several 55-gallon drums and half of an underground storage tank.

As a result, Priority sued Ground Down, alleging a failure to properly perform the environmental assessment and a failure to recommend additional environmental assessments that might have led to the discovery of the debris, drums and tank.

Priority asserted three counts against Ground Down, breach of contract, promissory estoppel and negligent misrepresentation. It also asserted a single count for negligence against Laurel A. Hall, the environmental engineer in charge of the assessment. Answer Brief of Appellee Priority Development LP, 2007 WL 5444871.

Ground Down tendered the complaint to its professional liability carrier, James River Insurance Company, for a defense and indemnity. James River provided a defense under a reservation of rights, but subsequently filed a declaratory judgment action, alleging that a pollution exclusion in Ground Down's policy excluded coverage.

The district court dismissed the action, finding that the exclusion did not exclude coverage for Ground Down's alleged errors in performing its contract for Priority.

On appeal, the Court of Appeals for the Eleventh Circuit vacated the dismissal and remanded the matter with instructions to the district court to enter summary judgment in favor of James River.

James River had issued Ground Down an Architects and Engineers Professional Liability Insurance policy, which provided coverage for claims "arising out of or resulting from the performing or failure to perform 'Professional Services.'"

At first blush, Priority's claims against Ground Down would appear to be covered by the policy. However, the policy also contained a very broad pollution exclusion. This exclusion provided:

Absolute Pollution And Pollution-Related Liability — Exclusion

Pollution/environmental impairment/contamination is not covered under this policy, nor are any expenses nor any obligation to share damages with or repay anyone else who must pay damages from same in conjunction with occurrences arising out of or alleged to have arisen out of same.

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All liability and expense arising out of or related to any form of pollution, whether intentional or otherwise and whether or not any resulting injury, damage, devaluation, cost or expense is expected by any insured or any other person or entity is excluded throughout this policy.

This insurance does not apply to any damages, claim, or suit arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of “pollutants” including but not limited to any:

Any loss, cost, expense, fines and/or penalties arising out of any

(1) request, demand, order, governmental authority or directive or that of any private party or citizen action that any Insured, or others, test for, monitor, clean up, remove, contain, treat, detoxify or neutralize or in any way respond to, or assess same, the effects of pollutants, environmental impairments, contaminants or

(2) any litigation or administrative procedure in which any Insured or others may be involved as a party as a result of actual, alleged or threatened discharge, dispersal, seepage, migration, release, escape or placement of pollutants, environmental impairments, or contaminants into or upon land, premises, buildings, the atmosphere, any water course, body of water, aquifer or ground water, whether sudden, accidental or gradual in nature or not, and regardless of when.

“Pollutants” mean any solid, liquid, gaseous, fuel, lubricant, thermal, acoustic, electrical, or magnetic irritant or contaminant, including but not limited to smoke, vapor, soot, fumes, fibers, radiation, acid, alkalis, petroleums, chemicals or “waste”. “Waste” includes medical waste, biological infectants, and all other materials to be disposed of, recycled, stored, reconditioned or reclaimed.

The district court concluded that the pollution exclusion did not apply because the claim arose from the failure of Ground Down to perform its professional responsibilities, not from pollution. It found that because Ground Down had not caused the pollution, the exclusion should not apply.

The district court noted that it would be “unconscionable at best” to hold that claims relating to “any form of pollution, regardless of causation” were excluded from coverage.

The district court was clearly reacting to the possibility that an environmental consultant would be deprived of coverage for the very type of work it was hired to do and for which it sought professional liability coverage.

Indeed, mistakes by an environmental consultant will very likely — if not always — involve claims relating to “pollution.”

The Court of Appeals clearly felt no such qualms. Applying Florida law, it held that the pollution exclusion barred coverage for the alleged inadequacies of Ground Down’s

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performance. Although there were no cases on point, it relied on language in other types of insurance cases to come to its conclusion.

The Eleventh Circuit began with the basic principle that the policy language is controlling and while ambiguous language is construed against the insurer, under Florida law the phrase “arising under” is not ambiguous.

Moreover, although courts in many other jurisdictions construe the coverage provisions in a policy broadly in favor of insureds and interpret exclusions narrowly, see, e.g., Mazzilli v. Accident & Cas. Ins. Co., 35 N.J. 1, 8 (1961) (strict interpretation of exclusion clauses), Florida does not appear to make such a distinction between coverage provisions and exclusions.

In a recent decision, heavily relied upon by the Eleventh Circuit, the Florida Supreme Court held that the term “arising out of” in the context of a products-completed operations hazard exclusion should be construed broadly.

Taurus Holdings Inc. v. United States Fidelity and Guaranty Co., 913 So. 2d 528 (Fla. 2005) (holding, in case where municipalities sued gun manufacturer seeking to recover costs of medical and other services incurred as result of gun violence in their communities, that “arising out of” was unambiguous and should be interpreted broadly regardless of context).

Given the state of Florida law, one cannot fault the Eleventh Circuit for finding that the phrase “arising from” is unambiguous. However, although the Court quotes Taurus Holdings on the meaning of “arising out of,” it failed to give effect to an important nuance expressed by the Florida Supreme Court in that case regarding causation:

The Florida Supreme Court held that the phrase “arising out of” is not ambiguous and should be interpreted broadly.

The court declared that “the term ‘arising out of’ is broader in meaning than the term ‘caused by’ and means ‘originating from,’ ‘having its origin in,’ ‘growing out of,’ ‘flowing from,’ ‘incident to’ or ‘having a connection with.’”

To have arisen out of something, there must be “some causal connection, or relationship” that is “more than a mere coincidence” but proximate cause is not required.

Ground Down, 540 F.3d at 1275. Thus, under Florida law as announced by Taurus Holdings, liability or an occurrence giving rise to liability does not “aris[e] out of” pollution unless there is a causal connection between the two.

The Eleventh Circuit misapplied this aspect of Taurus Holdings and found that the claim against Ground Down arose from pollution because the compensation demanded in the underlying complaint included the need for environmental remediation, as well as lost profits and lost property value. Id. at 1275.

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The “causal connection” found by the Eleventh Circuit, however, was quite attenuated. Ground Down had not been hired to search for construction debris, but rather to search for hazardous substances and petroleum.

Therefore, to allege that that Ground Down had improperly carried out its professional responsibilities, Priority had to allege that Ground Down failed to find hazardous substances and petroleum.

To connect construction debris to “hazardous substances,” Priority alleged that the construction debris caused elevated levels of methane gas.

The court seized upon this alleged connection, stating, “These claims for damages arise directly out of the alleged discovered pollution, and are covered explicitly by the exclusion. Although the alleged conduct was negligence in performing the site assessment, Priority’s claim depends upon the existence of the environmental contamination.” Id.

The court in Ground Down confused the nature of the damages sought in the underlying claims with the activity that gave rise to the claims. In this case, that activity was the alleged wrongful performance of the site assessment, not the existence of the contamination on the site.

The court attempted to bolster its finding of a causal connection by citing two cases that found the exclusion to bar coverage even when the insured was not the polluter.

However, both of those cases involved fraudulent concealment of pollution. Northern Ins. Co. of New York v. Aardvark Associates Inc., 942 F.2d 189, 194 (3d Cir. 1991); United States Fidelity & Guaranty Co. v. Korman Corp., 693 F. Supp. 253, 258 (E.D. Pa. 1988).

The court also quoted policy language clarifying the breadth of the exclusion: “Furthermore, we are bound by the plain language of the policy which states that the pollution exclusion applies regardless of whether the “cause for the injury or damage is the Insured's negligent hiring, [etc.] ... or wrongful act.”

This language implies the exclusion applies regardless of whether the pollution results from conduct by the insured.” Ground Down 540 F.3d at 1276. With all due respect to the court, the quoted language does not justify applying the exclusion to claims based on an alleged failure to discover contamination and not the contamination itself.

The court also distinguished a case whose facts actually match up much more closely with those of the Ground Down. In Evanston v. Treister, 794 F. Supp. 560, 571-72 (D.V.I. 1992).

In Triester, the insured, an architect, designed, approved, and supervised the construction of sewer and water lines for a municipality, and the water line was

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improperly placed beneath the sewer line in the same trench. When there was an outbreak of typhoid, the residents sued the government, which in turn sued the architect.

The Treister court determined that the pollution exclusion did not apply because the claims arose out of the improper performance by the architect.

The Eleventh Circuit distinguished the case on the grounds that the government was seeking recovery of the cost to replace the water and sewer lines, not damages as a result of pollution.

However, one could just as easily interpret replacement of the defectively installed water and sewer lines as "remediation." In short, the Eleventh Circuit's distinction is questionable.

The ramifications of the Ground Down case are significant. Environmental consultants are routinely called upon to perform Phase 1 assessments and Phase 2 intrusive sampling.

The risk of claims "having a connection with" pollution is substantial, because that is the very point of Phase 1 and Phase 2 investigations: to find out if there is pollution.

In addition, in connection with remedial activities, the risk of claims "having a connection with" pollution is equally high. Drilling, sampling, dredging and similar activities all entail the risk of mistakes involving pollution.

In light of Ground Down, it certainly behooves environmental consultants to reread their E & O policies carefully, and to analyze whether they need additional coverage if their policies have similar pollution exclusion clauses. They may find they have less coverage than they thought.

Similarly, those who retain environmental consultants would do well to request a copy of the consultant's policies in appropriate cases, rather that simply specifying requirements in terms of policy limits and insurance certificates.

This evaluation is particularly critical in situations where the consulting agreement limits the consultant's liability for damages arising out of its services to the insurance coverage under the consultant's own policies.

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