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## Allstate in brief

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Item Type	Article
Authors	Kozik, Benjamin
Publisher	UC Berkeley School of Law
Rights	With permission of the license/copyright holder
Download date	2026-07-09 17:56:24
Link to Item	<a href="http://hdl.handle.net/20.500.12424/175841">http://hdl.handle.net/20.500.12424/175841</a>

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# *Allstate* in Brief

## INTRODUCTION

In *State v. Allstate Insurance Co.*,<sup>1</sup> the California Supreme Court closed a loophole that had allowed insurers to escape their duty to indemnify the insured from “sudden and accidental” discharges of pollutants. This holding prevents non-negligent parties and future victims of environmental damages from bearing the ultimate financial burden of pollution.

## I. BACKGROUND

Most private and public liability insurance policies take one of two approaches to covering property damage caused by pollution. The majority of contemporary policies include *absolute* pollution exclusion clauses, which deny coverage for damages caused by all sources of pollution. Older policies usually contain *conditional* pollution exclusions, extending indemnity for damages resulting only from “sudden and accidental” discharges of pollutants.<sup>2</sup> While conditional pollution exclusions have fallen out of favor over the last two decades, all standard California Governmental Liability policies prior to 1986 contained similar “sudden and accidental” exceptions to standard pollution coverage exclusions.<sup>3</sup>

California courts have struggled with establishing the boundaries for “sudden and accidental” exceptions, reaching inconsistent conclusions regarding whether coverage extends to specific pollution events under different policies. Early guidance came from *Shell Oil Co. v. Winterthur Swiss Insurance Co.*,<sup>4</sup> in which an appellate court relied on the unambiguous meaning of the words “sudden” and “accidental” in rendering its decision. Shell Oil Company had been using water from three nearby lakes to cool chemical manufacturing equipment used in the production of pesticides. After wildlife began dying in the lakes, Environmental Protection Agency (EPA) investigators found chemical

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1. *State v. Allstate Ins. Co.*, 201 P.3d 1147 (Cal. 2009).

2. 4 NEIL SELMAN, CALIFORNIA INSURANCE LAW & PRACTICE § 49.39 (2009).

3. *Id.*

4. *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815 (Cal. Ct. App. 1993).

pesticides in the pipes that returned cooling water back to the lakes. Discharges contaminated with pesticides caused extensive damage, including the deaths of 1200 ducks in the spring of 1952 alone as well as crop failures in nearby farms.<sup>5</sup> Upon being cited by the EPA for environmental contamination, Shell sought indemnification from its insurers for the estimated 1.8 billion dollar cleanup costs.<sup>6</sup>

In evaluating the jury instructions given in the indemnification suit, the court reasoned from existing case law that “courts generally interpret coverage clauses broadly and interpret exclusions narrowly to protect the insured’s objectively reasonable expectations.”<sup>7</sup> With this rule in mind, the court held that the phrase “sudden and accidental” unambiguously refers to abrupt, unintended, and unexpected discharges of pollutants.<sup>8</sup> The court therefore held that the jury had been properly instructed with regards to the meaning of the policy’s “sudden and accidental” language.<sup>9</sup> Accordingly, any occurrence of pollution that does not meet the plain and simple meaning of the “sudden and accidental” exception would not be covered under conditional pollution exclusions in California.<sup>10</sup>

The California Supreme Court elaborated on this rule in *Aydin Corp. v. First State Insurance Co.*<sup>11</sup> The court held that in indemnity cases for damages caused by pollution, the insurer has the initial burden of showing the pollution exclusion applies. The burden then shifts to the insured to make a prima facie case that the pollution in question is covered by an applicable exception to the exclusion.<sup>12</sup> However, these shifting burdens are complicated when property damage is caused by multiple sources of pollution, only some of which qualify for coverage under “sudden and accidental” exceptions.

Since 2001, California appellate courts have reached similar conclusions in two cases involving indivisible damages caused by covered and non-covered discharges of pollution. In *Golden Eagle Refinery Co. v. Associated International Insurance Co.*, the court held that a policyholder is not entitled to indemnification if it is incapable of distinguishing those

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5. *Id.* at 826.

6. *Id.* at 827.

7. *Id.* at 829.

8. *Id.* at 840–41.

9. *Id.* at 842. However, the court remanded the case based on a separate erroneous jury instruction concerning the “expected and intentional” clause of Shell’s insurance policy. *Id.* at 836, 861.

10. See, e.g., *ACT Techs., Inc. v. Northbrook Prop. & Cas. Ins. Co.*, 22 Cal. Rptr. 2d 206, 214 (Cal. Ct. App. 1993) (holding that the gradual leakage of hazardous wastes over a thirty-year period does not fall under the exclusion exception because it does not meet the commonly accepted definition of the term “sudden”).

11. *Aydin Corp. v. First State Ins. Co.*, 959 P.2d 1213 (Cal. 1998).

12. *Id.* at 1219.

damages caused by “sudden and accidental” discharges of pollution from those excluded from coverage.<sup>13</sup> Between 1947 and 1984, Golden Eagle routinely released crude oil and crude oil derivatives into the soil surrounding its refineries.<sup>14</sup> While some of these discharges were sudden and accidental, the insurers presented evidence of forty years of repeated and intentional dumping at the site.<sup>15</sup> In 1985, the state of California required Golden Eagle to investigate and remediate the contamination at the site, leading to 150 million dollars worth of losses for the company.<sup>16</sup>

In its suit for indemnification, Golden Eagle argued that if it could prove any “appreciable amount of damage” was covered under the “sudden and accidental” exception, then the burden to show what portion of the damages should not be covered rested on the insurers.<sup>17</sup> The court rejected Golden Eagle’s “appreciable amount of damage” standard, holding that “where both covered and not covered events cause damages[,] a failure to differentiate and allocate is fatal to a claim for indemnity.”<sup>18</sup> Under this rule, the insured must show a causal connection between covered pollution events and the specific amount of damages these discrete events caused.<sup>19</sup>

The appellate court reaffirmed this holding four years later in *Lockheed Martin Corp. v. Continental Insurance Co.*<sup>20</sup> Lockheed sued for indemnification after it was cited by the EPA for contaminating thirteen separate storage yards, research and development facilities, and manufacturing plants with industrial wastes, leading to an estimated 500 million dollars in liability.<sup>21</sup> In ruling against Lockheed, the court articulated a slightly different rule than in *Golden Eagle*, holding that “[i]n a case where some damage has been caused by noncovered events, the first step in the insured’s proof sequence is to show that there is damage resulting from a covered event, i.e., damage over and above that which is not covered under the policy.”<sup>22</sup>

The California Supreme Court denied review in both *Golden Eagle* and *Lockheed*, implying tacit approval for the rule that, as a matter of

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13. *Golden Eagle Refinery Co. v. Associated Int’l Ins. Co.*, 102 Cal. Rptr. 2d 834 (Cal. Ct. App. 2001), *overruled by* *State v. Allstate Ins. Co.*, 201 P.3d 1147 (Cal. 2009).

14. *Id.* at 837.

15. *Id.* at 840.

16. *Id.* at 838.

17. *Id.* at 842.

18. *Id.* at 844.

19. *See also* *Travelers Cas. & Sur. Co. v. Superior Court of Santa Clara County*, 75 Cal. Rptr. 2d 54, 66 (Cal. Ct. App. 1998) (“[T]he insured must do more than point to possible intervening events, such as a fire, to support a claim for coverage under the sudden and accidental exception.”)

20. *Lockheed Martin Corp. v. Cont’l Ins. Co.*, 35 Cal. Rptr. 3d 799 (Cal. Ct. App. 2005).

21. *Id.* at 804.

22. *Id.* at 815.

law, indemnity for pollution liability requires affirmatively distinguishing damages that result from “sudden and accidental” discharges of pollution from those that result from excluded sources. However, in *California v. Allstate Insurance Co.*, the California Supreme Court overturned the *Golden Eagle* and *Lockheed* standards and established a much lower and more feasible burden for policyholders seeking indemnification under “sudden and accidental” clauses.

## II. ALLSTATE ANALYSIS

In 1950, California began construction of the Stringfellow Acid Pits, a Class I<sup>23</sup> hazardous waste site just north of Glen Avon. In 1955, the State employed geologist Robert Fox to inspect the site. Having made no borings into the bedrock and conducting no soil analysis, Fox erroneously concluded that the Stringfellow subsurface contained an impermeable layer of rock with no subterranean water flow.<sup>24</sup> Relying on this conclusion, the state constructed an unlined pit for the storage of over thirty million gallons of industrial waste.<sup>25</sup> Groundwater contamination was first detected in 1972, when officials discovered chemical waste seeping through a crack in the bedrock and around the edges of negligently constructed barrier dams.<sup>26</sup>

In addition to serving as a prolonged source of contamination, the Stringfellow Acid Pits experienced two “overflow episodes” leading to massive discharges of waste. The first occurred in March of 1969, when twenty inches of rain caused the pits to overflow.<sup>27</sup> Despite taking precautionary measures following the 1969 overflow, torrential rains in March of 1978 forced the state to order a series of controlled discharges from the pits.<sup>28</sup> While the controlled discharges prevented a disastrous breach of the containment dams, they sent one million gallons of waste into a nearby creek.<sup>29</sup> The total estimated liability of all sources of contamination is approximately 500 million dollars.<sup>30</sup>

The State of California sued four of its general liability insurers for indemnification for all liability arising from the Stringfellow contamination. The State appealed the lower court’s grant of summary judgment in favor of the insurers’ claim that the state was not entitled to

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23. Class I refers to a site capable of accepting all type of liquid wastes. *State v. Allstate Ins. Co.*, 201 P.3d 1147, 1153 (Cal. 2009).

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.* at 1152.

indemnification. The appeal presented the supreme court with four separate issues: (1) Is the proper focus of the “sudden and accidental” analysis the initial deposit of waste into the facility or the escape of the waste into the environment?; (2) Is there a triable issue of fact regarding whether the absolute exclusion for pollution of a “watercourse” applies to the 1969 overflow?; (3) Is there a triable issue of fact regarding whether the 1978 emergency release qualifies as sudden and accidental?; and (4) “[D]id the trial court properly grant the insurers summary judgment on the ground that the State cannot prove what part of its property damage liability resulted from sudden and accidental discharges?”<sup>31</sup>

The court easily answered the first three questions in the affirmative.<sup>32</sup> However, the importance of the opinion lies with the court’s approach to situations in which sudden and accidental discharges of pollution cannot be separated from excluded sources. In a unanimous opinion, the court held that “[i]f the insured’s nonexcluded negligence ‘suffices, in itself, to render him fully liable for the resulting injuries’ or property damage, the insurer is obligated to indemnify the policyholder even if other, excluded causes contributed to the injury or property damage.”<sup>33</sup> Accordingly, the court in *Allstate Insurance* overturned *Golden Eagle* and *Lockheed*, and the four insurers named as defendants had a duty of indemnification for all of the state’s Stringfellow liability.

The court’s holding conforms to the longstanding rule established in *Shell Oil* that requires courts to generally “interpret coverage clauses broadly and interpret exclusions narrowly to protect the insured’s objectively reasonable expectations.”<sup>34</sup> No policy holder would reasonably expect insurance coverage to be denied in the wake of two “sudden and accidental” and calamitous pollution events like the 1969 and 1978 overflows, merely because a comparatively small amount of waste was slowly leaking into the groundwater all along. The State of California took out the liability policies to protect itself and its taxpayers against exactly these kinds of accidents. To then hold that the State’s taxpayers were ultimately financially responsible for the damages of these overflow episodes simply because it could not precisely differentiate between the multiple sources of damages would deny the state the benefit of the “sudden and accidental” exception it had bargained for.

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31. *Id.*

32. *Id.* at 1157, 1158, 1161.

33. *Id.* at 1163 (citation omitted) (quoting *State Farm Mut. Auto. Ins. Co. v. Partridge*, 10 Cal.3d 94, 103 (1973)).

34. *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815, 829 (Cal. Ct. App. 1993).

Approaching the California Supreme Court's decision from this line of reasoning helps illuminate its true importance. Common knowledge indicates that almost every entity, both public and private, pollutes in some way. Allowing insurers to escape indemnity obligations in the wake of accidental environmental catastrophes simply because the insured in question also pollutes routinely undermines the purpose of these indemnification agreements. This is particularly true in a case like *Allstate Insurance* in which the liability would ultimately fall on a non-culpable party like the general public. The same would be true if a judgment against a polluting corporation were to leave it insolvent and incapable of paying the victims of its negligence. In such a case, the "sudden and accidental" exception in the company's insurance policy would be the victims' last chance for recovery of the damages they are owed.<sup>35</sup> Holding insurers responsible for the "plain and simple" meaning of its sudden and accidental clauses prevents such injustice while remaining in line with California case law.

One could make the argument that a liberal application of "sudden and accidental" exceptions to pollution exclusions will lead to an increase in moral hazard among insured parties.<sup>36</sup> Enhanced insurance coverage might have the unintended consequence of incentivizing polluters to exercise less care in the handling of hazardous materials.<sup>37</sup> Rather than internalize the costs of preventative measures, polluters will choose to pass the costs of their negligence on to their insurers.<sup>38</sup> As a result, more accidents will occur, leading to a rise in insurance premiums for all public and private entities, including those that diligently avoid negligent pollution.<sup>39</sup> Perhaps courts should be conservative in their application of "sudden and accidental" exceptions, so as to incentivize potential polluters to exercise due diligence, instead of ensuring that polluters have the funds to clean up the messes they make after the damage has already been done.<sup>40</sup>

However, this argument presents a false choice. Pollution occurrences fall under the "sudden and accidental" exception only when they could not have been anticipated and prevented with reasonable certainty. Disincentives for events like the Stringfellow overflows cannot

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35. See Sharon M. Murphy, *The "Sudden and Accidental" Exception to the Pollution Exclusion Clause in Comprehensive General Liability Insurance Policies: The Gordian Knot of Environmental Liability*, 45 VAND. L. REV. 161, 176 (1992).

36. See Kenneth S. Abraham, *Environmental Liability and the Limits of Insurance*, 88 COLUM. L. REV. 942, 952-53 (1988) (discussing the affects of the sudden and accidental pollution exceptions in terms of their impact on the goals pollution exclusions generally).

37. *Id.* at 953.

38. *See id.*

39. *See id.* at 947.

40. *See* Murphy, *supra* note 35, at 169-70.

be created in any meaningful way precisely because they are “sudden and accidental.” Thus, indemnification is appropriate because it prevents the cost of environmental contamination from being passed on to its victims. When courts strictly adhere to the plain and simple meaning of “sudden and accidental” clauses, as they did in *Allstate Insurance*, they can balance the needs of the insured and its victims without undermining the purpose and function of pollution exclusions.<sup>41</sup>

#### CONCLUSION

At first glance it is hard to see what real impact *Allstate Insurance* has on environmental conservation and protection efforts. It does not discourage future acts of negligence, nor does it impose harsher consequences on negligent polluters. Its impact is also limited by the insurance industry’s shift toward absolute pollution exclusions. However, when viewed from the standpoint of who is ultimately responsible for paying for these acts of environmental carelessness, the importance of the opinion becomes clear. The holding in *Allstate Insurance* closes a loophole that would have allowed Allstate and other insurance companies to avoid responsibility for paying the victims of the Stringfellow disaster, and in doing so it removes that weight from the shoulders of the already overburdened California tax payer. Though state insurance policies no longer include “sudden and accidental” exceptions, the courts should continue to liberally enforce these exceptions when they apply.

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41. See generally Nicholas J. Guiliano, *Comment, the Sudden and Accidental Exception to the Pollution Exclusion Solution?*, 13 TEMP. ENVTL. L. & TECH. J. 261, 301–07 (1994).

**We welcome responses to this In Brief. If you are interested in submitting a response for our online companion journal, *Ecology Law Currents*, please contact [ecologylawcurrents@boalt.org](mailto:ecologylawcurrents@boalt.org). Responses to articles may be viewed at our website, <http://www.boalt.org/elq>.**

