

The 1999 CGL Insuring Agreement: ISO's "Montrose Endorsement"

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ISO has revised the CGL insuring agreement to address "known loss" issues raised by the California Supreme Court in *Montrose Chemical v Admiral*. Find out how significant the new restrictions on coverage are.

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In July 1995 the California Supreme Court ruled in *Montrose Chemical Corp. v Admiral Insurance Co.*, 913 P2d 878, that the "continuous injury" trigger governs coverage under the standard CGL policy; the court ruled further that the "known loss" rule does not necessarily interfere with CGL coverage for loss or damage from a known occurrence, as long as either (1) the scope of injury or damage occurring during the policy period or (2) the insured's ultimate liability for that injury or damage is still undetermined. (The "known loss" or "loss-in-progress" rule is established by statute in California and some other jurisdictions; elsewhere it has traditionally been recognized as an axiom of insurance law--the principle that events already known to have taken place are uninsurable, that one may not procure "fire insurance on a burning building.")

The reasoning of the *Montrose* decision has since been adopted by a number of other courts, both in California and in other jurisdictions. (See, for example, *Pittston Company Ultramar America Ltd. v Allianz Insurance Co.*, 124 F3d 508 (3rd Circuit 1997); *E&L Chipping Co., Inc., v Hanover Ins. Co.*, 962 SW2d 272 (Tex App 1998).) In response to these judicial developments, insurers manuscripted a variety of CGL endorsements to prevent application of one or both of the "Montrose doctrines"--the continuous injury trigger and the restriction on the known loss rule. In September 1999, Insurance Services Office, Inc. (ISO), introduced its own version of a "Montrose endorsement"--a revision of the CGL insuring agreement that addresses the applicability of the known loss rule, specifically as that rule comes into play in the context of on-going or progressive injury and damage.

The Known Loss Rule

In *Montrose*, some of the claims against the insured arose out of the escape of toxic wastes from a disposal site over a period of 4 years during which the insured had general liability coverage with a single insurer. The first of the applicable policies took effect in October 1982. Just prior to that, in August 1982, the insured had received notice from the Environmental Protection Agency (EPA) that it was a potentially responsible party (PRP) for cleanup costs at the waste disposal site. In denying coverage of these costs under its policies, the general liability insurer argued that the EPA notice to the insured--before coverage went into effect under any of its policies--took the escape of toxic wastes out of the "contingent or unknown" category in which it would be insurable. In short, *Montrose* could not insure itself against liability for a pollution event that had already happened and of which it was already aware.

The California Supreme Court declined to apply the statutory known loss rule to the claims against *Montrose*. The court's reasoning was simple. Although there was a known event--the escape of toxic waste from a disposal site used by *Montrose*--there was at the inception of the policy no known loss, no certainty that *Montrose* would in fact be held liable. The court drew a distinction between the known loss rule as it applies to first-party property insurance and application of the rule within the context of third-party liability coverage. One cannot purchase insurance on property that has already been damaged by the peril being insured against. The corollary in liability insurance, said the court, is that one may not insure one's own "known liability," since it is the liability that is the loss, not the occurrence out of which liability may arise. The court then enunciated this line of reasoning as a general principle.

In the context of continuous or progressively deteriorating property damage or bodily injury insurable under a third party CGL policy, as long as there remains uncertainty about damage or injury that may occur during the policy period and the imposition of liability upon the insured, and no legal obligation to pay third party claims has been established, there is a potentially insurable risk Stated differently, the loss-in-progress rule will not defeat coverage for a claimed loss where it had yet to be established, at the time the insurer entered into the contract of insurance with the policyholder, that the insured had a legal obligation to pay damages to a third party in connection with a loss.

ISO's Response

The newly filed ISO amendatory endorsement, CG 00 57, addresses the issue of "loss-in-progress" without reference to "known loss" or "known events" or "known liability." Instead, the endorsement imposes coverage restrictions with respect to "known injury or damage." Under current CGL editions, the policy's

insuring agreement places two conditions on how and when covered bodily injury and property damage must occur. First, the injury or damage must be caused by an "occurrence" that takes place within the "coverage territory." Second, the bodily injury or property damage itself must occur during the policy period.

CG 00 57 adds a third condition to section b of the Coverage A insuring agreement.

(3) Prior to the policy period, no insured listed under Paragraph 1. of Section II-Who Is An Insured and no "employee" authorized by you to give or receive notice of an "occurrence" or claim, knew that the "bodily injury" or "property damage" had occurred, in whole or in part.

This new provision may seem partly redundant. To be covered under the CGL, bodily injury or property damage must occur during the policy period. Any injury or damage that has occurred "in whole" and is known to the insured "prior to the policy period" would not be covered in the first place, even without this paragraph b.(3). The point of the new language becomes clearer, however, when the rest of paragraph b.(3) is read. The issue is not injury or damage that occurs "in whole" and is known before the inception of coverage. Rather, it is injury or damage that occurs "in part" before the policy period begins. The rest of the new paragraph reads as follows.

If such a listed insured or authorized "employee" knew, prior to the policy period, that the "bodily injury" or "property damage" occurred, then any continuation, change or resumption of such "bodily injury" or "property damage" during or after the policy period will be deemed to have been known prior to the policy period.

The only injury and damage eliminated from coverage by paragraph b.(3) of the new CGL insuring agreement is injury or damage known to have occurred before the policy period begins. But if that known injury or damage continues after the policy's inception date, then, by the terms of the new insuring agreement, the ongoing injury or damage during the policy period becomes injury or damage known to have occurred before the policy period begins, and is therefore excluded from coverage.

Let's look at how this new language would apply in the case of a typical "continuous injury" claim of a kind covered under the current CGL form. In January of a certain year a contractor builds storage tanks at a manufacturing plant; the tanks are used to store the manufacturer's product, a toxic chemical. Some months after the tanks are built, the manufacturer discovers that the tanks have been allowing the chemical to leak into the ground virtually from the day they were filled. The manufacturer informs the contractor of the leak on July 1. The contractor performs corrective work on the tanks and refers the manufacturer's claim of soil cleanup costs to its CGL insurer. On August 1, the contractor renews its CGL coverage under a policy with endorsement CG 00 57 attached. On October 1, the manufacturer notices chemical fumes in another of its buildings and discovers that chemical from the original leak has migrated to other parts of the premises. On November 1, a property owner near the plant makes a claim against the manufacturer and the contractor, alleging that his water well has become contaminated with the chemical from the leaky tank. On December 1, other nearby property owners sue the manufacturer and the contractor, alleging that they have suffered bodily injury from drinking contaminated ground water caused by the leak.

The contractor's original CGL policy responds to the cost of cleaning up the manufacturer's premises--that is, the cost to repair property damage caused by an unexcluded pollution event. (The contractor's cost to repair the leaky tank would not be covered, since it is damage to the insured's work arising out of the work.) The second claim of the manufacturer based on the October 1 discovery of additional pollution, and the property damage claim of the well owner, represent allegations of damage that are continuations of the original pollution event. Under the "continuous injury" coverage trigger, the insured contractor could argue that the pollution of other parts of the manufacturer's premises and the contamination of nearby water wells was property damage that occurred during the policy period that began August 1, with a separate set of policy limits applicable to those claims.

Regardless of what coverage trigger applies, however, many insurance professionals would argue that the contractor cannot purchase on August 1 any insurance for liability arising out of property damage that occurred (or began to occur) the previous January and that the contractor knew about before the August 1 policy took effect. The Montrose decision contradicts the opinion of these insurance professionals, holding that the "known loss" rule is not applicable in such circumstances. Paragraph b.(3) of the new CGL insuring agreement, on the other hand, provides new specific grounds for invoking a "known loss" rule in exactly these circumstances. The October 1 claim of the manufacturer and the November 1 claim of the water well owner represent a "continuation, change or resumption" of property damage that the insured knew about before the August 1 policy period began. Those claims are regarded under the new CGL language as property damage "known prior to the policy period," even though the damage occurred during the policy period. There is no coverage under the August 1 policy for this damage.

With respect to the subsequent bodily injury claims of nearby residents, the new CGL language does not provide any clear grounds for denial. Prior knowledge of "property damage" is not prior knowledge of "bodily

injury," even if the injury stems from the same release that caused the property damage. Nothing in the new language makes the bodily injury claims a form of "known loss."