Case Alert

Texas Supreme Court Rules EPA Proceeding Constitutes a "Suit" Within the Meaning of a CGL Policy, Triggering the Duty to Defend

Recently, in a significant win for policyholders, the Texas Supreme Court refused to revisit its 5-4 decision that a Potentially Responsible Party ("PRP") letter from the U.S. Environmental Protection Agency ("EPA") constitutes a "suit" within the meaning of the Commercial General Liability ("CGL") policy. This holding activates the CGL duty to defend recipients of EPA PRP letters in EPA proceedings. *McGinnes Indus. Maint. Corp. v. Phoenix Ins. Co.,* 2015 Tex. LEXIS 624 (Tex. 2015), rehearing denied, 2016 Tex. LEXIS 58 (Tex. 2016).

In 2008, the EPA identified McGinnes Industrial Waste Corporation as a PRP for dumping pulp and paper mill waste in disposal pits near the San Jacinto River in Pasadena, Texas. The dumping occurred in the 1960s, during which time McGinnes was covered by Commercial General Liability policies issued by Phoenix Insurance Company and Travelers Indemnity Company.

Under the authority of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"), the EPA served a general notice letter on McGinnes in December 2008, stating that it was a PRP and "offering it the opportunity to enter into negotiations concerning cleaning up the Site and reimbursing EPA for costs incurred." McGinnes's parent company had received a similar letter, in November 2007. The letters provided that a failure to respond could result in daily penalties of up to $32,500.

In July 2009, McGinnes was served with an additional, special notice letter. It stated that McGinnes was responsible for site clean-up, demanded $378,863.61 in costs, and further required McGinnes to make a good-faith offer to settle within 60 days. McGinnes did not comply, and, as a result, the EPA issued a unilateral administrative order requiring McGinnes to perform a "remedial investigation and feasibility study." The order also stated that a failure to comply would result in a $37,500 daily penalty, with the potential for additional punitive damages up to triple the EPA's costs incurred. Between receipt of the two letters, McGinnes requested that Phoenix and Travelers defend McGinnes in the EPA proceedings under the CGL policies issued in the 1960s. When the insurers refused to defend, McGinnes sued for coverage in federal district court. The district court granted the insurers' motion for summary judgment, finding no coverage. On appeal, the Fifth Circuit certified the following issue to the Texas Supreme Court:

> Whether the EPA's PRP letters and/or unilateral administrative order, issued pursuant to CERCLA, constitute a "suit" within the meaning of the CGL policies.

In response, the Texas Supreme Court identified three reasons why a CERCLA enforcement proceeding by the EPA constitutes a "suit" within the meaning of a CGL policy. First, it held that a CERCLA proceeding literally is a suit, conducted outside the courtroom.

Second, the court determined that there would be substantial issues created by imposing a well-settled duty to indemnify for clean-up costs without imposing a duty to defend in the same action. Finally, the court noted that thirteen of the sixteen high courts to consider this issue had favored policyholders and expressed a preference toward uniformity in coverage rules across jurisdictions.

In its analysis, the Texas Supreme Court first outlined the development of EPA enforcement actions against polluters. Originally, pursuant to *Illinois v. City of Milwaukee, 406 U.S. 91, 99-100 (1972),* the EPA and other parties affected by pollution held polluters accountable through common law actions, with a majority of cases founded in the law of nuisance. This structure changed fundamentally in 1980 with the passage of CERCLA. CERCLA gave the EPA two options for remediating a polluted area: conduct the cleanup itself and later seek to recover its costs from PRPs or *compel the PRPs to perform the cleanup (either voluntarily or involuntarily) through administrative or judicial proceedings*, subject to extremely limited defenses. When the EPA takes the administrative route, as it nearly always does, it need only turn to the courts occasionally for enforcement of its decision.

The Court next examined the CERCLA process and found such significant similarities between it and a judicial proceeding that it determined the CERCLA process actually is a suit. In comparing a traditional law suit with CERCLA proceedings, the Court determined that PRP letters are pleadings, requests for information are indistinguishable from interrogatories, invitations to settle are mediations, unilateral administrative orders constitute summary judgment, and fines and penalties for willful non-cooperation are no different than judicial sanctions.

The Court's ruling was more favorable for policyholders than McGinnes requested. McGinnes argued that EPA proceedings are the functional equivalent of a suit. The Court found that "in actuality, they are the suit itself, only conducted outside a courtroom.... CERCLA effectively redefined a 'suit' on cleanup claims to mean proceedings conducted by one of the parties, the EPA, followed by an enforcement action in court, if necessary."

The Court also identified significant issues in indemnification for clean-up costs without imposing a duty to defend. It explained that within the Fifth Circuit and other courts, cleanup costs are generally considered "damages" covered by the CGL. Therefore, insurers would potentially be required to cover those costs. McGinnes argued that if the insurers were not required to defend the action, there would be no incentive for the insured to mount a defense, as it would know the insurers would ultimately be required to indemnify it for all costs. The insurers countered that such an approach by the policyholder would constitute a breach of the insured's duty to cooperate and the insurers would then be able to deny coverage. The Court acknowledged these issues as possible results of not imposing a duty to defend.

Finally, the Court identified sixteen states whose high courts had considered the same issue. Of those, thirteen determined that the administrative proceeding was a "suit," with only California, Illinois, and Maine holding to the contrary. The Court noted that seven of the thirteen favorable opinions had been issued since 1998, when California, the most recent of the three, decided the issue. The Court expressed a desire for uniformity across jurisdictions for policyholders.

Texas's decision in McGinnes is a landslide victory for policyholders who could potentially be subjected to PRP letters for past, present, or future activities. The opinion represents another step in the national trend of state high courts holding that EPA CERCLA proceedings constitute a suit, within the meaning of the CGL policy.

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