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AYDIN V. FIRST STATE: THE CALIFORNIA SUPREME COURT HOLDS THAT THE INSURED BEARS THE BURDEN OF PROVING THAT A CLAIM COMES WITHIN THE "SUDDEN AND ACCIDENTAL" EXCEPTION TO THE POLLUTION EXCLUSION IN CGL POLICIES

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SUMMARY

On August 20, 1998, the California Supreme Court held in *Aydin Corporation v. First State Insurance Company*[1] that an insured bears the burden of proof as to whether a claim comes within the exception to the "sudden and accidental" pollution exclusion found in comprehensive general liability ("CGL") policies issued from the early 1970's to the mid-1980's. The four to three opinion adds California to the growing list of jurisdictions holding that at indemnity trial an insurer does not have to prove long term or intentional discharge of pollutants to prove the applicability of the "sudden and accidental" pollution exclusion. The insurer's burden at such a trial is to show only that the liability in question arises out of a discharge of a pollutant. The burden then shifts to the insured to prove that the resulting injury or damage falls within the scope of the exception to the exclusion.

The *Aydin* decision follows closely upon the favorable duty to defend ruling by the same four to three majority in *Foster-Gardner v. National Union Fire Insurance Company of Pittsburgh, P.A.*,[2] and may well signal a change in disposition toward environmental insurance questions on the part of this influential state court.

BACKGROUND

Aydin Corporation ("Aydin") operated a research and manufacturing complex in Palo Alto, California where it fabricated, assembled and repaired electrical transformers. Polychlorinated biphenyl ("PCB") and solvent contamination was found at the complex. PCB

1 77 Cal. Rptr. 2d 537, 959 P.2d 1213 (1998).

2 18 Cal. 4th 857, 77 Cal. Rptr. 2d 107, 959 P.2d 265 (1998) (holding that CGL insurer had no duty to defend PRP letters; motion for rehearing pending).

contamination was localized near a series of underground tanks, and, upon removal, "numerous holes" were found in the tanks.

Aydin commenced an action seeking a declaration of coverage against its primary and excess insurers. Excess insurer First State Insurance Company ("First State") asserted that there was no coverage because, among other things, the pollution exclusion applied. The pollution exclusion in question stated that the policy:

> shall not apply . . . to any liability of any INSURED arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, solids, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water unless such discharge, dispersal, release or escape is sudden and accidental.

At trial, the court instructed the advisory jury that First State had the both the burden of proving the general exclusion for pollution and disproving the applicability of the sudden and accidental exception to the exclusion. The jury found that First State had not met its burden and the trial court adopted those findings. The Court of Appeal reversed the trial court, accepting Aydin's concession that any misapplication of the burden of proof was prejudicial, and holding that the burden of proof as to the "sudden and accidental" exception belonged to Aydin. The Supreme Court of California has now affirmed.

THE COURT'S ANALYSIS

As the Supreme Court noted, it is well established that an insured bears the burden of establishing at an indemnity trial "that an occurrence forming the basis of its claim is within the basic scope of insurance coverage." Once the requisite showing is made by the insured, the insurer then bears the burden of proving that the claim is specifically excluded. The question facing the Supreme Court in *Aydin* was whether an exception to an exclusion should be treated as part of the exclusionary provision in which the language appears, or as a coverage provision.

The Supreme Court began its analysis by establishing that there were no California cases on point. It distinguished its opinion in *Bebbington v. Cal. Western Insurance Company*[3] by noting that there the burden of proof was not a contested issue and that the past decisions of the Court had established that *Bebbington* should be strictly limited to its facts. Next, the Court distinguished the Court of Appeal's opinion in *Strubble v. United Services Automobile Association*[4] on the basis that the policy in question there was an "all risks" policy under which an insured does not have to establish that the peril proximately causing the loss is covered by the policy. In

[3] 30 Cal. 2d 157, 180 P.2d 673 (1947).

[4] 35 Cal. App. 3d 498, 110 Cal. Rptr. 828 (1973).

contrast, the Court observed that a CGL policy such as the one at issue in *Aydin* is a limited risks policy as to which the insured has the burden of proving that a loss is caused by a peril falling within the coverage provisions of the policy.

Finding no relevant California case law, the Court examined how other jurisdictions have decided the issue, and found that "the overwhelming weight of authority now places the burden of proving the 'sudden and accidental' exception on the insured." Noting that it had conducted its own research, the Court stated that the five state high courts that have considered the question all issued unanimous opinions placing the burden on the insured.[5] Further, the Ninth Circuit, in predicting how the California Supreme Court would decide the issue, held that the insured bears the burden of proof,[6] and, similarly, all of the currently valid federal appellate decisions have placed the burden on the insured.[7]

The Court was persuaded by the reasoning of this "extensive body of case law" and agreed that the "sudden and accidental" exception should be construed as a coverage provision when allocating the burden of proof. The majority focused upon the function served by policy language and not on the fact that the language was located in an exclusionary provision. In this regard, the Court said that in the context of the "broad exclusionary language, [the] `sudden and accidental' exception serves to `reinstate coverage' where it would not otherwise exist."

The majority concluded that because the insured has the burden with respect to coverage provisions, the insured should bear the burden of proving an exception to an exclusion that reinstates coverage after the exclusion is triggered. As a coverage provision, the Court noted, the exception should be construed broadly in favor of the insured. However, the Court flatly rejected arguments based on the premise that the insurer could unfairly "manipulate" the burden of proof by changing contract language because parties are generally free to contract as they choose.

Next, the Court considered whether there was any reason to alter the normal allocation of the burden of proof based upon "`the knowledge of the parties concerning the particular fact,

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5 *See E.I du Pont de Nemours v. Allstate Ins.*, 693 A.2d 1059, 1061 (Del. 1997); *Highlands Ins. Co. v. Aerovox Inc.*, 676 N.E.2d 801, 804-05 (Mass. 1997); *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 314 (Minn. 1995); *Northville Industries v. Nat. Union Ins.*, 89 N.Y.2d 621, 657 N.Y.S.2d 564, 679 N.E.2d 1044, 1048-49 (1997); *Sinclair Oil Corp. v. Republic Ins. Co.*, 929 P.2d 535, 543 (Wyo. 1996).

6 *See Aeroquip Corp. v. Aetna Cas. and Sur. Co., Inc.*, 26 F.3d 893, 894-95 (9th Cir. 1994).

7 *See LaFarge Corp. v. Travelers Indem. Co.*, 118 F.3d 1511, 1516 (11th Cir. 1997) (applying Florida law); *Harrow Prods., Inc. v. Liberty Mut. Ins. Co.*, 64 F.3d 1015, 1020 (6th Cir. 1995) (applying Michigan law); St. *Paul Fire and Marine Ins. v. Warwick Dyeing*, 26 F.3d 1195, 1199-1200 (1st Cir. 1994) (applying Rhode Island law); *Northern Ins. Co. v. Aardvark Assocs.*, 942 F.2d 189, 194-95 (3d Cir. 1991) (applying Pennsylvania law); *A. Johnson & Co., Inc. v. Aetna Cas. and Sur. Co.*, 933 F.2d 66, 75-76 n.14 (1st Cir. 1991) (applying Maine law).

the availability of the evidence to the parties, the most desirable result in terms of public policy in the absence of proof of the particular fact, and the probability of the existence or nonexistence of the fact.'"[8] The Court stated that in the case of disputes over the applicability of the pollution exclusion the insured will have greater information and knowledge about the insured's property and operations. Moreover, the majority found that the public policy of providing incentives to prevent, eliminate and reduce pollution weighs in favor of the burden being placed on the insured. As such, the Court held that there was no reason to deviate from the normal allocation of the burden of proof. In a final footnote the Court acknowledged the case law from the Court of Appeal requiring that the insured defend if there is any potentiality that the release or escape of pollutants was "sudden and accidental" and stated that because the duty to defend was not at issue in this case, the Court would express no opinion as to which party should bear the burden of proof in that context.

As a practical matter, the allocation of the burden of proving the exception to the "sudden and accidental" pollution exclusion is not likely to be dispositive in many cases. Nonetheless, *Aydin* may prove to be very significant. The majority decision in *Aydin* is purposely in line with the precedents of other states and supplies further evidence of a shift in the views of the same majority of the California Supreme Court that decided *Foster-Gardner*. In particular, the majority's comments on the public policy to prevent, eliminate and reduce pollution suggests that *Aydin* may go beyond contract analysis to a fundamental reevaluation of whether the best means to further public policy is by expanding the availability of liability insurance coverage in cases of pollution resulting from ordinary industrial operations. Finally, the footnote implying that the Court views as an open question whether an insured has a "burden of proof" in seeking a defense of pollution liability cases under a policy containing a "sudden and accidental" pollution exclusion further suggests the majority's willingness to reevaluate the Court's recent direction and raises the possibility that the Court may grant review of that issue in the future.

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If you have any questions or comments concerning the *Aydin* decision or other matters, please do not hesitate to contact Barry Ostrager (at 212-455-2655) or Joseph Noga (at 212-455-3159) in New York or Seth Ribner (at 818-755-9611) in Los Angeles.

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[8] *Quoting Larkin v. Watkins Associated Indus.*, 6 Cal. 4th 644, 660-61, 25 Cal. Rptr. 2d 109, 120, 863 P.2d 179, 189 (1993). *See also* Cal. Evid. Code § 500.