

**BEFORE THE COURT-APPOINTED REFEREE
IN RE THE HOME INSURANCE COMPANY IN LIQUIDATION
DISPUTED CLAIMS DOCKET**

In Re Liquidator Number: 2008-HICIL-39
Proof of Claim Number: INSU700645-01; INSU275296
INSU700638; INSU700640
INSU700641; INSU700624
INSU700655; INSU700657
INSU700658; INSU700659
INSU700660; INSU700662
Claimant Name: Sheldon Holson and Melvin Holson
Claimant Number:
Policy or Contract Number:
Insured or Reinsured Name: Holson Company
Date of Loss:

ORDER ON THE MERITS

Sheldon Holson and Melvin Holson, Hereinafter “the Holsons,” seek an Order that they are entitled to reimbursement from Home for defending claims against them and Holson Company brought by KVL, a full reimbursement of the amount paid by the Holsons to KVL, and attorneys fees incurred in the prosecution of this action. Home denies that it had a duty to defend or indemnify the Holsons or the Holson Company for the claims by KVL.

RELEVANT FACTS

Melvin and Sheldon Holson managed a business, the Holson Company. The Holson Company assembled and sold photo albums. In 1968, the company moved to a new facility in Wilton, Connecticut (“the site”). In 1986, the Holsons sold the Holson Company to an acquisition corporation that eventually sold the company to Intercraft Company. As part of the transaction, the Holsons received back the site. In 1989 the Holsons sold the site to K.V.L. Corporation (hereinafter “KVL”). Before the purchase, KVL hired an environmental consultant to inspect the site. KVL went through with the purchase. Sometime after the purchase, KVL decided to sell the site. In 1990, an inspection by a potential buyer noted some solvent contamination in an underground sump and in a concrete vault on the southern end of the site. Further investigation found groundwater contamination in the area.

In 1991, KVL sued the Holsons and the Holson Company. The Holsons and the Holson Company requested defense and indemnification from their primary insurers, The Travelers Indemnity Company (“Travelers”) and Fireman’s Fund Insurance Company (“Fireman’s Fund”). The Holsons and Holson Company also notified Home on February 22, 1991, and asked Home to defend them.

Home had issued seven manuscript excess liability policies to the Holson Company which were in effect from 1973 to 1981 and provided varying limits of liability ranging from \$3 million to \$5 million excess of

scheduled primary policies. Home also issued insurance policies to Melvin Holson for the period November 10, 1972 to November 10, 1979 and to Sheldon Holson for the period November 10, 1973 to November 10, 1979.

Travelers and Fireman's Fund declined defense of the KVL action and the case was tried in federal court in Connecticut in 1995. The Holson Company brought a declaratory judgment action against Travelers and Fireman's Fund seeking defense and indemnification for the KVL action. In 1999, while the KVL action was still pending, Holson Company entered into confidential settlements with Fireman's Fund and Travelers. The May 1999 Travelers settlement included an agreement that the two cgl policies issued by Travelers for the 1979-1980 and 1980-1981 policy periods were "deemed to be exhausted." The settlement agreement with Fireman's Fund in August 1999 "bought back" the Fireman's Fund policies. These settlements did not end the KVL action. The settlement amounts were not used to pay KVL but rather used to defray the defense costs in the KVL action.

On August 3, 2000, a decision was issued in the KVL action against the Holsons on certain claims. One finding was that the Holsons made "fraudulent misrepresentations as alleged by KVL." In April 2001, the Court entered a partial judgment holding the Holsons liable for an amount in excess of \$2 million. In September 2002, the Holsons reached a settlement with KVL that resolved the action for a payment of \$612,500.

The Holsons' proof of claim seeks the settlement funds paid, \$25,000 in future monitoring and remediation expenses, and \$1,109,260.72 in defense expenses, less the proceeds of the settlements with Travelers and Fireman's Fund. The Holsons also seek "compensatory damages."

The Liquidator issued a notice of determination denying the claim on July 28, 2008 and the Holsons filed their objection on September 5, 2008.

The Home Insurance Policies

A schedule of the Home policies can be found in Liquidator's Exhibit 1. The first policies for the periods 1973 to 1976 provide they are excess of a Federal Insurance Company cgl policy with \$50,000 property damage limit. The 1976-1980 Home policies provide they are excess of Fireman's Fund cgl policies with a \$100,000 limit. The 1980-1981 Home policy schedules provide the policy is excess of a Travelers CGL policy with a \$100,000 limit.

The Home policies are manuscript policies. The Insuring Agreement of the Home policy effective August 12, 1977 through August 12, 1981 states:

With respect to any occurrence not covered by the underlying policies listed on Endorsement 1 hereof or any underlying insurance collectible by the insured, but which is covered by the terms and conditions of this policy...the Company shall:

- (a) Defend any suit against the insured alleging injury or destruction and seeking damages on account thereof, even if such suit is

groundless, false or fraudulent and the Company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient provide, however, that the settlement of any claim or suit within the retained limit shall be with the consent of the insured;

- (b) pay all premiums on bonds to release attachments for an amount not in excess of the applicable limit of liability of this policy, all premiums on appeal bonds required in any such defended suit, but without obligation to apply for or furnish any such bonds;
- (c) pay all expenses incurred by the Company, all cost taxed against the insured in any such suit, all interest occurring after entry of judgment until the Company has paid or tendered or deposited in court such part of such judgment as does not exceed the limit of the Company's liability thereon;
- (d) reimburse the insured for all reasonable expenses, other than loss of earnings, incurred at the Company's request.

The amount so incurred, except settlement or satisfaction of claims and suits, are payable by the Company in addition to the applicable limit of liability of this policy...

Coverage afforded under this Insuring Agreement shall not apply to defense, investigations, settlement of legal expenses covered by underlying insurances.

Endorsement 2 of the Home policies in effect after August 12, 1977 states:

With respect to any occurrence not covered by the underlying policies listed on Endorsement 1 hereof or any underlying insurance collectible by the insured, but which is covered by the terms and conditions of this policy...the Company shall:

- (a) defend any suit against the insured alleging such injury or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent and the Company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient provided, however, that the settlement of any claim or suit within the retained limit shall be with the consent of the insured;....

Those policies contain a Limit of Liability provision that states that Home:

Home shall only be liable for the ultimate net loss the excess of either
(a) the limits of the underlying insurances as set out in the attached

schedule in respect of each occurrence covered by said underlying insurances; or (b) [\$10,000]¹ ultimate net loss in respect of each occurrence not covered by underlying insurances, (hereinafter called the 'underlying limits').

The Loss Payable clause provides:

Liability under this policy with respect to any occurrence shall not attach unless and until the Insured, or the Insureds underlying insurer, shall have paid the amount of the underlying limits on account of such occurrence. The Insured shall make a definitive claim for any loss for which the Company may be liable under the policy within twelve (12) months after the Insured shall have paid an amount of ultimate net loss in excess of the amount borne by the Insured or after the Insured's liability shall have been fixed and rendered certain either by final judgment against the Insured after actual trial or by written agreement of the Insured, the claimant, and The Company. If any subsequent payment shall be made by the Insured on account of the same occurrence, additional claims shall be made similarly from time to time. Such losses shall be due and payable within thirty (30) days after they are respectively claimed and proven in conformity with this policy.

The Home policies also contain a pollution exclusion. By endorsement that exclusion is for coverage for pollution claims unless they arise from a "sudden and accidental" release. The endorsement also provides that pollution coverage under the policies is no broader than that provided by the scheduled underlying policies by stating:

It is agreed that the insurance does not apply to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waster materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.

It is further understood and agreed that in no event shall coverage provided by this policy for Contamination or Pollution be broader than that provided by the Underlying Insurances set forth in the Schedule of Underlying Insurances.

The Home policies define "Ultimate Net Loss" as:

¹ The \$10,000 amount is specified in an policy endorsement.

[T]he total sum which the Insured, or any company as his insurer, or both, become obligated to pay by reason of personal injury, property damage or advertising liability claims, either through adjudication or compromise, and shall also include hospital, medical and funeral charges and all sums paid as salaries, wages, compensation, fees, charges and law costs, premiums on attachment or appeal bonds, interest, expenses for doctors, lawyers, nurses, investigators and other persons, and for litigation, settlement, adjustment and investigation of claims and suits which re paid as a consequence of any occurrence covered hereunder, excluding only the salaries of the Insured's or of any underlying insurer's permanent employees.

* * *

The Company shall not be liable for expenses as aforesaid when such expenses are included in other valid and collectible insurance.

Condition H of the policies provides:

The Company shall not be called upon to assume charge of the settlement or defense of any claim made or suit brought or proceeding instituted against the Insured by The Company shall have the right and shall be given the opportunity to associate with the Insured or the Insured's underlying insurers, or both, in the defense and control of and claim, suit, or proceeding relative to an occurrence where the claim or suit involves or appears reasonably likely to involved The Company, in which event the Insured and The Company shall cooperate in all things in the defense of such claim, suit or proceeding.

The policies also require that the Insured maintain the underlying policies in full effect, except for payment of claims. Condition Q provides:

It is a condition of this policy that the policy or policies referred to in the attached "schedule of Underlying Insurances" shall be maintained in full effect during the currency of this policy except for any reduction of the aggregate limit or limits contained therein solely by payment of claims un respect of accidents and/or occurrences occurring during the period of this policy. Failure of the Insured to comply with the foregoing shall not invalidate this policy but in the event of such failure, the Company shall only be liable to the same extent as they would have been had the Insured complied with the said condition.

LEGAL ANALYSIS²

The Holsons assert that Home had a duty to defend them in the suit brought by KVL. The Holsons assert the duty to defend is based on the language of Endorsement 2 and the fact that the underlying insurers, Travelers and Fireman's Fund, denied a duty to defend under their policies. In addition, the Holsons argue that the settlements with Travelers and Fireman's Fund also triggered a duty to defend on the part of the Home. The Holsons also assert that they have met their burden to demonstrate that the sudden and accidental exception to the pollution exclusion does not apply because there are allegations in the KVL Complaint that demonstrate the possibility that the pollution was caused by a sudden and accidental event.

Home argues that it had no duty to defend the Holsons or Holson Company because the claims against them by KVL were excluded by the pollution exclusion because the Holsons did not demonstrate that the claims by KVL arose as the result of pollution that was sudden and accidental. Home further asserts that because the pollution exclusion applies, Endorsement 2 is inapplicable in this case. Home also argues that it has no duty to defend pollution claims because the Home policies were excess above the scheduled underlying insurance and Endorsement 2 does not apply because the pollution exclusion endorsement provides that coverage for pollution claims will be no broader than that provided by the underlying policies. Home contends because those policies have not been exhausted by payment as required to trigger the Home coverage, since refusal by the underlying insurers to defend and settlements with those underlying insurers for partial defense costs do not satisfy the exhaustion requirement. Finally Home asserts the policies do not include a duty to indemnify the Holsons because of the pollution exclusion and the allocation of the settlement amount across the many years of primary coverage.

Under Connecticut law, and that of other jurisdictions, the duty to defend is broader than the duty to indemnify. According to the Supreme Court of Connecticut, if an allegation of the complaint falls even possibly within the coverage, then the insurance company must defend the insured. *Community Action for Greater Middlesex County, Inc. v. American Alliance Ins. Co.*, 757 A.2d 1974 (Conn.2000). Whether the duty to defend exists is based on the facts as alleged in the four corners of the complaint, not those ultimately established at trial. *Stamford Wallpaper Company v. TIG Insurance*, 138 F.3d 75 (2nd Cir. 1998). If one claim of the underlying action is covered by the policy, there is a duty to defend. *Id.*

I. The Holsons Have Not Demonstrated that the Sudden and Accidental Exception to the Pollution Exclusion Applies.

The duty to defend extends to claims that fall within the coverage afforded by the terms of the policy. Home alleges that the sudden and accidental pollution exclusion eliminates all coverage for the claims by KVL under the Home policy, including the duty to defend. The pollution exclusion excludes from coverage suits arising from the discharge, dispersal, release or escape of pollutants into or upon land, the atmosphere, or any watercourse or body of water. However, the exclusion excepts from its

² The parties agree that the law of Connecticut applies to the interpretation of the insurance policies in this case. The Referee agrees and therefore analyzes the obligations of Home based on Connecticut law.

elimination of coverage any such discharge, dispersal, release or escape that is sudden and accidental. The terms "sudden" and "accidental" have been defined by the Connecticut Supreme Court in the context of the pollution exclusion. In *Buell Industries, Inc. v. Greater New York Mutual Ins. Company, et al*, 259 Conn. 527, 791 A.2d 489 (2002), the Supreme Court of Connecticut held that the meaning of "sudden" is a temporal one and "requires the release in question occur in a rapid or otherwise abrupt manner."

Generally, when determining whether there is a duty to defend, the burden is on the insurance company to demonstrate that the claim does not fall within the grant of coverage. However, in the case of the sudden and accidental pollution exclusion, the insureds are seeking coverage under an exception to the exclusion. Therefore, it is the Holsons who have the burden to demonstrate that the claims fall within the coverage afforded by the policy. *Buell* 259 Conn. at 551; 791 A.2d at 504. In other words, the Holsons have the burden to demonstrate that the facts in the underlying KVL complaint at least allege a sudden and accidental event that led to the damages claims by KVL at the Site. If the claims against the insured allege any facts that even possibly fall within the coverage terms, there is a duty to defend. *Community Action for Greater Middlesex County, Inc. v. American Alliance Ins. Co.*, 254 Conn. 387, 399, 757 A. 2d 1074, 1081 (2000).

The Holsons assert that they have met their burden. They point to the allegations in the KVL Complaint of "severe environmental contamination on the site, concentrated in but not limited to the areas surrounding several large underground concrete vaults which are adjacent and connected to the building on the Site through a network of underground piping." The Complaint alleges that the contamination resulted from disposal practices at the facility which introduced contaminants into the sump and vaults 1 and 2 and which in turn resulted in contamination of soils and groundwater. According to the Complaint, the contamination was the result of negligence or other actions on the part of the Holson Company and the Holsons individually. The Holsons acknowledge the Complaint does not specify how the contamination itself occurred, at what point it occurred, or with what frequency it occurred. They also agree the allegations do not specify whether the contaminating event or events occurred over time or as a sudden event. Thus, the Holsons argue that the allegations do not foreclose an accident or a sudden release of contaminants. Therefore, given the broadest reading of the exclusion, the Holsons argue that the allegations do not eliminate the possibility that the exclusion may not apply to the particular facts developed in the KVL action. The Holsons assert that a reasonable interpretation of the substance of the allegations in the KVL Complaint is that there was a possibility that the discharge was sudden and accidental.

Home asserts the Holsons have not satisfied their burden to demonstrate that the allegations of the KVL complaint fall within the exception to the pollution exclusion. Home asserts that there are no allegations of pollution due to occurrences that were both sudden and accidental.³

³ Home also asserts it has not duty to indemnify the Holsons because of the Court's finding that the Holson's made fraudulent misrepresentations to procure the sale to KVL. Connecticut law does not allow insurers to "look back" to the ultimate findings by the Court. Rather, it requires that the

The Supreme Court of Connecticut has discussed the burden of proof related to the sudden and accidental exception to the pollution exclusion in *Buell*. Buell discovered contamination on two sites at which it had undertaken manufacturing. At each site, there was contamination. Buell sought insurance coverage for claims arising from the pollution from its insurers. The Supreme Court first found that the term “sudden” is not ambiguous and is defined as having a temporal quality and requiring a quick or abrupt release. *Buell* 259 Conn. at 541; 791 A.2d at 498-99. The Court then undertook an extensive analysis of the issue of burden of proof that the sudden and accidental exception to the pollution exclusion applies to allow for coverage. First, the Supreme Court stated “[i]n the context of these comprehensive general liability policies, the burden properly rests with the insured to prove that the “sudden and accidental” exception is applicable.” *Buell* 259 Conn. at 551; 791 A.2d at 504. Next the Court reviewed the Complaint and determined that the pleading did not include allegations of sudden and accidental releases of pollutants.

The Supreme Court then reviewed the evidence presented in the underlying case and found that the insured had not met its burden. The insured asserted that the contamination at one site could have been the result of an abrupt release of TCE caused by a malfunction in the degreasing machine. The insured alleged this type of malfunction “would result in a large release of TCE to the lagoon equivalent to punching a hole in the degreaser and allowing 500 gallons of TCE to pour out.” However, the Court found no evidence submitted by the insured to suggest that an event like this had occurred. The insured did not present evidence that an abrupt release had occurred but instead cited evidence to show that normal operating procedures would not result in the release of TCE to the lagoon. The Supreme Court found this was not enough to meet the burden of proof that the release of pollutants fell within the exception to the exclusion. *Buell* 259 Conn. at 553; 791 A.2d at 505. The same reasoning applied to the insured’s claims as to the second site.

The Supreme Court of Connecticut did another analysis of the duty to defend under the sudden and accidental exception to the pollution exclusion in *Schilberg Integrated Metals Corporation v. Continental Casualty Company, et al.*, 263 Conn. 245, 819 A.2d 773 (2003). In that case, Schilberg sued its insurers after they denied a defense in an administrative action brought by the Pennsylvania Department of Environmental Resources (“the Department”). Schilberg had arranged for treatment and disposal of waste from its scrap metal processing in a landfill in Pennsylvania. In 1988, the Department took remedial action related to significant contamination at the landfill site. The Department filed an action against several parties including Schilberg seeking remediation costs.

determination of the insurer’s duties is based on the four corners of the Complaint. *Stamford Wallpaper Company v. TIG Insurance*, 138 F.3d 75 (2nd Cir. 1998). Therefore, the Referee does not consider this argument.

Schilberg requested defense from its insurers, who declined. The policies issued to Schilberg prior to 1985 included pollution exclusions with the sudden and accidental exception. The language of those exclusions is identical to that at issue in this case.

The Supreme Court of Connecticut first confirmed that the insured had the duty to show the exception from the exclusion applied to provide coverage. *Schilberg* 263 Conn. at 256; 819 A.2d at 782. According to the Court, if an allegation of a complaint falls even possibly within the coverage then the insurance company must defend the insured. *Schilberg* 263 Conn. at 256-57; 819 A.2d at 783. The relevant inquiry is “not whether the substance of [the complaint] rules out the possibility of a sudden and accidental discharge...but rather whether the [insured] has demonstrated that a reasonable interpretation of the substance of the department’s allegations potentially would bring the claims within the purview of the sudden and accidental discharge exceptions in the policies.” *Schilberg* 263 Conn. at 259; 819 A.2d at 784. To determine whether the underlying complaint can be read as even potentially bringing the claim within the sudden and accidental exception to the exclusion, a court “should not attempt to impose the duty to defend on an insurer through a strained, implausible reading of the complaint that is linguistically conceivable by tortured and unreasonable. *Id.*, citations omitted.

The Supreme Court then reviewed Schilberg’s arguments that the exception to the pollution exclusion applied. Schilberg argued that the allegation that it “began arranging for treatment of hazardous waste” left open the possibility of a sudden and accidental discharge. The Supreme Court disagreed. Schilberg also presented a hypothetical scenario involving the possibility of sudden and accidental discharges based on the economic incentives to remove all processing by-products from the site. The Supreme Court refused to “speculate as to an occurrence that finds no reasonable basis in the...allegations [in the underlying complaint.” *Schilberg*, 263 Conn. at 262; 819 A.2d at 786.

In this case, the Holsons point out that the KVL complaint alleges the contamination resulted from disposal practices at the facility which introduced contaminants into the sump and vaults 1 and 2 and which in turn resulted in contamination of soils and groundwater. The Holsons argue that the specific allegations in the Complaint do not foreclose accidental or sudden release of contaminants and that they are entitled to the broadest reading of the exclusion. Although the Holsons acknowledge the Complaint does not specify how the contamination itself occurred, at what point it occurred, or with what frequency it occurred they assert that a reasonable interpretation of the substance of the allegations in the KVL Complaint is that there was a possibility that the discharge was sudden and accidental.

The Supreme Court of Connecticut has made clear the burden on an insured seeking to demonstrate a duty to defend based on the sudden and accidental exception to the pollution exclusion in *Buell* and *Schilberg*. Although the facts reviewed by the Supreme Court in *Schilberg* differ from those in this case, the test set forth by the Court is clear. Based on the Supreme Court’s reasoning in these cases, the Holsons assertions are not enough to demonstrate that the sudden and accidental exception to the pollution exclusion applied based on the allegations in the KVL complaint. There is no specific allegation of such a dispersal, release or escape of pollutants. To find one would require the kind of speculation

the Supreme Court specifically refused to undertake. The claims do not fall within the sudden and accidental exception to the pollution exclusion.

II. Endorsement 2 Does Not Expand Home's Duty to Defend the Holsons

The Holsons also argue that they are entitled to defense from Home based on the language of Endorsement 2 for policies with periods beginning after August 12, 1977. They assert that Endorsement 2 applies because the occurrences alleged by KVL were not covered by the underlying policies but are covered by the terms of the Home policies. The Holsons argue that the claims were not covered by the underlying insurers because the claim was over \$25 million and therefore well in excess of the limit per occurrence of the Travelers and Fireman's Fund policies. In addition, the Holsons argue that because Travelers and Fireman's Fund refused to defend, the Home's duty to do so was triggered.

Home asserts that the duty to defend language in the "Defense Settlement" provision of Endorsement 2 is inapplicable because the pollution exclusion eliminates coverage for the claims by KVL. The pollution exclusion specifically states that "in no event shall coverage provided by this policy for Contamination or Pollution be broader than that provided by the Underlying Insurances set forth in the Schedule of Underlying Insurances." Home asserts that this language means Home provides no independent coverage for pollutions claims, but only follows the coverage provided by the primary policy. Therefore, the Defense Settlement provision for claims not covered by underlying insurance but covered by the Home policy does not extend to pollution claims.

The Referee has found that the pollution exclusion eliminates a duty to defend Holsons for the claims by KVL. Therefore, the claims by the Holsons are not claims that are covered by the terms and conditions of the Home policy. For this reason, Endorsement 2 does not apply.

The Referee need not reach the issue of whether there is a duty to defend because the claims in the KVL action exceeded the limits of the primary insurance, or because the underlying policies were exhausted based on the settlement agreements. The finding that there was no duty to defend based on the pollution exclusion makes those arguments moot. In fact, during oral argument the Holsons acknowledged that if there is no coverage for the claims by KVL because they are not sudden and accidental, then Endorsement 2 does not provide a duty to defend by Home.

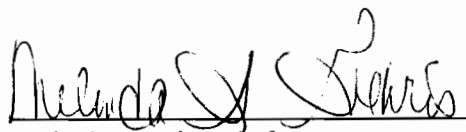
CONCLUSION

For the reasons set forth above, the Referee finds that Home did not have a duty to defend the Holsons for the claims brought by KVL. The Referee sustains the Liquidator's determination denying the Holsons' claims.

So ordered.

11/5/09

Dated



Melinda S. Gehris, Referee