

New York Court Addresses Impact of Allowing Insured to Default

Friday, February 3, 2012

In its recent decision in *Sunnyside Dev. Co., LLC v. Chartis Specialty Ins. Co.*, 2012 U.S. Dist. LEXIS 9392 (S.D.N.Y. Jan. 26, 2012), the United States District Court for the Southern District of New York demonstrated the consequences that an insurer faces when allowing an insured to default.

Chartis insured Opsys under a pollution legal liability policy that provided first and third party liability coverage for a property that Opsys leased from Sunnyside in Fremont, California. Opsys used the premises for research and development in the organic light emitting diode industry. During the policy term, Opsys filed for Chapter 7 bankruptcy, which triggered a regulatory inspection of Opsys' facility, which in turn resulted in a Notice of Violation based on "a condition dangerous to human health, property, and the environment by abandoning hazardous materials and hazardous waste." As a result, Sunnyside was advised that the property could not be re-occupied until a Closure Order was issued.

Chartis paid certain costs under the policy relating to pollution caused as a result of leaking or ruptured drums within the facility. Sunnyside nevertheless received permission from the bankruptcy court to commence suit against Opsys, to obtain benefits under the Chartis policy, primarily relating to lost rent resulting from its inability to lease the facility while undergoing remediation. Sunnyside thereafter commenced suit against Opsys in California, and advised Chartis that it intended to take a default against Opsys if the action was not defended. For reasons not clear, Chartis did not provide a defense, and Sunnyside eventually obtained a default judgment against Opsys for the \$1 million limit of the Chartis policy.

After determining that Chartis received proper notice of the pending default, and had an opportunity to defend the suit, and even had an opportunity to attempt to vacate the default after it had been entered, the court considered the effect of Chartis' inaction. Chartis argued that Sunnyside failed to demonstrate that its damages were caused as a result of a "pollution condition," a term defined in pertinent part as a "leak" or a "release," but instead were caused as a result of an abandonment or the mere presence of pollutants. While court agreed that Chartis could raise defenses to its policy's coverage, since coverage was not technically at issue in Sunnyside's suit against Opsys, the court nevertheless held that Chartis could not relitigate facts that were decided in Sunnyside's suit against Opsys. Thus, the California court's judgment that there was property damage at the premises resulting from leaking or ruptured drums, and that there was a release of hazardous materials, even if inaccurate, was nevertheless binding on Chartis for the purpose of determining coverage. As the court explained, "if Chartis wanted to litigate the proximate cause of Sunnyside's damages, it should have intervened in the California Action or moved to set aside the Default Judgment."