

# COMMON LAW & JURISDICTIONS: CORROSION, UNITED STATES

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# Introduction and Background

- Corrosion can be caused by ineffective pipeline coatings, contaminants within the pipeline, and soil conditions and other external influences on the pipeline.
- Corroded pipes can lead to leaks, spills, and explosions, which can cause damage to the environment, private property, and persons.
- Corrosion can expose pipeline owners to significant liabilities, including civil and criminal fines.

# Clean Water Act and Oil Pollution Act

- Clean Water Act permits the US Government to bring Civil suit for damages and Criminal charges against the owner of the pipeline for violations of OPA 90
- OPA – Enacted shortly after Exxon-Valdes
  - Section 311(b)(3) prohibits the discharge of threshold amounts of oil or hazardous substances to navigable waters of the United States.
  - Section 311(j) requires facilities that store oil in significant amounts to prepare spill prevention plans and to adopt certain measures to keep accidental releases from reaching navigable waters.
  - Certain types of facilities that pose a greater risk of release must also develop plans to respond promptly to clean up any spills that do occur.

# Illustrative Cases and Settlements

- 2003 - Colonial Pipeline owned a 5,500-mile underground pipeline that stretched from Texas to New York City. Due to corrosion causing leaks and other mechanical failures, the pipeline faced a series of leaks and spills that caused significant environmental damages. Colonial paid \$34 million in punitive fines under the Clean Water Act, which was the largest punitive award ever levied under the CWA. This fine was in addition to a criminal fine of \$7 million Colonial had paid in 1999.
- 2012 - BP settled CWA claims against it after the *Deepwater Horizon* spill for nearly \$4 billion payable over 5 years, which included \$1.256 billion in criminal fines, \$2.394 billion to the National Fish and Wildlife Foundation for remediation efforts and \$350 million to the US National Academy of Sciences.

# Insurance Issues

- The insurance industry has taken steps to exclude coverage caused by improperly maintained pipelines.
- In nearly all CGL or “all-risk” insurance policies, naturally occurring rust or other corrosion is excluded from coverage.
- Insurance Policies cover “fortuitous losses” not resulting from an excluded risk.
  - A Fortuitous Loss is one that is unexpected and not probable and not resulting from an internal characteristic of the property.

# State-By-State Analysis

- The interpretation of insurance policies is done on a state-by-state basis.
- A court in one state may look to other courts' interpretation of the words in a policy, decisions from courts of another state are only persuasive authority and are not necessarily binding.
- Similarly, the federal courts will look to state insurance law to determine the meaning of exclusions in a disputed policy.

# First-Party Property Insurance

- *MarkWest Hydrocarbon, Inc. v. Liberty Mutual*
  - MarkWest owned a 65-mile stretch of natural gas liquids pipeline running across several states. It was originally built in 1957.
  - After an explosion caused by a faulty valve, the U.S. Office of Pipeline Safety ordered MarkWest to conduct a series of tests on the pipeline and to repair “integrity threatening conditions.”
  - MarkWest discovered several corroded sections of pipe and filed a claim with its insurance carriers seeking to recoup certain losses it incurred as a result of the explosion and its compliance with the government's mandated tests and repairs.

# First Party Property Insurance – Carriers do not insure corrosion

- *MarkWest Hydrocarbon, Inc. v. Liberty Mutual*
  - The policy issued to MarkWest explicitly stated that it "does not insure . . . corrosion."
  - The policy further provided that the insurance companies "shall not be liable for any increase in loss resulting from . . . [e]nforcement of any ordinance or law regulating the use, construction, repair or demolition of any property."
  - MarkWest argued that the Demolition and Cost of Construction ("DICC") Endorsement provided coverage for the otherwise excluded corrosion.



# OPS Concerned with “Tomorrow’s Problem”

- *MarkWest Hydrocarbon, Inc. v. Liberty Mutual*
  - The District Court rendered judgment in favor of the insurers, finding that the cause of the OPS’ directives was related corrosion, an excluded peril under the terms of the policy.
  - In affirming the district court, the Court of Appeals specifically noted that the OPS directives were not concerned with “yesterday’s problem” – the broken valve – OPS was instead concerned about preventing tomorrow’s problem – safe operation of the entire 65-mile pipeline.

# Policy Decision behind MarkWest Decision

- The Court of Appeals noted that the policy issued to MarkWest was not a “Maintenance Contract” and that an “all-risk” policy should only cover a “fortuitous loss.”
  - Under MarkWest’s reading of the policy, the insurance companies would be responsible for [the owner’s] costs in testing the entire stretch of pipeline for any “integrity threatening conditions” -- including normal wear and tear -- and then repairing those conditions.
  - Also under MarkWest’s reading of the policy, a pipeline operator could run the least-safe, least-modern, and least well-run pipeline in the country, a pipeline in violation of every regulation in the books. Yet if an accident exposed these problems to the OPS, the insurers would be on the hook for repairing and modernizing the entire pipeline.
- The Court clearly rejects such a reading of the insurance policy, finding that normal wear-and-tear, such as corrosion is not covered under an all-risk policy.

# *Damages Caused to Third Parties*

- A pipeline owner's Comprehensive General Liability ("CGL") policy will provide coverage for damages to third parties' property and personal injuries. Negligence of the insured is presumed to be a fortuity under most states' law.
- In specialized policies, insurers have increasingly demanded maintenance programs and other monitoring of pipes by its insureds.
- These clauses may be in policies as warranties, obligations of the insured, or may be a "condition of coverage."
- An insurer will consider age of the pipelines, material used in construction of the pipelines, and other factors in placing the conditions or obligations of coverage on its policy holder.

# *Corrosion Caused by Defective Coating – Lafarge Case*

- *Lafarge Corp. v. Hartford Casualty Ins. Co.*
  - In this duty-to-defend suit, Hartford refused to defend its insured, Leonard Pipeline-Anchor Wate ("LAC"), a supplier of protective coating designed to prevent corrosion on sub-surface pipelines.
- Facts:
  - All American Pipeline Company contracted with American West Pipeline Constructors (American West) for the construction of a pipeline to run from California to Texas.
  - American West subcontracted LAC to provide a special coating to protect the pipeline, which was to be buried, from the elements.
  - Subsequently, All American discovered that the protective coating supplied by LAC had failed at the field joints, damaging the pipeline, and brought suit against LAC for its defective product and resulting corrosion.

# Lafarge – Insurer’s Refusal to Defend

- The insurers contended:
  - That “the failure of a product to work does not constitute an accident;” and
  - That “corrosion of the pipeline was not an accident because exposure to soil was contemplated.”
- The Court rejected the insurer’s arguments, noting that “the complaint sought damages not simply because the coating failed but because the failure of the coating caused damage to the pipeline.”
  - The Court inferred that an accident had occurred based on the allegation that LAC’s product caused damage (accelerated corrosion) to the pipeline.

# COGSA and the *Retla* Rust Clause

- Under US law, maritime shipment of goods is governed by Carriage of Goods by Sea Act (COGSA).
- COGSA generally requires bills of lading to include a statement that the shipped items were received in good condition by the shipowner.
  - Regarding products subject to corrosion, such as iron, steel, and lumber products, US courts have held that COGSA permits the *Retla* rust clause to insulate shipowners from liability.
  - The *Retla* Clause states that the shipped items subject to corrosion were not necessarily free from rust or moisture upon receipt by the shipowner.

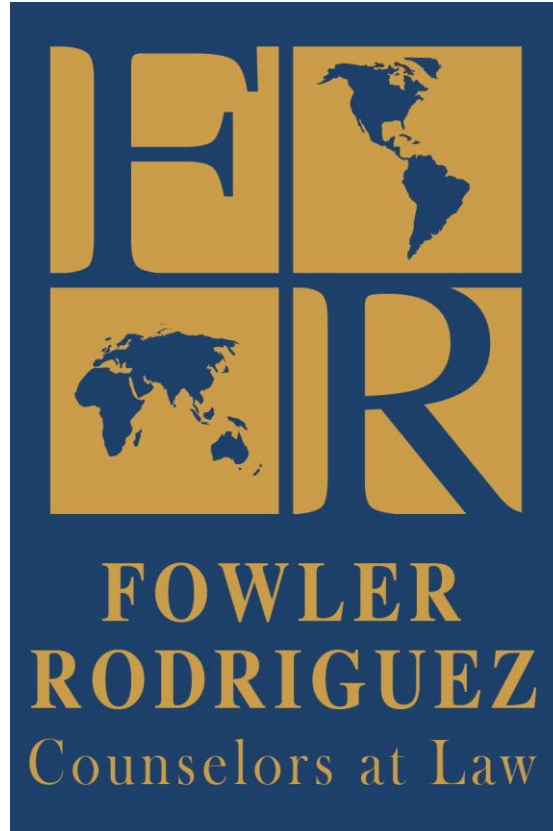
# Placing of the *Retla* Rust Clause

- The Clause will be enforced if:
  - The Clause is conspicuously displayed on the front; and
  - The Clause permits the shipper to request a separate bill of lading.
- If the clause is buried in fine print, US Courts will not enforce it.

## *Final Questions*

- Should policies contain an express exclusion of corrosion damage? As a naturally occurring event, can corrosion ever be considered a “fortuity” under an insurance policy?
- If an insurer includes testing and monitoring conditions in its policy, does the insurer expose itself to a suit for corrosion repair if the pipeline fails despite the testing?





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