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September 22, 2008

Brian Walsh
South Dakota Department of Energy and Natural Resources
523 E. Capitol Avenue
Pierre, SD 57501

RE: Question about liability insurance
Our File: 0257

Dear Brian:

Our firm acts as general counsel to the South Dakota Public Assurance Alliance (SDPAA). As you know, the SDPAA provides liability and property coverage to many of the cities, counties, and special districts in South Dakota.

Sandi Larson forwarded your email on liability insurance for a governmental entity that causes pollution. It is very difficult to answer hypothetical questions about the coverage provided by coverage documents, as a coverage question in the real world has more facts, complexities, and nuances than does any hypothetical scenario. Ultimately, an insured person or entity has the coverage that their insurance contracts provide, no more and no less, and coverage in a real-life accident can only be determined by reference to the coverage documents.

That being said, I will attempt to answer the question you posed in your email. A member of the SDPAA generally has coverage for liability to third parties arising from negligent damage to a privately-owned pipeline, unless additional facts cause an exclusion to come into play. However, a member generally does not have property coverage for pollutant seepage from a privately-owned pipeline, unless the seepage was caused by an event for which the member otherwise has property coverage AND the damage caused by the pollutants is of a sort for which the member otherwise has coverage. In other words, there is no liability exclusion that applies specifically to privately owned oil pipelines, but there are specific property exclusions that apply to pollutant seepage.

Specifically, you asked Sandi whether a South Dakota municipality would have insurance coverage if a crew working on a waterline accidentally damaged a crude oil pipeline. For purposes of the question, I'm going to assume that the crew was composed of municipal employees and that the oil pipeline was owned by a third party. In this scenario, the general liability coverage provided by the SDPAA would likely cover the negligent acts of the municipal employees – the fact that the harm caused by that negligence included pollution would not exclude coverage for the municipality's liability to third parties.

To give you an idea how additional facts can alter coverage, however, suppose that the municipality employee who caused the damage had intentionally and repeatedly hacked at the exposed pipeline with a pickaxe. In this scenario, the damage to the pipeline did not occur because of mere negligence, but as a result of deliberate, criminal action. In this case, coverage may be excluded because the SDPAA coverage documents contain a liability exclusion for criminal activity. Likewise, assume that pollution from the pipeline damaged not only property owned by third parties, but also damaged a park owned by the municipality. Any damage to the park would not be covered by the municipality's liability coverage, and pollution damage to municipal real estate is typically not covered by SDPAA property coverage.

As you can see, whether or not a member has coverage will turn on the specific facts of the accident that caused the pollution. I hope that this letter has provided some answers to the question that you sent to Sandi. Ultimately, however, each member has the coverage described in their coverage documents and must determine which risks they should insure against and whether those risks are covered under the terms, limitations, conditions, and exclusions of their coverage documents.

Feel free to contact me if you have additional questions about this matter.

Sincerely,

MAY, ADAM, GERDES & THOMPSON LLP

PATRICK M. GRODE