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INSURANCE COVERAGE FOR SUPERFUND CLAIMS: ARE RESPONSE COSTS RECOVERABLE DAMAGES?

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I. INTRODUCTION

As the costs of remediating uncontrolled hazardous waste disposal sites soar, potentially responsible parties (PRPs) under the Comprehensive Environmental Response, Compensation and Liability Act¹ (CERCLA or Superfund) are looking increasingly to their insurance carriers, past and present, to help finance both the site cleanup and the associated legal defense costs. Insurers, however, typically deny coverage as well as any duty to defend. The result has been extensive litigation between insurers and their insureds regarding the scope of liability coverage under comprehensive general liability (CGL) insurance policies.

The issues in Superfund insurance cases are complicated by arguably ambiguous insurance policy language, the typical delayed manifestation of the claim, and the need to regularly consult state insurance law. Several federal courts have faced these coverage issues, but with differing results. Attorneys practicing in South Carolina should be aware that the Fourth Circuit has held in favor of the insurer in every published action to date. This Article will analyze rulings in the Fourth Circuit and contrast these decisions with the reasoning utilized by other courts.

Prior to discussing the case law, it may be beneficial to briefly review some common insurance policy language upon which most Superfund insurance claims are based and to briefly outline CERCLA requirements. Although standard language and definitions have varied over the years, the following provision is typical of most CGL policies:

The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of
Coverage A. bodily injury or
Coverage B. property damage

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1. 42 U.S.C. §§ 9601-9675 (1982 & Supp. V 1987).

to which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage²

“Occurrence” typically is defined as “‘an accident, including injurious exposure to conditions, which results, *during the policy period*, in bodily injury or property damage, neither expected nor intended from the standpoint of the insured.’”³ “‘Property damage’ means injury to or destruction of tangible property.”⁴ The majority of Superfund insurance cases focus on these provisions, questioning whether response costs are considered “damages” under the policy and whether leakage from a hazardous waste site constitutes an “occurrence” within the policy’s coverage.⁵ A growing number of cases address the applicability of pollution exclusion clauses in CGL policies.⁶ Exclusion clauses, however, typically are consulted only if the policy otherwise would cover the loss. Because the Fourth Circuit bases its determination of coverage on the initial applicability of the policy to response costs,⁷ thereby eliminating the need to consider these provisions, pollution exclusion clauses are not included in this discussion.

The vast number of PRPs under Superfund has contributed to the extensive insurance litigation before the courts. CERCLA includes, as potentially responsible for uncontrolled hazardous waste sites, anyone owning property or operating a facility where hazardous substances are located, anyone arranging for disposal or treatment of hazardous substances at the facility, or anyone generating the waste.⁸ The statute

2. *Mraz v. Canadian Universal Ins. Co.*, 804 F.2d 1325, 1327 (4th Cir. 1986) (giving CGL language and definitions for 1969 policy); *see also* *Waste Management, Inc. v. Peerless Ins. Co.*, 315 N.C. 688, 340 S.E.2d 374 (1986) (giving similar language in insurance policies from 1974 to 1980).

3. *Mraz*, 804 F.2d at 1327 (quoting 1969 Canadian Universal liability policy).

4. *Township of Gloucester v. Maryland Casualty Co.*, 668 F. Supp. 394, 397 (D.N.J. 1987)(quoting definition from defendant’s insurance contract).

5. *See, e.g., Mraz*, 804 F.2d at 1327-29.

6. *See, e.g., FL Aerospace v. Aetna Casualty & Sur. Co.*, 897 F.2d 214, 217-18 (6th Cir. 1990); *Jonesville Prods., Inc. v. Transamerica Ins. Group*, 156 Mich. App. 508, 402 N.W.2d 46 (1986).

7. *See Mraz*, 804 F.2d at 1328-29.

8. CERCLA § 107(a), 42 U.S.C. § 9607(a) (1982 & Supp. V 1987). The actual text reads:

Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section--

- (1) the owner and operator of a vessel or a facility,
- (2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of,
- (3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treat-

subjects responsible parties to liability for:

- (A) all costs of removal or remedial action incurred by the United States Government or a state not inconsistent with the national contingency plan;
- (B) any other necessary costs of response incurred by any other person consistent with the national contingency plan;
- (C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and
- (D) the costs of any health assessment or health effects study carried out under section 9604(i) of this title.⁹

The state or federal government can exercise its authority to recover response costs even if the injury, or threat of injury, to the environment is confined to the responsible party's property. Furthermore, the government has the option of conducting the remedial activity itself and suing for reimbursement, or seeking equitable relief in the form of an injunction ordering the responsible parties to remedy the damage. This option, in addition to the government's ability to sue for either response costs, damages for injury to natural resources, or both, is particularly important in many of the Superfund insurance cases denying coverage.

II. FOURTH CIRCUIT CASES

One of the earliest cases dealing with insurance coverage under Superfund is *Mraz v. Canadian Universal Insurance Co.*¹⁰ *Mraz* arose from the related case of *United States v. Bissell*,¹¹ in which the United States and the state of Maryland sued Paul and Sally Mraz, among others, for costs incurred by the Environmental Protection Agency (EPA) for remedial activity at the Leslie hazardous waste site. The Mrazs operated Galaxy, a solvent recycling corporation. In August of 1969, Galaxy had arranged for several hundred barrels of chemical waste to be removed from the facility and buried at the Leslie site. The

ment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances, and (4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable

Id.

9. CERCLA § 107(a), 42 U.S.C. § 9607(a)(4) (1982 & Supp. V 1987).

10. 804 F.2d 1325 (4th Cir. 1986).

11. Civ. No. Y-83-3745 (D. Md.) (cited in *Mraz*, 804 F.2d at 1326).

Mraz contended that their prior insurance carrier, Canadian Universal Insurance Co. (Canadian Universal), was obligated to defend and indemnify them in the *Bissell* litigation pursuant to policies in effect from 1966 until December 31, 1969. Because the EPA's investigation of and remedial activity at the site did not occur until the early 1980s, Canadian Universal argued that no "occurrence" within the meaning of the insurance policy existed. Canadian Universal also claimed that response costs did not constitute "property damage" under the policy.¹²

The Canadian Universal policy defined property damage as "injury to or destruction of tangible property."¹³ The court noted that facts to this effect were alleged in the complaint, but emphasized that under the policy, a release resulting in property damage could not be an occurrence unless damage resulted *during the policy period*.¹⁴ The initial inquiry therefore focused on determining which event triggers liability in a hazardous waste disposal case: disposal or discovery.¹⁵

"The general rule is that '[t]he time of the occurrence of an accident within the meaning of an indemnity policy is not the time the wrongful act was committed but the time when the complaining party was actually damaged.'¹⁶ In many cases, however, the existence or scope of damage can remain concealed for an extended period of time, rendering it difficult, if not impossible, to determine precisely when the damage occurred. In these situations, "the better rule is that the occurrence is deemed to take place when the injuries first manifest themselves."¹⁷ Accordingly, the Fourth Circuit held that in hazardous waste burial cases, "the occurrence is judged by the time at which the leakage

12. *Mraz*, 804 F.2d at 1327-28.

13. *Id.* at 1327.

14. *Id.* The policy period in question was January 1, 1969 through January 1, 1970. *Id.* Not all CGL policies contain this limitation in the definition of occurrence.

15. *See id.* at 1327-28. The court in *Idaho v. Bunker Hill Co.*, 647 F. Supp. 1064, 1070 (D. Idaho 1986), studied and cited several opinions addressing a similar trigger of liability issue in asbestos cases. Three theories have developed in those cases: manifestation, exposure, or a combination of the two known as multiple trigger of continuous exposure. The manifestation theory identifies the responsible insurer as the one whose policy is in effect at the time the injury manifests itself. The exposure theory assigns liability under the policy in effect at the time of the initial exposure to the harm. The multiple trigger theory includes, as potentially responsible, all insurers with policies in effect from the time of the initial exposure until manifestation. *Id.* (citing *Eagle-Picher Indus. v. Liberty Mut. Ins. Co.*, 682 F.2d 12 (1st Cir. 1982), *cert. denied* 460 U.S. 1028 (1983) (manifestation); *Insurance Co. of N. Am. v. Forty-eight Installations*, 633 F.2d 1212 (6th Cir. 1980) (exposure); *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982) (multiple trigger); *AC&S, Inc. v. Aetna Casualty & Sur. Co.*, 764 F.2d 968 (3d Cir. 1985) (exposure)).

16. *Mraz*, 804 F.2d at 1328 (quoting *United States Fidelity & Guar. Co. v. American Ins. Co.*, 169 Ind. App. 1, 7, 345 N.E.2d 267, 270 (1976)).

17. *Id.*

and damage are first discovered.”¹⁸ Because nothing in the complaint indicated that a release from the Leslie site was discovered prior to 1981, eleven years after the final Canadian Universal policy coverage period expired, the court found there was no occurrence.¹⁹ Consequently, Canadian Universal was under no obligation to defend or indemnify the Mrasz in the *Bissell* litigation.

While the Fourth Circuit could have based its opinion solely on the rationale that the “occurrence” was outside of the policy period, the court also addressed Canadian Universal’s alternative argument: even if the loss was caused by an occurrence, no duty to defend existed because the plaintiffs did not allege property damage.²⁰ The court concluded that response costs are an economic loss, not an injury to or destruction of real property.²¹ Explaining its decision, the court stated:

The district court observed that the *Bissell* complaint alleged that the release caused contamination of soil and water resulting in the need for the cleanup and therefore concluded that the complaint alleged property damage. The problem is that the court failed to consider whether the alleged contamination of the Leslie site was the injury for which the governments sought relief or merely a factual predicate of the cost reimbursement claim. . . .

. . . .
 . . . The allegations of property damage set forth the basis for the governments’ response costs, and do not constitute part of the governments’ request for relief.²²

The court thus concluded that no property damage existed within the meaning of the policy.

In 1987, the Fourth Circuit struck another blow to insureds within its jurisdiction. In *Maryland Casualty Co. v. Armco, Inc.*,²³ the court held that response costs do not constitute a claim for “damages” under a CGL policy. As stated earlier, CGL policies typically provide coverage for any sums which the insured legally is obligated to pay as dam-

18. *Id.* (citations omitted).

19. *Id.* The Fourth Circuit was, at least theoretically, applying Maryland law to this diversity action. In South Carolina, however, a different result may have been mandated. At least one South Carolina decision has implied that the “exposure” theory is followed in this state. See *Boggs v. Aetna Casualty & Sur. Co.*, 272 S.C. 460, 252 S.E.2d 565 (1979). *Boggs* involved a contractor’s negligent siting of a house which ultimately led to damage from water seepage. The court concluded that the contractor’s negligent placement of the house caused the house to be exposed to water seepage and the resulting property damage constituted an occurrence. *Id.* at 463; 252 S.E.2d at 567.

20. *Mraz*, 804 F.2d at 1328.

21. *Id.* at 1329.

22. *Id.* at 1328-29 (citation omitted).

23. 822 F.2d 1348 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (1988).

ages. The Fourth Circuit reasoned that response costs under Superfund are a form of equitable relief in the nature of restitution, and that as such they cannot be considered damages within the policy coverage.²⁴

Most states hold that the terms of an insurance policy are to be construed according to the meaning a reasonably prudent layman would infer.²⁵ This rule is tempered, however, since some courts narrow the scope of the term "damages" by adopting a narrow, technical definition which includes only payments to third parties with a legal claim for damages, thus excluding claims for injunctive or restitutionary relief. The Fourth Circuit in *Armco* relied upon this Maryland limitation, and noted that "[d]amages is [sic] a form of substantial redress which seeks to replace the loss in value with a sum of money. Restitution, conversely, is designed to reimburse a party for restoring the status quo."²⁶ The Fourth Circuit reasoned that without this interpretation, the term, as used in the policy provision "obligated to pay as damages," would become surplusage, because all obligations to pay would be covered.²⁷ The court rejected all of Armco's arguments to the contrary.²⁸

Armco initially argued that no distinction should be drawn in Superfund cases between actions seeking compensation for injury or loss (e.g., a CERCLA section 107 action for damage to natural resources) and actions to recover response costs or to force a responsible party cleanup. Armco contended that recognizing the distinction would result in the liability of the insurer being determined by the "merely fortuitous" event that the government chose to remediate the contaminated site itself and then sue to recover costs, rather than sue directly for damage to the property.²⁹ Armco reasoned that an insurer's liability on its policy should not rest on the procedural decisions of a third party. The Fourth Circuit disagreed, noting that the measure of damages to natural resources was not necessarily equivalent to the cost of restoring the area: "It might very well cost far more to restore [damaged property] than it would to pay damages for its loss."³⁰

The Fourth Circuit viewed investigative and remedial action taken or required by the government in response to adverse environmental

24. *Id.* at 1350.

25. *Id.* at 1352 (citing *Pacific Indem. Co. v. Interstate Fire & Casualty Co.*, 302 Md. 383, 488 A.2d 486 (1985)).

26. *Id.* at 1353.

27. *Id.* at 1352.

28. *Id.* at 1352-53.

29. *Id.* (citing *United States Aviex Co. v. Travelers Ins. Co.*, 125 Mich. App. 579, 336 N.W.2d 838 (1983)).

30. *Id.* at 1353.

conditions as harm-avoidance measures, and noted in *Armco* that courts would establish a dangerous precedent if they construed insurance policies as encompassing costs of compliance with "injury prevention measures."³¹ The court explained:

Maryland Casualty has contracted with Armco to reimburse only where Armco is obligated to pay damages which result from injury, which in the insurance context means damages in the legal sense. In the absence of clear contract language or specific Congressional authorization in CERCLA, we decline to extend the obligations of insurance carriers beyond the well-illuminated area of tangible injury and into the murky and boundless realm of injury prevention. We hold that the costs to Armco of complying with the directives of a regulatory agency are not covered within the terms of the insurance policy.³²

The Court, however, failed to cite any cases supporting its position that remedial activity is a prophylactic measure not covered by CGL insurance policies.

The *Armco* and *Mraz* opinions purportedly were based on Maryland law. In deciding similar questions under South Carolina law, the Fourth Circuit in *Cincinnati Insurance Co. v. Milliken & Co.*³³ "perceive[d] no material distinctions between the South Carolina and Maryland laws in the construction and interpretation of insurance policies that should cause [it] to deviate from *Armco* and *Mraz*."³⁴ Accordingly, the court held that under South Carolina law, "damages" in the insurance context means legal damages and does not include response costs which are claims for equitable relief.³⁵

The Federal District Court for the Northern District of California in *Intel Corp. v. Hartford Accident & Indemnity Co.*³⁶ criticized the Fourth Circuit for failing to actually apply Maryland law in *Mraz* and *Armco*.³⁷ As pointed out in *Intel*, the defendants in *Mraz* were before the Fourth Circuit on diversity of citizenship and therefore the law of the forum state should have been applied.³⁸ A brief review of the *Mraz*

31. *Id.* at 1353-54. The court viewed the EPA's intervention at the disposal site as preventive in nature, claiming that the case presented no instance of actual harm to human or animal life. Even if there had been some injury, the court indicated it would still view the government's involvement as preventive in nature. The court, however, did not discuss why contamination of the soil and possible groundwater contamination at the site did not constitute actual damage to the property.

32. *Id.* at 1354.

33. 857 F.2d 979 (4th Cir. 1988).

34. *Id.* at 980-81.

35. *Id.* at 981.

36. 692 F. Supp. 1171 (N.D. Cal. 1988).

37. *Id.* at 1186-87.

38. *Id.* (citing *Erie Railroad v. Tompkins*, 304 U.S. 64, 78-79 (1938)).

opinion reveals that no Maryland cases were even cited and no explanation was given for their absence. Instead, the court based its analysis of the terms "property damage" and "occurrence" on CERCLA, a federal statute, and non-Maryland case law. Furthermore, the court summarily dismissed response costs as "economic loss" without citing any Maryland precedent. This classification did not necessarily resolve the issue of whether response costs are a loss compensable as "damages" under the insurance policy. Some states, for instance, recognize that economic losses may constitute property damage.³⁹

Similarly, a close review of the *Armco* decision reveals only limited application of Maryland law in that diversity case. The Fourth Circuit cited one Maryland opinion as precedent that "black-letter law [requires] that the terms of an insurance policy are to be construed according to the meaning a reasonably prudent layman would infer."⁴⁰ The court, however, failed to apply the rule of that case, claiming that Maryland had adopted a more narrow definition of damages, to include only legal damages and not injunctive or restitutionary relief.⁴¹ The cases cited by the court, however, are from federal and New Hampshire courts.⁴² If Maryland precedent for this proposition existed, the Fourth Circuit failed to include it in the *Armco* opinion.⁴³

It is similarly questionable whether the brief *Milliken* opinion properly summarized and applied South Carolina law. In a recent case, *Braswell v. Faircloth*,⁴⁴ the South Carolina Court of Appeals held that a government mandated cleanup of a chemical spill constituted property damage within the meaning of the CGL insurance policy.

Pepper Industries leased property from Braswell Shipyards and later from Neckland Associates to use in its business of cleaning commercial fuel oil tanks and boilers. Pepper Industries maintained a general liability insurance policy with United States Fidelity and Guar-

39. See, e.g., *Gasque v. Eagle Mach. Co.*, 270 S.C. 499, 503, 243 S.E.2d 831, 832 (1978) (consequential loss of profits suffered when tobacco picking machine failed to function properly and crop could not be harvested constituted property damage).

40. *Maryland Casualty Co. v. Armco, Inc.*, 822 F.2d 1348, 1352 (4th Cir. 1987), cert. denied, 484 U.S. 1008 (1988).

41. See *supra* text accompanying notes 25-32.

42. See *id.* (citing *Aetna Casualty & Sur. Co. v. Hanna*, 224 F.2d 499, 503 (5th Cir. 1955); *Haines v. St. Paul Fire & Marine Ins. Co.*, 428 F. Supp. 435 (D. Md. 1977); *Desrochers v. New York Casualty Co.*, 99 N.H. 129, 106 A.2d 196 (1954)).

43. Since *Armco* was decided, the Maryland Court of Appeals in *Maryland Cup Corp. v. Employer's Mutual Liability Insurance Co.*, 81 Md. App. 518, 568 A.2d 1129 (1990), directly addressed the definition of damages in a non-CERCLA context. The court recognized that the issue had not been decided previously by Maryland state courts. See *id.* at 523, 568 A.2d at 1129. The court then proceeded to adapt the *Armco* definition to its purpose. See *id.*

44. — S.C. —, 387 S.E.2d 707 (Ct. App. 1989).

anty (USF&G). The policy was in effect from February 1980 through February 1984. Neckland Associates terminated Pepper Industries' lease in March of 1983 after it became evident that the company had abandoned the property. In May of that year, corrosive chemicals left by Pepper Industries on the leased premises ate through a valve on one of the storage tanks and 1000 gallons of the stored material spilled onto the ground.⁴⁵

After Pepper Industries failed to remedy the spill, the South Carolina Department of Health and Environmental Control (DHEC) and the EPA ordered Neckland Associates to perform the necessary response work and remove the remaining waste stored at the site. Neckland Associates completed the remedial action. Subsequently, Neckland was awarded more than \$180,000 in damages against Pepper Industries in a lawsuit brought in federal court. Elliott Braswell, a partner in Neckland Associates, brought the state action seeking a declaratory judgment that USF&G's CGL policy covered the damages.⁴⁶

The trial court held the damages claimed by Braswell did not constitute "property damage" within the meaning of the insurance policy.⁴⁷ The court, viewing the claim against Pepper Industries as one for restitution since the claimant attempted to restore the status quo, relied upon *Armco* to deny coverage.⁴⁸ The court of appeals reversed in part, holding that the chemical spill *did* cause "property damage."⁴⁹ Thus, the cleanup portion of the federal court judgment⁵⁰ was covered under the policy.⁵¹ While the court of appeals impliedly refuted the *Milliken* interpretation of South Carolina law on this matter, the court failed to discuss why these response costs were considered "damages" under the insurance contract.

The court of appeals only briefly discussed *Armco* and *Milliken*, and cited those cases as authority for holding that the costs of removal of stored waste were not covered by the policy. The court noted that the stored chemicals, which were not leaking, had not yet caused physical injury to property.⁵² The money expended for removal of these materials, therefore, was preventive in nature and did not constitute a sum Pepper Industries was legally obligated to pay as damages for

45. *Id.* at —, 387 S.E.2d at 708.

46. *Id.*

47. *Id.* at —, 387 S.E.2d at 710.

48. *See id.*

49. *Id.*

50. The damage award included \$6,643.72 for cleanup costs. *Id.* at —, 387 S.E.2d at 711.

51. *Id.* at —, 387 S.E.2d at 710.

52. *Id.* at —, 387 S.E.2d at 709.

physical injury to or destruction of tangible property.⁵³ Accordingly, these costs from the federal court judgment were not covered by the USF&G policy, although the actual cleanup costs were covered.

III. OTHER JURISDICTIONS

Mraz, Armco, and Milliken demonstrate the Fourth Circuit's position that CGL insurance policies do not cover the costs of responding to uncontrolled hazardous wastes sites. Other jurisdictions are split with regard to coverage for these CERCLA expenses. Massachusetts, for example, classifies cleanup costs as "property damages" within the coverage of CGL policies.⁵⁴ The Eighth Circuit believes Missouri law excludes response costs from coverage as damages under CGL policies,⁵⁵ but the United States District Court for the Eastern District of Pennsylvania disagrees.⁵⁶ Additionally, California federal and state courts are split on the issue.⁵⁷

Courts addressing Superfund insurance issues are basically in agreement that the cases are to be decided under applicable state law. Furthermore, a review of the opinions indicates that most state insurance law requires ambiguities or doubts in coverage to be construed against the insurer and policy terms to be given their plain, ordinary meaning. Courts within various jurisdictions, however, are applying these rules of construction and reaching different results on the issue of coverage.⁵⁸

Some of the most instructive criticism of the Fourth Circuit's reasoning can be found in the dissent of an opinion actually adopting the

53. *Id.*

54. See *Hazen Paper Co. v. United States Fidelity & Guar. Co.*, 19 *Env'tl. L. Rep. (Env'tl. L. Inst.)* 20364 (Mass. Super. Ct. Jan. 10, 1989).

55. See *Continental Ins. Cos. v. Northeastern Pharmaceutical and Chem. Co.*, 842 *F.2d* 977 (8th Cir.), *cert. denied*, 109 S. Ct. 66 (1988).

56. *Jones Truck Lines v. Transport Ins. Co.*, 29 *Env't Rep. Cas. (BNA)* 1606, 1614 (E.D. Pa. May 10, 1989) ("[B]ecause 'under Missouri law the rules of construction applicable to insurance contracts require that the language used be given its plain meaning,' and because I am unable to discern any basis for the [Northeastern Pharmaceutical] majority's decision under existing Missouri caselaw, I conclude that under Missouri law, the term 'damages' in the standard-form general comprehensive liability policy includes cleanup costs." (citation omitted)), *modified*, No. 88-5723 (E.D. Pa. June 28, 1989) (WESTLAW, DCTU database) (modified to exclude expenses dealing solely with insured's own property).

57. Compare *Intel Corp. v. Hartford Accident & Indem. Co.*, 692 *F. Supp.* 1171 (N.D. Cal. 1988) (cleanup of contamination constitutes damages within the terms of the CGL policy) with *AIU Ins. Co. v. Superior Court*, 213 *Cal. App. 3d* 1219, 262 *Cal. Rptr.* 182 (1989) (response costs are equitable in nature and are not "damages" anticipated under CGL policies), *review granted*, 264 *Cal. Rptr.* 354, 782 *P.2d* 595 (1989).

58. See *infra* notes 59-100 and accompanying text.

Fourth Circuit rationale. In *Continental Insurance Cos. v. Northeastern Pharmaceutical & Chemical Co.*⁵⁹ (*NEPACCO*), a closely divided court agreed with the Fourth Circuit's reasoning and held that "damages" in the standard form CGL policy excludes cleanup costs.⁶⁰ The court noted, however, that environmental contamination caused by the disposal of hazardous substances can constitute "property damage."⁶¹

NEPACCO was decided under Missouri law, which holds that

"rules of construction applicable to insurance contracts require that the language used be given its plain meaning. If the language is unambiguous the policy must be enforced according to such language. If the language is ambiguous it will be construed against the insurer. Language is ambiguous if it is reasonably open to different constructions; and language used will be viewed in light of 'the meaning that would ordinarily be understood by the lay [person] who bought and paid for the policy.'"⁶²

Obviously, the lay insured expects the term "damages" to include all monetary claims, whether described as damages, expenses, costs, or losses. The term, therefore, is ambiguous.⁶³ The *NEPACCO* court, however, draws a distinction if the term is used within the context of insurance. "[T]he term 'damages' is not ambiguous [in the insurance context], and the plain meaning of the term 'damages' as used in the insurance context refers to legal damages and does not include equitable monetary relief."⁶⁴ No Missouri cases are cited for this proposition. Instead, the Eighth Circuit relies heavily on *Armco* which, at least theoretically, applied Maryland law.⁶⁵

It is difficult to comprehend how "damages" loses its ambiguity with respect to the average lay person when the word appears in an insurance policy. After all, the rules of construction for insurance policies are designed to protect an insured. The Eighth Circuit attempted to rationalize the limited construction of "damages," apparently by analogy, claiming such an interpretation is consistent with: (1) the in-

59. 842 F.2d 977 (8th Cir.), *cert. denied*, 109 S. Ct. 66 (1988).

60. *Id.* at 987.

61. *Cf. Mraz* (governmental claims for remediation costs are not claims for damages due to "property damage").

62. *Id.* at 985 (quoting *Robin v. Blue Cross Hosp. Serv., Inc.*, 637 S.W.2d 695, 698 (Mo. 1982) (en banc)).

63. *See id.* at 988 (Heaney, J., dissenting); *see also Avondale Indus. v. Travelers Indem. Co.*, 697 F. Supp. 1314 (S.D.N.Y. 1988) (cleanup costs recoverable as damages because the average businessman would consider himself covered for those expenses), *aff'd*, 887 F.2d 1200 (2d Cir. 1989), *petition for cert. filed*, No. 89-1576 (April 10, 1990).

64. *NEPACCO*, 842 F.2d at 985 (citing *Maryland Casualty Co. v. Armco, Inc.*, 822 F.2d 1348, 1352 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (1988)).

65. *See Armco*, 822 F.2d at 1354.

surer's obligations under the policy as a whole; (2) the distinction drawn in insurance law between money damages and equitable relief; and (3) the statutory scheme of CERCLA.⁶⁶

According to the court, NEPACCO's policy did not cover "'all sums which the insured shall become legally obligated to pay.'"⁶⁷ Continental, the insurer, only obligated itself to pay the sums NEPACCO was obligated to pay *as damages*.⁶⁸ Borrowing once again from *Armco*, the Eighth Circuit reasoned that permitting recovery for anything but monetary legal damages would render the "as damages" provision in the policy mere surplusage, since *any* obligation to pay would be covered.⁶⁹

The court next pointed out that insurance coverage typically is not recognized for the costs of complying with an injunction even though the suit could have been brought for damages.⁷⁰ The court, however, cited no Missouri cases for that proposition.

Finally, the Eighth Circuit noted that CERCLA differentiates between cleanup costs and damages.⁷¹ The court noted that "[u]nder CERCLA cleanup costs are not substantially equivalent to compensatory damages for injury to or destruction of the environment."⁷² The court then claimed several cases have "overlooked" this distinction.⁷³ Nothing in the court's opinion, however, indicates whether this distinction actually was overlooked, or was considered and discarded as form over substance.⁷⁴ Somewhat surprisingly, *NEPACCO* cited *Jack L. Baker Cos. v. Pasley Manufacturing & Distributing Co.*⁷⁵ to support

66. *NEPACCO*, 842 F.2d at 986.

67. *Id.* (emphasis in original) (quoting *Armco*, 822 F.2d at 1352).

68. *Id.*

69. *Id.*

70. *Id.*

71. *See id.*; *see also* CERCLA § 107(a)(4), 42 U.S.C. § 9607(a)(4) (1982 & Supp. V 1987) (detailing relief available under Superfund).

72. *NEPACCO*, 842 F.2d at 986.

73. *Id.*

74. *NEPACCO* references *United States Aviex Co. v. Travelers Ins. Co.*, 125 Mich. App. 579, 336 N.W.2d 838 (1983). *See id.* The *Aviex* court determined that the distinction between recovery for response costs and recovery of damages for damage to nature resources was "'merely fortuitous from the standpoint of either [the insured] or [the insurer].'" *NEPACCO*, 842 F.2d at 986 (quoting *Aviex*, 125 Mich. App. at 590, 336 N.W.2d at 843). The court reasoned that in either case, the measure of monetary relief granted is measured by the cost to restore the environment to its original state. *Aviex* rejected the argument that the term "damages" should be limited so as not to include equitable costs. *Id.* (citing *Aviex*, 125 Mich. App. at 590, 336 N.W.2d at 843). *NEPACCO* failed to discuss why this distinction existed. If the court was relying upon the legal damages/equitable relief distinction, its reasoning is somewhat circular.

75. 413 S.W.2d 268, 273-74 (Mo. 1967).

its position.⁷⁶ *Baker* is a Missouri case which held that the measure of damages to real property is the lesser of the following: (1) the difference in value before and after injury, or (2) the cost of restoring the land to its original condition.⁷⁷ Thus, under *Baker* a plaintiff can recover, as damages, the cost of restoring real property to its predamaged condition.⁷⁸ The court failed to explain why CERCLA "restoration costs" should be treated differently.

One final jurisdiction merits some discussion. Courts in California are sharply divided on the issue of insurance coverage of Superfund response costs. As discussed previously, the Federal District Court for the Northern District of California in *Intel Corp. v. Hartford Accident & Indemnity Co.*⁷⁹ rejected the Fourth Circuit's analysis, claiming that the Fourth Circuit failed to apply state law as required in federal diversity cases.⁸⁰ The *Intel* court concluded California law would recognize that response costs represent damage incurred for which compensation in the form of "damages" is appropriate.⁸¹ This was true even though the majority of the cleanup operations would be performed by Intel and other PRPs involved at the site. *Intel* cited several California cases which, though not precisely on point, supported the court's reasoning.⁸²

A California court of appeal, however, disagreed in *AIU Insurance Co. v. Superior Court*⁸³ with *Intel's* analysis of California law and held that the term "damages" unambiguously excludes remediation costs under governmental compulsion.⁸⁴ *AIU Insurance* based its decision

76. See *NEPACCO*, 842 F.2d at 988.

77. *Id.* at 987.

78. See *id.*

79. 692 F. Supp. 1171 (N.D. Cal. 1988). For the earlier discussion of *Intel*, see *supra* notes 36-38 and accompanying text.

80. *Id.* at 1186-87.

81. *Id.* at 1189. Under California law, groundwater is a public resource, contamination of which is a tangible injury to a third party, the state. *Id.* Much of the decision focused on several exclusions contained in the policy which the insurer was attempting to enforce. The court agreed that Intel could not recover the portion of costs attributable to cleanup of its own property. The court determined, however, that segregation of expenses between abatement costs for cleaning up damage to third party interests (which are recoverable) and those for Intel's property (which are not recoverable) was not as difficult as the insurer claimed. Basically, the court concluded that any activity required by governmental agencies was necessary to meet the health and safety mandates of the relevant states, and therefore was recoverable as remedying damage or potential damage to the public (*i.e.*, a third party). *Id.* at 1194.

82. *Id.* at 1190 (citing *Hanson v. Prudential Ins. Co. of Am.*, 783 F.2d 762 (9th Cir. 1985); *Globe Indem. Co. v. State*, 43 Cal. App. 3d 745, 118 Cal. Rptr. 75 (1974)).

83. 213 Cal. App. 3d 1219, 262 Cal. Rptr. 182, *petition for review granted*, — Cal. 3d —, 782 P.2d 595, 264 Cal. Rptr. 354 (1989).

84. *Id.* at —, 262 Cal. Rptr. at 194.

denying coverage for response costs on a "majority of decisions hold[ing] that liability insurance does not cover the costs of compliance with a mandatory injunction."⁸⁵ The court relied heavily upon *Armco*, noting that the case did not turn on "hypertechnical distinctions between law and equity."⁸⁶ The court explained:

A careful reading of the ARMCO decision reveals that the court there determined that as a matter of law a liability insurer did not intend to assume the massive and open ended risk of the costs of the insured's compliance with mandatory injunctions to remedy toxic pollution conditions. The decision is . . . that insurers never intended to assume such uncertain and potentially enormous risks. It is clear the decision is not based on common law formalism or arcane nuances of Maryland law (which law is barely touched upon in the *Armco* opinion). It represents the considered opinion of the court that liability insurance policies were never intended to foot the bill for the kinds of remedies CERCLA and like statutes provide.⁸⁷

The court determined that the *Armco* holding was consistent with California case law denying coverage for the costs of compliance with governmental directives.⁸⁸

There is little doubt that neither party entered the insurance contract anticipating a claim of this sort; Superfund did not exist at the time the contract was executed. The parties did contemplate and expressly agree, however, that the insurer would honor the policy if the insured became legally obligated to pay damages to a third party because of property damage. An insured could legitimately expect its insurance carrier to pay these damages.⁸⁹ As a PRP, an insured is legally obligated to pay the costs associated with the cleanup of uncontrolled hazardous waste sites. Moreover, this obligation does not arise exclusively from a civil judgment.⁹⁰ The *AIU Insurance* court was unimpressed with this reasoning, however, and rejected the *Intel* holding.⁹¹

AIU Insurance also rejected another California court of appeal decision, *Aerojet-General Corp. v. Superior Court*,⁹² which held that response costs under CERCLA and similar statutes are covered by a

85. *Id.* at ___, 262 Cal. Rptr. at 185 (citing a number of cases from California and other jurisdictions).

86. *Id.* at ___, 262 Cal. Rptr. at 187.

87. *Id.*

88. *Id.*

89. *See Intel Corp. v. Hartford Accident & Indem. Co.*, 692 F. Supp. 1171, 1190 (N.D. Cal. 1988) (discussing liability to third parties under similar insurance contract).

90. *See id.*

91. *See AIU Ins.*, 213 Cal. App. 3d at ___, 262 Cal. Rptr. at 194.

92. 209 Cal. App. 3d 973, 257 Cal. Rptr. 628, *supplemented on denial of rehearing*, 211 Cal. App. 3d 216, 258 Cal. Rptr. 684 (1989).

CGL policy except for preventive relief.⁹³ The *AIU Insurance* court determined *Aerojet* was distinguishable because it involved allegations of pollution damage to the state's interest in subsurface and navigable waters. According to *AIU Insurance*, coverage for such an injury is within the plain meaning of the term "damages," whether the aggrieved party is a governmental entity or a private individual.⁹⁴ The court stated:

To the extent that the result in *Aerojet* rests on that court's perception that the governmental agencies there sought recompense for damage to proprietary governmental interests in property, we do not disagree with the decision; but insofar as the decision holds that there is coverage for the costs of compliance with the police power, we must respectfully disagree.⁹⁵

AIU Insurance, unlike the cases discussed previously, emphasized that CGL policies do not encompass expenses incurred pursuant to a governmental exercise of the police power. According to *AIU Insurance*, the federal government utilizes CERCLA to recover response costs as a direct exercise of the police power.⁹⁶ "The government does not own the affected property; rather it exercises its statutory authority to compel cleanup for the benefit of all the public at large."⁹⁷ The court also noted the lack of any precedent requiring insurance coverage for compliance with such a governmental directive, and the danger of recognizing coverage in this situation. The court cautioned that "[t]he broad principle stated in *Aerojet* could render liability insurers responsible for the costs of doing business, such as mandatory compliance with a local zoning ordinance."⁹⁸ While it is doubtful that the court's fears would be realized if response costs were held to be recoverable under insurance policies, the "police power" exclusion is more plausible than the technical equitable relief/legal damages distinction advanced by so many other courts denying coverage.

The court in *AIU Insurance* combined the rationale of *Armco* and its own police power argument to formulate the following three reasons to deny insurance coverage for response costs under CERCLA: (1) cost

93. *Id.* at ___, 257 Cal. Rptr. at 634.

94. *AIU Ins.*, 213 Cal. App. 3d at ___, 262 Cal. Rptr. at 189. According to the court in *AIU Ins.*, the parties had not presented facts establishing what part, if any, of the injured property was owned by the governmental agencies seeking remediation of the site. *Id.*

95. *Id.* at ___, 262 Cal. Rptr. at 190.

96. *Id.* "The stated purpose of a CERCLA action . . . is equitable, not to compensate parties for harm, but to facilitate government cleanup to protect the public health." *Id.*

97. *Id.*

98. *Id.*

recovery is an exercise of the police power; (2) response costs are restitutionary in nature; and (3) coverage of response costs was not contemplated by the parties to the insurance policy.⁹⁹ The court apparently viewed these facts as interrelated, as is illustrated by the final holding. The court reasoned that at the time the parties to the insurance policy entered the contract, they could not have reasonably expected that the policy would cover CERCLA response costs, because no precedent exists for coverage of a governmental exercise of the police power. Consequently, no coverage existed.¹⁰⁰ While certainly there are arguments to the contrary, the *AIU Insurance* court has utilized a somewhat novel approach to the growing debate over insurance coverage for Superfund liabilities.

IV. CONCLUSION

As the expense of CERCLA cleanup of uncontrolled hazardous waste sites continues to rise, the number of PRPs seeking insurance coverage for those costs also will increase. Currently, the forum in which the claim is brought is crucial to the determination on coverage—a condition which likely will continue to exist until the United States Supreme Court agrees to accept one of these cases for review. Until that time, federal court litigants should ask the federal courts to certify the question of coverage to the appropriate state supreme court,¹⁰¹ since various federal courts appear to find differing meanings in the so called “black-letter” insurance law.

99. *Id.*

100. *Id.* at —, 262 Cal. Rptr. at 191.

101. *See, e.g.,* Claussen v. Aetna Casualty & Sur. Co., 865 F.2d 1217 (11th Cir. 1989) (certified question to Georgia Supreme Court concerning how Georgia state law would construe pollution exclusion clause); Claussen v. Aetna Casualty & Sur. Co., 259 Ga. 333, 380 S.E.2d 686 (1989) (under Georgia law, CGL policy covers property damages caused by pollution, despite pollution exclusion clause).