Whether Governmentally Compelled Cleanup Costs Constitute "Damages" Under CGL Policies: The Nationwide Environmental Liability Dilemma and a California Model for its Resolution

David W. Miller†

I. INTRODUCTION

Twelve years after the news media reported stories of a strange black sludge bleeding through residential basement walls near a New York ditch called Love Canal, the 1990s have dawned with a high-stakes debate between hazardous waste generators and their insurers over the appropriate entity to finance environmental remediation.[1] The astronomical cost of environmental remediation, presently estimated to be $150 billion for known hazardous waste sites alone,[2] has escalated the debate into a full-scale, nationwide litigation war between hazardous waste generators and their insurers.[3]

This article focuses on whether governmentally compelled environmental cleanup costs constitute "damages" within the meaning of Comprehensive General Liability ("CGL") insurance policies.[4] The issue is significant not only to determine *who* pays the environmental cleanup bills, but also *when*, because insured

† Associate, Landels, Ripley & Diamond, San Francisco, California. A.B., University of California at Davis, 1980; Coro Fellow, San Francisco, California, 1981-82; J.D., Santa Clara University School of Law, 1986; Law Clerk to the Hon. Edward A. Panelli, Associate Justice, California Supreme Court, 1986-87. The author is especially grateful to Lynn Stewart and Chris Locke for their invaluable editing and advice.

1. *See, e.g.*, Avondale Industries, Inc. v. Travelers Indem. Co., 887 F.2d 1200, 1201 (2d. Cir. 1989), *reh'g denied per curiam*, 894 F.2d 498 (2d. Cir. 1990), *cert. denied*, 110 S. Ct. 1588 (1990) ("Millions of tons of hazardous waste generated yearly are stored, deposited, recycled or dumped, and eventually escape. . . . When its source is identified, the question becomes who is to clean it up and who is to pay for the damages it caused.").

2. Feder, *New Battles Over Disclosure*, N.Y. Times, June 24, 1990, at 10, col. 1.

3. *See infra* notes 41-43 and accompanying text.

4. *See, e.g.*, AIU Ins. Co. v. Superior Court (FMC Corp.), 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990).

polluters tend to commence cleanup activities "sooner and with greater cooperation with government."[5] The issue is also timely since numerous state and federal appellate court decisions published in 1989-90 have taken a markedly different course from the leading decisions published in 1986-88.[6] These more recent cases emphasize that the use of the ambiguous and typically undefined term "damages" in CGL policies compels a determination that the term embraces governmentally compelled environmental cleanup costs.[7] Further, because these decisions generally follow the requirements of state insurance law by evaluating the scope of policy coverage in terms of the insured's reasonable expectations, they are better reasoned than the earlier cases.[8]

The reason for the sharp split among courts over who should finance environmental remediation may be the persuasive nature of the arguments advanced by both insurers and insureds. Decisions favoring insurers have embraced either or both of two general arguments. One approach excludes coverage by rejecting established rules of insurance policy interpretation in favor of more restrictive principles,[9] while a second approach reaches the same conclusion under traditional rules of interpretation.[10] Courts accepting the second approach have focused on the restitutionary nature of governmentally compelled cleanup costs, distinguishing these costs from "legal" damages.[11] On the other side, some of the decisions favoring insureds have held that environmental cleanup costs fall within the plain meaning of "damages" in the coverage section of the CGL policies, legally obligating the insurers to pay, while others have held that the language of the policies is ambiguous and therefore must be re-

5. Aerojet-General Corp. v. Superior Court (Cheshire), 211 Cal. App. 3d 216, 237, 257 Cal. Rptr. 621, 634, *reh'g denied*, 258 Cal. Rptr. 684 (1989). *See also* Note, *Insurance Coverage of CERCLA Response Costs: The Limits of Damages in Comprehensive General Liability Policies*, 16 ECOLOGY L.Q. 755, 758 (1988) ("coverage disputes between businesses and insurers" have delayed CERCLA cleanups).

6. *Compare* the leading cases cited in footnote 41 (holding for insurers) and the cases cited in footnote 42 (holding for insureds).

7. *See infra* notes 75-98 and accompanying text.

8. *See e.g., AIU*, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820, discussed *infra* notes 132-174 and accompanying text.

9. *See, e.g.*, Mraz v. Canadian Universal Ins. Co., Ltd., 804 F.2d 1325 (4th Cir. 1986).

10. *See, e.g.*, Maryland Casualty Company v. Armco, Inc., 822 F.2d 1348 (4th Cir. 1987).

11. *AIU*, 51 Cal. 3d at 820, 799 P.2d at 1263, 274 Cal. Rptr. at 830.

solved in favor of coverage under ordinary rules of insurance policy interpretation.[12]

These arguments are thoughtfully analyzed in the California Supreme Court's recent decision in *AIU Insurance Co. v. Superior Court (FMC Corp.)* which holds the insurers' use of the vague and generic term "damages" should not be read in the narrow, technical sense urged by the insurers, but rather should be read in the light of established principles of contract interpretation by resolving ambiguities in favor of coverage. The court's decision comports with the common-sense notion that comprehensive coverage should protect the insured against all liabilities not specifically excluded. The decision rejects the insurers' overly technical argument, accepted by some federal courts, that the restitutionary nature of environmental cleanup costs precludes a finding of coverage.[13] Rather, the *AIU* court properly limits its analysis to established principles of contract interpretation, declining to consider public policy considerations that support either insurers or insureds.[14] For these reasons, and because of the court's attention to lesser issues such as whether an insured's prophylactic measures are covered and whether a "sophisticated insured" defense applies, *AIU* stands as a thorough, well-reasoned model. The decision thus merits the attention of any court addressing the dilemma of whether environmental polluters or their insurers should finance environmental remediation. *AIU* should be of particular interest to courts obligated to follow the laws of Michigan, NewYork, Missouri, Illinois, Idaho and Iowa—states in which there is a split of authority and/or the issue is pending before the state court of last resort.[15]

Part II of this article reviews the federal environmental enforcement provisions and insurance policy terms that typically trigger generator claims for insurance coverage. Part III examines the split of judicial authority across the country regarding who should pay governmentally compelled environmental cleanup costs. Part IV examines the example of California, a state in which conflicting appellate court decisions rendered the issue uncertain until the California Supreme Court's decision in *AIU*. Part V suggests an analytical model based on *AIU*, emphasizing reasons why our

12. *Id.* at 818, 799 P.2d at 1262, 274 Cal. Rptr. at 829.
13. *Id.* at 842, 799 P.2d at 1279, 274 Cal. Rptr. at 846.
14. *Id.* at 814, 799 P.2d at 1259, 274 Cal. Rptr. at 826.
15. *See infra* note 43 and accompanying text.

nation's dilemma over the appropriate entity to finance environmental remediation should be resolved in a manner consistent with established principles of contract interpretation.

II. THE STATUTORY PROVISIONS AND POLICY LANGUAGE AT ISSUE IN THE COVERAGE CONTROVERSY

The government's fundamental interest in protecting human health and the environment underlies an array of federal and state statutory enforcement mechanisms aimed at compelling timely and effective environmental remediation. The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA")[16] and the Resource Conservation and Recovery Act ("RCRA"),[17] together with their state counterparts, provide the principal statutory bases authorizing governmentally compelled environmental cleanups.[18] Generally, these environmental statutes operate in one or both of two ways: (1) they authorize the government to compel polluters themselves to clean up hazardous waste, or (2) they empower the government to clean up the waste, then seek reimbursement from the polluter. These two basic remedies form the bases for government imposition of liability on polluters for cleanup costs.

From the government's perspective, choosing one remedy over the other is often just a matter of convenience. For the responsible party, however, the choice may be determinative of insurer liability for cleanup costs. In some courts, the remedy applied has been the crucial factor in deciding whether the environmental polluter or its insurer must finance an environmental cleanup. This dilemma has contributed to the nationwide litigation war

16. Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Pub. L. No.96-510, 94 Stat. 2767 (codified as amended in 42 U.S.C. §§ 9601-9657 (1988)), *reauthorized and amended in part by* Superfund Amendments and Reauthorization Act of 1986, Pub. L. No.99-499, 100 Stat. 1613 (1986) (codified at 42 U.S.C. §§ 9601-9657 (1988)). Spawned amid the outcry over Love Canal and other abandoned toxic waste dumps, CERCLA was passed in December 1980 by a lame duck Congress in the waning days of the Carter Administration. The litigation regarding insurance coverage may properly be viewed as a direct outgrowth of CERCLA. *See* Answer to Petition for Writ of Mandate filed by Real Party in Interest FMC Corporation at 6-7, AIU Ins. Co. v. Superior Court (FMC Corp.), 213 Cal. App. 3d 1219, 262 Cal. Rptr. 182 (1989) (No. 643058).

17. 42 U.S.C. §§ 6901-6992 (1988).

18. Other statutory schemes often relied on by federal regulators to compel environmental cleanups include the Clean Water Act (33 U.S.C. §§ 1251-1387 (1988)) and the Safe Drinking Water Act (42 U.S.C. §§ 300f-300m (1988)).

over the scope of CGL policy coverage that has stalled environmental remediation.

A. *Response Costs under CERCLA and RCRA*

CERCLA authorizes the President, acting through the Environmental Protection Agency ("EPA"), to respond to the release or substantial threat of release of any hazardous substance or any pollutant or contaminant that may present an imminent and substantial danger to public health or welfare.[19] Under CERCLA, the EPA has broad authority to take whatever response measures it deems necessary to remove or neutralize hazardous waste.[20] As defined by CERCLA, the term "response costs" includes two components: (1) costs of removal, defined as the cleanup or removal of hazardous substances in the event of their release or threatened release into the environment, and (2) costs of remedial actions, defined as actions to effect a permanent remedy to prevent or minimize the release of hazardous substances so that they do not migrate to endanger present or future public health, welfare or the environment.[21] To recover response costs, the EPA and other parties are permitted under CERCLA to seek reimbursement from "responsible parties."[22] Responsible parties include hazardous waste generators, transporters, and disposal facility owners and operators.[23] Under CERCLA, the EPA also has the remedy of seeking injunctive relief to compel responsible parties themselves to take necessary response action.[24] This remedy avoids the necessity of seeking reimbursement from the responsible parties.

RCRA is EPA's most extensive regulatory program.[25] Its goal is the regulation of all aspects of the management of hazardous waste from the time it is generated to the time of its proper dispo-

19. 42 U.S.C. § 9604(a)(1) (1988); Exec. Order No. 12,316, 46 Fed. Reg. 42,237 (1981).

20. 42 U.S.C. §§ 9604, 9621(a) (1988).

21. 42 U.S.C. §§ 9601(23)-9601(25) (1988); *see* Aerojet-General Corp. v. Superior Court (Cheshire), 211 Cal. App. 3d 216, 235, 257 Cal. Rptr. 621, 623, *reh'g denied*, 258 Cal. Rptr. 684 (1989).

22. 42 U.S.C. §§ 9607(a)(4)(A)-9607(a)(4)(B) (1988); *see* State v. Shore Realty Corp., 759 F.2d 1032, 1041 (2d Cir. 1985).

23. 42 U.S.C. § 9607(a) (1988).

24. 42 U.S.C. § 9606(a) (1988).

25. R. HALL, T. WATSON, J. DAVIDSON, D. CASE & N. BRYSON, RCRA HAZARDOUS WASTES HANDBOOK at xii (7th ed. 1988) [hereinafter RCRA HAZARDOUS WASTES HANDBOOK].

sal.[26] This "cradle to grave" regulatory program applies "to all persons who currently manage hazardous waste."[27]

Several types of RCRA enforcement actions are available to the EPA to compel the lawful management and disposal of hazardous waste. Notably, RCRA empowers the EPA to compel the cleanup of existing and abandoned hazardous waste sites through compliance orders and penalties.[28] RCRA also empowers the EPA to seek injunctive relief against responsible parties who control sites that present an imminent and substantial endangerment to health or the environment.[29] Although the EPA typically coordinates RCRA enforcement actions with other federal laws such as CERCLA, there are situations, such as underground petroleum leaks, where the waste involved is excluded from CERCLA but not RCRA regulation.[30]

B. *Relevant Policy Language*

When an environmental polluter is ordered by government regulators to finance environmental investigation and/or remediation, it typically turns to its comprehensive general liability carrier for coverage pursuant to the carrier's CGL policy. The insurance industry developed the CGL policy in the early 1940s in order to provide comprehensive coverage for a wide range of possible liabilities, including those that are unknown and unanticipated.[31] A fundamental purpose of this coverage has been to shift the risk of such liabilities to the insurers.[32] Today, CGL policy language varies among insurers but the fundamental, typically undefined elements remain constant. In broad terms, the language sets forth the insurers' duty to pay as "damages" any amount the insured became legally liable to pay as a result of, *inter alia*, "property damage."

In *AIU*, over sixty primary and excess insurers provided similar policies. For example, the policies furnished by Liberty Mutual Insurance Company and others state that the insurer will provide coverage to FMC for "all sums which the insured shall become

26. *Id.* at 1-7.
27. *Id.* at 2-1.
28. 42 U.S.C. §§ 6928(a)-6928(d) (1988).
29. 42 U.S.C. § 6973(a) (1988).
30. *See* RCRA HAZARDOUS WASTES HANDBOOK, *supra* note 25 at 10-21 to -22.
31. 7A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4491 (rev. ed. 1979).
32. H. DENENBERG, RISK AND INSURANCE 150, 167 (2d. ed. 1964).

legally obligated to pay as damages because of. . . property damage to which this policy applies."[33] Policies issued by First State Insurance Company and others state that the insurer will provide coverage to FMC for:

> all sums which [FMC] shall be obligated to pay by reason of the liability . . . imposed upon [FMC] by law . . . for damages, direct or consequential and expenses, all as more fully defined by the term 'ultimate net loss' on account of . . . property damages. . . .[34]

Similarly, policies issued by FMC Insurance Company and others provide coverage for "all sums which [FMC] shall become obligated to pay by reason of the liability . . . imposed upon [FMC] by law . . . for damages on account of . . . property damage."[35] These coverage provisions were adopted verbatim from standard CGL policies used throughout the insurance industry.[36] Such policies neglect to define the terms "property damage" and "damages." Their common failure to define these critical policy terms has sparked the judicial split of authority examined in this article.[37]

33. AIU Ins. Co. v. Superior Court (FMC Corp.), 51 Cal. 3d 807, 814, 799 P.2d 1253, 1259, 274 Cal. Rptr. 820, 826 (1990).

34. *Id.* at 814-15, 799 P.2d at 1259, 274 Cal. Rptr. at 826. The First State Insurance Company policies define "ultimate net loss" as:

> the total sum which [FMC] . . . become[s] obligated to pay by reason of . . . property damage . . . claims, either through adjudication or compromise, and shall also include . . . all sums paid as salaries, wages, compensation, fees, charges and law costs, . . . expenses for doctors, lawyers, nurses and investigators and other persons, and for litigation, settlement, adjustment and investigation of claims and suits which are paid as a consequence of any occurrence covered hereunder . . . .

Id. at 815 n.2, 799 P.2d at 1259 n.2, 274 Cal. Rptr. at 826 n.2.

35. *Id.* at 814, 799 P.2d at 1259, 274 Cal. Rptr. at 826.

36. *Id.* at 815, 799 P.2d at 1259, 274 Cal. Rptr. at 826 (citing Note, *supra* note 5, at 759 and Chesler, Rodburg & Smith, *Patterns of Judicial Interpretation of Insurance Coverage for Hazardous Waste Site Liability*, 18 RUTGERS L.J. 9, 53 (1986)).

37. Aerojet-General Corp. v. Superior Court (Cheshire), 211 Cal. App. 3d 216, 222, 257 Cal. Rptr. 621, 634, *reh'g denied*, 258 Cal. Rptr. 684, 686 (1989) ("The policies do not specifically define 'damages.' ").

III. THE SPLIT OF AUTHORITY OUTSIDE CALIFORNIA: A CHECKERBOARD WAR BETWEEN INSURERS AND INSUREDS OVER THE FINANCING OF ENVIRONMENTAL CLEANUPS

Courts have split on the question of how the term "damages" should be interpreted in the CGL policy context.[38] The reason for the split is that while some courts have looked to established rules of insurance contract interpretation to resolve the issue, other courts have been persuaded by the insurers' myriad of legal, factual and policy-based arguments to adopt alternate analyses that would preclude insurers from financing environmental remediation.[39] Courts that have developed alternative analyses to reject coverage have ignored relevant state insurance law principles or have simply developed internally inconsistent theories. Perhaps as a result, decisions adhering to these alternate analyses appear to have fallen into disfavor. The overwhelming majority of appellate courts that have addressed the environmental liability issue in 1989-90 have held in favor of coverage.[40]

Courts holding that CGL policies do not cover environmental cleanup costs include the United States Courts of Appeals for the Fourth and Eighth Circuits, the highest state courts of Maine and New Hampshire, and a South Carolina intermediate appellate court.[41] Courts holding that CGL polices do cover environmental

38. The split of authority has fueled the growing body of commentary addressing whether environmental cleanup costs constitute "damages" within the meanings of CGL policies. *See, e.g.*, Pendygraft et al., *Who Pays for Environmental Damage: Recent Developments in CERCLA Liability and Insurance Coverage Litigation*, 21 IND. L. REV. 117 (1988); Comment, *The Applicability of Comprehensive General Liability Insurance for CERCLA Response Costs*, 18 CAP. U.L. REV. 413 (1989); Comment, *Insurance Coverage for Hazardous Waste Cleanup: The Comprehensive General Liability Insurance Policy Defined*, 39 CATH. U.L. REV. 195 (Fall 1989); Comment, *Comprehensive General Liability Insurance Coverage for CERCLA Liabilities: A Recommendation for Judicial Adherence to State Canons of Insurance Contract Construction*, 61 U. COLO. L. REV. 407 (1990); Comment, *Insurance Coverage of CERCLA Response Cost: The Limits of "Damages" in Comprehensive General Liability Policies*, 16 ECOLOGY L.Q. 755 (1989); Comment, *CERCLA Cleanup Costs Under Comprehensive General Liability Insurance Policies: Property Damage or Economic Damage?*, 56 FORDHAM L. REV. 1169 (1988); Note, *Environmental Cleanup Costs and Insurance: Seeking a Solution*, 24 GA. L. REV. 705 (Spring 1990); Comment, *The Superfund Insurance Dilemma: Defining the Super Risks and Rights of Comprehensive General Liability Policies*, 21 IND. L. REV. 735 (1988); Comment, *CERCLA Cost Recovery Suits: A Suit Against an Insured for Damages Under a Comprehensive General Liability Policy*, 14 WM. MITCHELL L. REV. 829 (1988).

39. *Compare* cases cited in notes 41 and 42.

40. *See infra* notes 41-43.

41. *See* Cincinnati Ins. Co. v. Milliken & Co., 857 F.2d 979 (4th Cir. 1988) (following *Maryland Casualty*); Continental Insurance Companies v. Northeastern Pharmaceutical &

cleanup costs include the United States Court of Appeals for the Second Circuit, the highest state courts of California, Massachusetts, Minnesota, Washington, North Carolina, and Wyoming, and the intermediate appellate courts in Wisconsin and New Jersey.[42] There is a split of authority, and/or the issue is still pending, before the highest state courts of Michigan, New York, Missouri, Illinois, Idaho and Iowa.[43]

A. *The Leading Decisions Denying Coverage: A Rejection of Established Rules of Insurance Policy Interpretation*

In one of the earliest cases denying coverage, *Mraz v. Canadian Universal Insurance Co.*,[44] owners of a solvent recycling plant sought a declaratory judgment that the defendant insurer had a duty to defend and indemnify them in a CERCLA response action

Chem. Co., 842 F.2d 977 (8th Cir. 1988) (applying Missouri law); Maryland Casualty Co. v. Armco, Inc., 822 F.2d 1348 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (applying Maryland law); Mraz v. Canadian Universal Ins. Co., 804 F.2d 1325 (4th Cir. 1986); Patrons Oxford Mut. Ins. Co. v. Marois, 573 A.2d 16 (Me. 1990); Troy Mills, Inc. v. Aetna Cas. & Sur. Co., No. 89-311 (N.H. App. Feb. 14, 1990); Braswell v. Faircloth, 300 S.C. 338, 387 S.E.2d 707 (1989).

42. *See* Avondale Indus. v. Travelers Indem. Co., 887 F.2d 1200 (2d Cir. 1989), *modified and reh'g denied per curiam*, 894 F.2d 498, *cert. denied*, 110 S.Ct. 2588 (1990) (applying N.Y. law); AIU Ins. Co. v. Superior Court (FMC Corp.), 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990); Hazen Paper Co. v. United States Fidelity and Guar. Co., 407 Mass. 689, 555 N.E.2d 576 (1990); Joslyn Corp. v. Liberty Mutual Ins. Co., 475 N.W.2d 175 (Minn. 1990); Broadwell Realty Services, Inc. v. The Fidelity & Cas. Co., 218 N.J. Super. 516, 528 A.3d 76 (N.J. Super. Ct. App. Div. 1987); C.D. Spangler Constr. Co. v. Indus. Crankshaft & Eng'g Co. Inc., 326 N.C. 133, 388 S.E.2d 557 (1990); Boeing v. Aetna Cas. & Sur. Co., 113 Wash. 2d 869, 784 P.2d 507 (1990) (en banc); Wagner v. Milwaukee Mut. Ins. Co., 145 Wis. 2d 609, 427 N.W.2d 854, 856 n.3 (1988); Compass Ins. Co. v. Cravens, Dargan & Co., 748 P.2d 724, 728-30 (Wyo. 1988).

43. *Compare* Jones v. Farm Bureau Mut. Ins. Co., 172 Mich. App. 24, 431 N.W.2d 242 (Mich. Ct. App. 1988) (holding for insurers) *with* United States' Aviex Co. v. Travelers Ins. Co., 125 Mich. App. 579, 336 N.W.2d 838 (Mich. Ct. App. 1983) (holding for insureds); County of Broome v. Aetna Casualty. & Surety Co., 146 A.D.2d 337, 540 N.Y.S.2d 620 (N.Y. App. Div. 1989) (insurers) *with* Kutsher's Country Club Corp. v. Lincoln Ins. Co., 119 Misc. 2d 889, 465 N.Y.S.2d 136 (N.Y. Sup. Ct. 1983) (insureds); *Continental Insurance*, 842 F.2d at 977 (applying Missouri law to hold for the insurers) *with* Jones Truck Lines v. Transport Ins. Co., No. 88-5723 (E.D. Pa. 1989), *question certified*, Nos. 89-1729/59 (3d Cir. Feb. 15, 1990) (notwithstanding *Continental Insurance*, under Missouri substantive law, cleanup costs are "damages"); Verlan, Ltd. v. John L. Armitage & Co., 695 F.Supp. 950, 954 (N.D. Ill. 1988) (insurers) *with* United States Fidel. & Guar. Co. v. Specialty Coatings Co., 180 Ill. App. 3d 378, 535 N.E.2d 1071 (Ill. App. Ct. 1989), *appeal denied*, 136 Ill. 2d 609, 545 N.E.2d 133 (1989) (insureds); Aetna Casualty & Sur. Co. v. Gulf Resources & Chem. Co., 709 F. Supp. 958, 962 (D. Idaho 1989) (insurers) *with* Unigard Mut. Ins. Co. v. McCarty's Inc., No. 83-1441 (D. Idaho Oct. 18, 1989) (insureds).

44. 804 F.2d 1325 (4th Cir. 1986).

brought by the United States and the State of Maryland. The action sought reimbursement of the cost of remediating a hazardous waste burial site.[45] The district court, observing that the governments' complaint had alleged that the release caused soil and water contamination resulting in the need for remedial cleanup, concluded that the complaint alleged property damage within the meaning of the CGL policy of issue.[46]

In determining whether the language in the CGL policies covering "damages" included CERCLA response costs, the Court of Appeals for the Fourth Circuit examined "whether the alleged contamination of the . . . site was the injury for which the governments sought relief or merely a *factual predicate* of the cost reimbursement claim."[47] The court held that because CERCLA's provisions distinguish between property damage and response costs, response costs are not property damage, but "economic loss."[48]

The *Mraz* court relied on CERCLA section 104[49] even though traditionally the determination of the meaning of insurance policy language is decided under state contract law.[50] The primary goal of contract law analysis is to determine what the parties intended when they entered into the contract. Although the parties in *Mraz* had executed a CGL policy that covered any "damages," in interpreting the policy the *Mraz* court never examined the parties' reasonable expectations as to what "damages" would include. Instead, the court focused on the meaning of "response costs" as that term is used in CERCLA section 104. The *Mraz* court thus

45. *Id.* at 1326.

46. *Id.* at 1327.

47. *Id.* at 1328 (emphasis added). The "factual predicate" approach warrants scrutiny. At best it is legal hairsplitting that merely belies the result-oriented nature of the court's decision. Carried to its logical extreme, the *Mraz* analysis permits *any injury* to be characterized as a "factual predicate" of a claim, and therefore fall outside the scope of coverage.

48. *Id.* at 1329.

49. CERCLA § 104 allows response costs to be incurred before there is property damage. *See* 42 U.S.C § 9604 (1988).

50. Generally, federal law does not regulate insurance contracts. *See, e.g.*, 15 U.S.C. § 1012 (1988) ("The business of insurance . . . shall be subject to the laws of the several States . . . ."). Where, as here, the issue involves interpretation of an insurance contract, the issue is one of state law. *See, e.g.*, California Insurance Code § 41 (West 1990) ("All insurance in this State is governed by the provisions of this code."); Hazen Paper Co. v. United States Fidelity & Guar. Co., 407 Mass. 689, 555 N.E.2d 576 (1990). Federal courts that rule on the issue do so solely pursuant to their diversity jurisdiction, in which the courts must apply the law of the particular state. *See* Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938).

converted a state law contract interpretation issue of the insured's reasonable expectations under its CGL policy into a federal statutory interpretation issue of whether environmental response costs constituted property damages under CERCLA.[51] By looking to CERCLA, rather than the insurance policy language, the court concluded that environmental response costs constituted mere economic loss, rather than insurable "damages."

Within one year of *Mraz*, in *Maryland Casualty Company v. Armco, Inc.*,[52] the Fourth Circuit refined its refusal to find CGL coverage for environmental contamination. In *Maryland Casualty*, the United States brought an enforcement action against the owners of a waste storage facility and the "original waste generators," alleging that improper maintenance techniques used in storing the hazardous wastes had caused soil and groundwater contamination.[53] Armco then filed a separate action against its insurers, alleging that they were obligated to defend and indemnify Armco in the action brought by the United States.[54] In the second action, the Fourth Circuit affirmed the trial court's holding, observing that "black letter insurance law holds that claims for equitable relief are not claims for 'damages' under liability insurance contracts."[55] According to the *Maryland Casualty* court, the restitutionary nature of the government's underlying claim meant that the government's claim was one for "equitable" damages, not "legal" damages, and therefore fell outside the scope of the CGL policy.

In drawing a distinction between underlying claims that seek equitable as opposed to legal relief, the *Maryland Casualty*, like the *Mraz*, court ignored relevant state law. Although it was obligated to apply Maryland law, the court nowhere cited to any relevant Maryland authority to support its analysis.[56] Further, as in *Mraz*,

51. *See supra* notes 48-49 and accompanying text.

52. 822 F.2d 1348 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (1988).

53. *Id.* at 1350.

54. *Id.* at 1351.

55. *Id.*

56. *See generally* 822 F.2d at 1352-55. Indeed, as one court observed:

> the relevant section of *Maryland Casualty* cites but a single Maryland state court decision. That decision, *Pacific Indemnity Co. v. Interstate Fire & Casualty Co.* is cited for the proposition that "the terms of an insurance policy are to be construed according to the meaning a reasonably prudent layman would infer. This proposition is hardly in keeping with the Fourth Circuit then assigning a legal, technical meaning to the term "damages." (citations omitted)

Chesapeake Util. Corp. v. Am. Home Assurance. Co., 704 F. Supp 551, 560 (1989). The *Chesapeake Utilities* court concluded that *Maryland Casualty* "misstates Maryland law." *Id.* at

the court failed to consider the reasonable expectations of the insured, an error particularly egregious in view of the court's acknowledgement that the policy language was less than clear.[57] Instead, the court borrowed an odd and circular definition of "damages" from a 1955 Fifth Circuit decision holding that damages include "only payments to third persons when those persons have a legal claim for damages."[58] Following *Mraz*, the *Maryland Casualty* court held that the government's underlying claim for equitable relief did not constitute legal "damages" within the meaning of the policy, despite the policy's silence on this issue.[59]

558. The *AIU* trial court was similarly troubled by *Maryland Casualty*'s analysis. ("It is impossible to reconcile [*Pacific Indemnity*] with a holding that in the insurance context, as opposed to any other, words should be given a technical, legal meaning.") Memorandum Of Intended Decision On Motion Of Certain Defendants For Adjudication That CERCLA Clean-up Costs Do Not Constitute Damages at 12, AIU Ins. Co. v. Superior Court (FMC Corp.) (No. 643058) [hereinafter *AIU* Memorandum] [this document constitutes the only opinion issued by the trial court]. *Maryland Casualty*'s only other reference to Maryland law is to Haines v. St. Paul & Marine Ins. Co., 428 F. Supp. 435 (D. Md. 1977), a federal securities case which held that a claim for restitution of unlawful profits was an action for equitable relief, not damages within the policy coverage.

57. 822 F.2d at 1354.

58. 822 F.2d at 1352 (citing Aetna Cas. & Sur. Co. v. Hanna, 224 F.2d 499, 503 (5th Cir. 1955)). *Hanna*'s determination that "damages" should be construed according to its technical meaning to include only legal damages was consistent with Florida's clear distinction between law and equity that existed when *Hanna* was published. *See Hanna*, 224 F.2d at 501-03. As numerous courts have since blurred that distinction, *Hanna* has become a much-maligned decision. *See, e.g.*, Intel Corp. v. Hartford Accident & Indem. Co., 692 F. Supp. 1174, 1187 ("It is not clear why the court elected a definition of 'damages' drawn from a thirty-year old case in another circuit. . . . The definition itself also is lacking in that it is a tautology defining damages as payment to a person who 'has a legal claim for damages.' "); *see also Continental Insurance*, 842 F.2d at 989 (Heaney, J., dissenting) ("[Hanna] is of doubtful applicability.").

59. 822 F.2d at 1352-54. This holding has been frequently criticized. *See, e.g.*, National Indem. Co. v. United States Pollution Control, Inc., 717 F.Supp. 765, 767 (W.D. Okla. 1989) (explicitly rejecting *Maryland Casualty* and finding that "the better approach is to construe the meaning of damages in its ordinary and popular sense," citing *Thomas Solvent* and New Castle County v. Hartford Accident & Indem. Co., 673 F. Supp. 1359 (D. Del. 1987); United States Fidelity & Guar. Co. v. Thomas Solvent Co., 683 F. Supp. 1139, 1168-70 (W.D. Mich. 1988) (fact that CERCLA claims might be characterized as seeking "equitable relief" does not override fact that, from insured's standpoint, environmental cleanup costs are essentially compensatory damages for injury to property); American Motorists Ins. Co. v. Levelor Lorentzen, No. 88-1994 (D.N.J. Oct. 14, 1988) (LEXIS, Genfed library, Dist file) ("[t]he average person would not engage in a complex comparison of legal and equitable remedies in order to define 'as damages' but would conclude based on the plain meaning of the words that the cleanup costs imposed [on the insured] under CERCLA would constitute an obligation to pay damages"); New Castle County v. Hartford Accident & Indem. Co., 673 F. Supp. 1359, 1365 (D. Del. 1987) ("[T]he 'legal, technical' interpretation of the word 'damages' used by the [*Maryland Casualty*] court is inappropriate under Delaware law."). *See also* Pacific Indem. Co. v. Interstate Fire & Casualty Co., 302

Despite its flaws, *Maryland Casualty* influenced the Eighth Circuit Court of Appeals in *Continental Insurance Companies v. Northeastern Pharmaceutical & Chemical Company, Inc. ("NEPACCO").*[60] In *NEPACCO*, the EPA brought an action against NEPACCO for burying hexachlorophene in a trench on a nearby farm.[61] The strong chemical odor near the trench yielded enough evidence for the EPA to seek abatement costs under RCRA and reimbursement for the EPA's response costs under CERCLA.[62] The insurer then sought a declaratory judgment that it was not obligated to defend and indemnify its insured.[63] Reviewing the damages issue *en banc*, the Eighth Circuit held that the term "damages" is not ambiguous in the insurance context. It also held that "the plain meaning of the term 'damages' used in CGL policies refers to legal damages and does not cover [restitutionary] cleanup costs."[64]

The *NEPACCO* court acknowledged that the term "damages," which was not defined in the CGL policy,[65] must be viewed as the lay purchaser of the policy would ordinariy understand it.[66] It noted that, under the relevant state law, policy language open to different interpretations is ambiguous and must be construed against the insurer.[67] According to the court, "damages" is an ambiguous term when "viewed outside the insurance context," as the dictionary definition does not distinguish between legal damages and equitable monetary relief.[68] Thus, the court observed that, from the insured's standpoint, "damages" *could* reasonably

Md. 383, 488 A.2d 486, 488 (1985), curiously cited with approval in *Maryland Casualty*, 825 F.2d at 1352 ("It is black-letter law that the terms of an insurance policy are to be construed according to the meaning a reasonably prudent layman would infer."). At least one court obligated to follow *Maryland Casualty* has expressed its preference that the issue be revisited. *See* Travelers Indem. Co. v. Allied-Signal, Inc., 718 F. Supp. 1252, 1255-56 (D.Md. 1989) ("This Court is bound by [*Maryland Casualty* and *Mraz*]. If it were not, it would certify the questions decided by [*Maryland Casualty* and *Mraz*] to the Maryland Court of Appeals.")

60. 842 F.2d 977 (8th Cir.), *cert. denied*, 488 U.S. 821 (1988).

61. *Id.* at 979.

62. *Id.* at 979.

63. *Id.* at 981.

64. *Id.* at 985.

65. *Id.* at 986.

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

67. *Id.*

68. *Id.* The court noted that "[t]he dictionary definition does not distinguish between legal damages and equitable monetary relief." *Id.* The dissent noted that this ambiguity, alone, should have been dispositive of the issue. *Id.* at 988.

include all monetary claims.[69] Nevertheless, the court concluded that, in an insurance policy, "damages" is not ambiguous and does not include equitable monetary relief.[70] It based its conclusion on *Maryland Casualty*'s holding that a CGL policy does not cover restitutionary claims.[71]

Objecting to the majority's failure to base its decision on state law principles of insurance policy interpretation, the *NEPACCO* dissent pointed out that:

> [i]f the insurer wished to use a technical legal meaning for that term which differed from the accepted dictionary definition, it should have explicitly done so. Thus, to the extent the word "damages" is open to different constructions, it must be accorded the meaning ordinarily given it by the lay person who bought and paid for the policy.
>
> Not surprisingly, the majority cites no Missouri case under which this Court may ignore the lay definition of "damages" and substitute in its place a "technical insurance" definition.[72]

In addition, the *NEPACCO* court's further claim that it was merely restating "black letter law" in narrowly defining "damages" to exclude equitable monetary relief,[73] also lacked a firm basis considering the court's citation to numerous decisions that had expressly rejected the narrow definition.[74]

69. *Id.*

70. *Id. Accord* Cincinnati Ins. Co. v. Milliken & Co., 857 F.2d 979, 981 (4th Cir. 1988) (holding that in the insurance context, the word "damages" is not ambiguous, but means legal damages).

71. 842 F.2d at 985.

72. *Id.* at 988. *NEPACCO* has been frequently criticized for the inconsistency between its analysis and its result. *See, e.g.*, Federal Ins. Co. v. Susquehanna Broadcasting Co., 727 F. Supp. 169, 173 (M.D. Pa. 1989) ("Our own analysis of the issue is not very different from the *en banc* discussion in [*NEPACCO*] except for the result."); National Indem. Co. v. United States Pollution Control, Inc., 717 F. Supp. 765, 767 (W.D. Okla. 1989); Jones Truck Lines v. Transport Ins. Co., No. 88-5723 (E.D. Pa. May 10, 1989) (LEXIS, Genfed, Dist file) (notwithstanding NEPACCO, under Missouri substantive law cleanup costs are damages; *NEPACCO* "seems to ignore settled Missouri law and its conclusion is hard to reconcile with its analysis."); Maryland Casualty Co. v. Ormond, No. 87-3030, slip op. at 6 (W.D. Ark. Jan. 6, 1989). *See also NEPACCO*, 842 F.2d at 987 (citation omitted) (Heaney, J., dissenting) ("The panel held that under Missouri law the term 'damages' in the standard form [CGL] policy includes clean-up costs. The majority now disregards established Missouri law and holds to the contrary.").

73. 842 F.2d at 986.

74. *See* 842 F.2d at 988-89 (Heaney, J., dissenting) (criticizing the majority for using the term "black letter law" to describe a "clear" conflict between the courts).

B. *The Leading Decisions Finding Coverage: Forming the Basis of an Emerging Trend*

Outside California, recent decisions finding coverage for environmental cleanup costs rely on one or more of three theories: (1) The plain, ordinary meaning of damages incorporates the relief sought; (2) the substance of the government cleanup, rather than its form, mandates coverage; and (3) costs associated with remedying property damage are "damages." These theories are examined below.

1. Avondale and Its Progeny: The Plain Meaning of Damages Controls

In *Avondale Industries, Inc. v. The Travelers Indemnity Company*,[75] the Court of Appeals for the Second Circuit applied New York law in holding that costs of cleaning up a waste site constituted "damages" within the meaning of the insured's CGL policy, thus triggering the insurer's duty to defend.[76] The court observed that "an ordinary businessman reading this policy would have believed himself covered for the demands and potential damage claims now being asserted in the . . . administrative proceeding, particularly absent any specific exclusionary language in the policy."[77] The essence of the court's holding was that "damages" is a broad term plainly designed to encompass any detriment suffered by the policyholder.

Similarly, in *Boeing Co. v. Aetna Casualty & Surety Co.*,[78] the Washington Supreme Court rejected the insurer's argument that "damages" should be given a legal, technical meaning and should exclude monetary equitable remedies.[79] Rather, the *Boeing* court held that the plain, lay meaning of "damages" does not distinguish between sums awarded on a "legal" basis and those awarded on an "equitable" basis. The court further held that the

75. 887 F.2d 1200 (2nd Cir. 1989), *modified and reh'g denied per curiam*, 894 F.2d 498 (2d Cir. 1990), *cert. denied*, 110 S. Ct. 2588 (1990).

76. *Avondale*, 887 F.2d at 1207.

77. *Id.* at 1207 (citation omitted). *Accord* National Indem. Ins. Co. v. United States Pollution Control, Inc., 717 F. Supp. 765, 767 (W.D. Okla. 1989); Chesapeake Util. Corp. v. American Home Assurance Co., 704 F. Supp. 551, 559-61 (D. Del. 1989); United States Fidelity & Guar. Co. v. Thomas Solvent Co., 683 F. Supp. 1139 (W.D. Mich. 1988); New Castle County v. Hartford Accident & Indem. Co., 673 F. Supp. 1359, 1365-66 (D. Del. 1987).

78. 113 Wash. 2d 869, 784 P.2d 507 (1990).

79. 113 Wash. 2d at 875-883, 784 P.2d at 510-14.

plain meaning of "damages" could include cleanup costs incurred as a result of property damage.[80]

The North Carolina Supreme Court in *C.D. Spangler Construction Co. v. Industrial Crankshaft and Engineering Co.*,[81] also used a plain meaning analysis to reach a similar result. In this case, the insured brought a declaratory judgment action seeking judicial construction of certain CGL policies to ascertain whether the policies covered the insured for cleanup costs stemming from its compliance with state environmental agency orders to remove hazardous waste from its premises.[82] The North Carolina Supreme Court determined that the CGL policies did cover such losses, holding that removal costs associated with the cleanup of state resources constituted "damages" within the meaning of the policies.[83] Specifically, the *Spangler* court stated:

> If the insurer intended that "damages" have only [one particular] meaning, it should have so indicated in the policy. The insured would then have understood that cleanup costs incurred pursuant to government mandate were not covered, and would have been able to enter into other insuring arrangements. Because such a limiting definition was not included in the policy, we must conclude that the parties did not intend "damages" to have a specific technical meaning in the insurance policy. Rather, they intended to use its ordinary meaning.[84]

2. Aviex: The Substance of the Government Claims Controls

The Michigan Court of Appeals in *United States Aviex Co. v. Travelers Ins. Co.*[85] reached the same result as *Avondale* and its progeny, but for a different reason. Rather than focusing on the plain meaning of "damages," *Aviex* emphasizes that the form of the underlying claim — equitable or legal — should not define the scope

80. 113 Wash. 2d at 884-887, 784 P.2d at 515-16.

81. 326 N.C. 133, 388 S.E.2d 557 (1990).

82. *Id.* at 135, 388 S.E.2d at 558.

83. *Id.* at 147, 388 S.E.2d at 565.

84. *Id.* at 568. *See also* CPS Chemical Co. v. Continental Ins. Co., 222 N.J. Super. 175, 190 n.4, 536 A.2d 311, 318 n.4 (App. Div. 1988) which involved the new standard CGL policy language that explicitly excludes coverage for: "[a]ny loss, cost or expense arising out of any governmental direction or request that [the policyholder] test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants." The new standard language indicates the ease with which insurers can plainly impose policy obligations upon their policyholders when they so intend.

85. 125 Mich. App. 579, 336 N.W.2d 838 (Mich. Ct. App. 1983).

of an insurer's duty to defend and indemnify. Otherwise, an insurer's duty would turn on a fortuity — the form of the underlying claim. In *Aviex*, the insured, a chemical manufacturing facility,[86] sought indemnification from its insurer for costs associated with a state-directed investigation of toxic seepage stemming from a fire at the insured's facility. The insured claimed under a policy provision requiring the insurer to pay "all sums which the insured shall become obligated to pay by reason of liability imposed by law."[87] The insurer rejected the claim, alleging that the costs of complying with equitable or injunctive orders were noncompensatory under the CGL policy.[88] The Michigan Court of Appeals, however, refused to limit the definition of damages to compensation, holding that state-mandated costs also constituted "damages." The fact that the costs were not the result of a lawsuit for compensation did not alter the court's view that they were nonetheless imposed upon the insured. The court observed that:

> [i]f the state were to sue in court to recover for additional "damages," including the state's costs incurred in cleaning up the contamination, for the injury to the groundwater, defendant's obligation to defend against the lawsuit and to pay damages would be clear. It is merely fortuitous from the standpoint of either plaintiff or defendant that the state has chosen to have plaintiff remedy the contamination problem, rather than choosing to incur the costs of cleanup itself and then suing plaintiff to recover those costs. The damage to the natural resources is simply measured in the cost to restore the water to its original state.[89]

This analysis of the coverage issue has been adopted by numerous other courts.[90] In *Broadwell Realty Services, Inc. v. Fidelity and Casualty Co.*,[91] for example, the insured brought an action to recover under a CGL policy for state-mandated costs stemming from a leaking underground gasoline storage tank.[92] The supe-

86. *Id.* at 583, 336 N.W.2d at 840.

87. *Id.*

88. *Id.* at 588, 336 N.W.2d at 842.

89. *Id.* at 589, 336 N.W.2d at 843.

90. *See* Centennial Ins. Co. v. Lumbermen's Mut. Casualty Co., 677 F. Supp. 342 (E.D. Pa. 1987); Township of Gloucester v. Maryland Casualty Co., 668 F. Supp. 394 (D.N.J. 1987); Fireman's Fund Ins. Companies v. Ex-Cell-O Corp., 662 F. Supp. 71 (E.D. Mich. 1987); United States v. Conservation Chemical Co., 653 F. Supp. 152 (W.D. Mo. 1986); Upjohn Co. v. New Hampshire Ins. Co., 178 Mich. App. 706, 444 N.W.2d 813 (Mich. Ct. App. 1989).

91. 218 N.J. Super. 516, 528 A.2d 76 (1987).

92. *Id.* at 519-522, 528 A.2d at 77-79.

rior court appellate division held that environmental response costs designed to abate the continued flow of contaminants were recoverable under the CGL policy.[93] The court observed that the insured's expenditures were made to discharge its legal obligation to the state agency, "incurred by virtue of the *in terrorem* and coercive effects" of the agency's directive.[94] In other words, the insured had little choice but to comply with the directive and pay the cleanup costs. By underscoring the significance of the underlying claim's substance, rather than its form, the court rendered irrelevant the issue of whether that claim sounded in law or in equity.

3. Port of Portland: Environmental Pollution as Tangible Property Damage

In seeking judicial approval for a narrow definition of "damages," insurers have argued that environmental pollution to groundwater or a waterway fails to constitute damages to tangible property because such bodies are not privately "owned" by anyone. In *Port of Portland v. Water Quality Insurance Syndicate*,[95] the Ninth Circuit Court of Appeals rejected that argument, turning instead to Oregon law to determine whether oil pollution of water in violation of the Federal Water Pollution Control Act constituted damage to "tangible property" within the meaning of the insurance policy property damage liability clause.[96] Finding that Oregon law was silent on the issue, save for a statutory provision that all water in Oregon belongs to the public,[97] the court looked to other jurisdictions' analyses of whether damage to water constitutes tangible property damage, and agreed with the district court that the Oregon Supreme Court would adopt the "reasonable, enlightened view" that discharge of pollution into water causes damage to tangible property. As a result, such cleanup costs were recoverable under a property damage liability clause.[98]

93. *Id.* at 525-527, 528 A.2d at 81-82.

94. *Id.* at 527, 528 A.2d at 82. *Accord Fireman's Fund Ins.*, 662 F. Supp. at 75. *See also* New Castle County v. Hartford Accident & Indem. Co., 673 F. Supp. 1359, 1366 (D. Del. 1987) (as the required remedial actions "were ultimately enforceable in a legal proceeding, they constituted sums that [the insured] was legally obligated to pay as damages").

95. 796 F.2d 1188 (9th Cir. 1986).

96. *Id.* at 1193.

97. *Id.*

98. *Id.* at 1193-94. *Accord* Boeing Co. v. Aetna Casualty and Sur. Co., 113 Wash. 2d 869, 874, 784 P.2d 507, 509-510 (1990).

IV. The California Example: A Coherent Analysis Emerges From Conflicting Authority

The judicial split of authority as to whether governmentally compelled environmental response costs constitute "damages" under CGL policies was nowhere more evident than in California during most of the period 1988-90. In 1988, a federal district court in California, examining the issue without the benefit of state appellate court guidance, decided in favor of insureds in *Intel Corp. v. Hartford Acc. and Indem. Co.*[99] In 1989, California state intermediate appellate courts reached conflicting decisions. In *Aerojet-General Corp. v. Superior Court (Cheshire)*,[100] the intermediate appellate court held for the insureds, based primarily on the ambiguous nature of the term "damages." A few months later, a different appellate court, in *AIU Insurance Co. v. Superior Court (FMC Corp.)*,[101] held for the insurers and expressly rejected *Aerojet*.[102] In 1990, the California Supreme Court reversed *AIU*, eliminating the appellate court conflict and setting forth a coherent analysis based on principles of contract interpretation. The *AIU* court integrated into its analysis the three theories favoring coverage developed outside California and emphasized the significance of a fourth theory — that ambiguous CGL policy language must be resolved in favor of coverage. The development of the law in California, a state traditionally influential in the areas of environmental and insurance law,[103] should be of particular interest in those states in which there is currently a split of authority over who should finance environmental remediation.[104]

99. 692 F. Supp. 1171 (N.D.Cal. 1988).

100. Aerojet-General Corp. v. Superior Court (Cheshire), 211 Cal. App. 3d 216, 257 Cal. Rptr. 621, *reh'g denied*, 258 Cal. Rptr. 684 (1989).

101. AIU Ins. Co. v. Superior Court (FMC Corp.), 213 Cal. App. 3d 1219, 262 Cal. Rptr. 182 (1989), *rev'd*, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990).

102. *AIU*, 213 Cal. App. 3d at 1232, 262 Cal. Rptr. at 182.

103. *See, e.g.*, Carrizosa, *Insurers to Pay for Toxic Cleanup*, San Francisco Daily J., Nov. 16, 1990, at 9 ("Though the decision from the California court is not the first in the country on the issue. . . none of the other courts have the prestige and influence of the California Supreme Court."); Marcus and Herman, *FMC's Cleanup Costs Are Covered By Insurance, Court Rules*, Wall St. J., Nov. 16, 1990, at B-10 (noting that the decision will have broad impact nationally).

104. *See supra* note 43 and accompanying text.

A. *California's Appellate Court Conflict*

California's appellate court split on the coverage issue was foreshadowed in *Intel Corp. v. Hartford Accident and Indem. Co.*[105] Intel sought reimbursement from its insurer for costs incurred in cleaning up hazardous waste located on and beneath its production facility in Mountain View, California.[106] It claimed under its CGL policy, which provided that Hartford would "pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of . . . property damage. . . ."[107] The policy failed to define the term "damages."

Finding in favor of the insured, the federal district court in *Intel* explicitly rejected the Fourth Circuit's decision in *Mraz*, pointing out that the *Mraz* court's determination that CERCLA response costs constituted mere economic loss "does not answer the question [of] whether it is a loss which is compensable as a form of 'damages' under the law of the relevant state."[108] The *Intel* court also found tautological, and thus unpersuasive, *Maryland Casualty*'s holding that damages includes a payment to a "person who has a legal claim for damages."[109]

The *Intel* court instead relied on the definition of "damages" set forth in California Civil Code section 3281, which provides that "[e]very person who suffers detriment from the unlawful act or omission of another, may recover from the person in fault a compensation therefor in money, which is called damages."[110] Focusing on this statutory definition, the court held that "detriment" is synonymous with "damages" under California law. Therefore, to the extent that the state and people of California had suffered a "detriment" due to Intel's pollution, the cost of that pollution should be borne by Intel's comprehensive liability insurer, not by Intel.[111]

105. 692 F. Supp. 1171 (N.D. Cal. 1988).

106. *Id.*

107. *Id.* at 1174.

108. *Id.* at 1187.

109. *Id.* at 1187 n. 21 (quoting *Maryland Casualty Co. v. Armco*, 822 F.2d 1348, 1352 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (1988)).

110. Cal. Civ. Code § 3281 (West 1971 & Supp. 1990).

111. 692 F. Supp. at 1189-90. By so finding, the court aligned itself with the *Portland* and *Aviex* lines of authority, holding that damage to underground water constitutes "damage to tangible property of a third party within the terms of a [CGL] policy." *Id.* at 1185-86.

Next, turning to the CGL insurance policy itself, the *Intel* court followed state law principles of contract interpretation, as well as the *Avondale* line of authority, to hold that insurance contracts be read "in the light of the reasonable and normal expectations of the parties to the extent of the coverage."[112] The court acknowledged that the parties could not have anticipated CERCLA claims when they negotiated the contract. However, the court interpreted the policy to contemplate that if Intel damaged third party property and became legally obligated to pay damages, Hartford would compensate Intel.[113] The court stated that:

> Intel legitimately could and does expect Hartford to make such compensation as long as Intel is legally obligated to pay damages to a third party. Intel, as a PRP ["potentially responsible party"], is legally obligated to pay all costs associated with the cleanup of the [Mountain View] property. The fact that [Intel's] obligation is not in the form of a civil judgment or criminal fine does not alter the fundamental nature of Intel's obligation. . . . Intel's participation in the "consent" decree is a polite way in which the EPA forebears the use of its legal authority to compel cleanup.[114]

Although *Intel* reached a result consistent with established principles of insurance policy interpretation, a better-reasoned analysis in support of coverage was set forth by the state Court of Appeal for the First Appellate District in *Aerojet-General Corp. v. Superior Court (Cheshire)*.[115] *Aerojet* revolved around Aerojet's leak of toxic chemicals into the soil and groundwater that had migrated offsite into the groundwater of neighboring properties and into the American River.[116] Lawsuits were brought by both the United States and the State of California seeking civil penalties and an injunction under CERCLA and state law to prevent fur-

112. 692 F. Supp. at 1189-90 (quoting Globe Indem. Co. v. California, 43 Cal. App. 3d 745, 751, 118 Cal. Rptr. 75, 79 (Cal. App. 5th Dist. 1974)).

113. *Id.* at 1190.

114. *Id.* The court added that the state and federal interests in cleanup of hazardous waste sites provide a public policy argument in favor of coverage. *Id.* at 1193. Although the court's observation has merit, it is superfluous given that the case is more properly viewed strictly as a contract interpretation matter. *See* AIU Ins. Co. v. Superior Court (FMC Corp.), 51 Cal. 3d 807, 818, 799 P.2d 1253, 1262, 274 Cal. Rptr. 820, 829 (1990). The parties presently await the Ninth Circuit's disposition of *Intel*. That disposition is likely to affirm the lower court, following the analysis set forth by the California Supreme Court in *AIU*.

115. Aerojet-General Corp. v. Superior Court (Cheshire), 211 Cal. App. 3d 216, 257 Cal. Rptr. 621, *reh'g denied*, 258 Cal. Rptr. 684 (1989).

116. *Id.*

ther discharge of hazardous substances into state waters. Both governments also sought recovery of response costs incurred in government-sponsored cleanup efforts.[117]

In order to recoup its response costs, Aerojet sought defense and indemnification from its insurers. Aerojet pointed to its CGL insurance policy in which the insurers had agreed "[t]o pay on behalf of the Insured all sums which the Insured shall become *legally obligated to pay as damages because of injury to or loss, destruction or loss of use of property*."[118] The CGL insurance policies did not specifically define "damages."[119]

In deciding whether the policies covered governmentally compelled environmental cleanup costs, the California Court of Appeal for the First Appellate District looked to California law governing the interpretation of insurance policies.[120] California law establishes the following guidelines: (1) in the absence of circumstances indicating a contrary intention, insurance policy language is to be used in its plain and ordinary sense;[121] (2) courts should interpret insurance policies according to the plain meaning that a layperson would ordinarily give them;[122] (3) whether the policy language is ambiguous is to be determined from the perspective of a layperson;[123] (4) any such ambiguity is to be re-

117. *Id.* Aerojet responded to these lawsuits by conducting cleanup activities aimed at mitigating the environmental damage. Aerojet claimed to have spent "tens of millions of dollars" on cleanup, removal of chemicals from the groundwater and activities designed to prevent chemicals in the soil from migrating to the groundwater. The federal and state governments subsequently entered into a consent decree with Aerojet incorporating the government actions. *Id.* at 222, 257 Cal. Rptr. at 624.

118. *Id.* at 222, 257 Cal. Rptr. at 624 (emphasis by the court).

119. *Id.*

120. *Id.* at 224-25, 257 Cal. Rptr. 625-26.

121. *Id.* at 224 257 Cal. Rptr. at 626 (citing Allstate Ins. Co. v. Thompson, 206 Cal. App. 3d 933, 938, 254 Cal. Rptr. 84, 87 (1988), Jarret v. Allstate Ins. Co., 209 Cal. App. 2d 804, 811, 26 Cal. Rptr. 231, 234 (1962)). *See also* Mullen v. Glen Falls Ins. Co., 73 Cal. App. 3d 163, 140 Cal. Rptr. 605 (1977).

122. 211 Cal. App. 3d at 224, 257 Cal. Rptr. at 625 (citing Reserve Ins. Co. v. Pisciotta, 30 Cal. 3d 800, 807, 640 P.2d 764, 180 Cal. Rptr. 628 (1982)). *See also* Ins. Co. of N. Am. v. Sam Harris Constr. Co., 22 Cal. 3d 409, 412, 583 P.2d 1335, 1337, 149 Cal. Rptr. 292, 293 (1978); Crane v. State Farm Fire & Casaulty Co., 5 Cal. 3d 112, 115, 485 P.2d 1129, 1130, 95 Cal. Rptr. 513, 514 (1971); Royal Globe Ins. Co. v. Whitaker, 181 Cal. App. 3d 532, 536, 226 Cal. Rptr. 435, 436 (1986); Spaid v. Cal-Western States Life Ins., 130 Cal. App. 3d 803, 806, 182 Cal. Rptr. 3, 5 (1982).

123. 211 Cal. App. 3d at 225, 257 Cal. Rptr. at 626 (citing Spaid v. Cal-Western States Life Ins. Co., 130 Cal. App. 3d 803, 806, 182 Cal. Rptr. 3 (1982)).

solved against the insurer;[124] and (5) if the ambiguity relates to the extent of coverage, "the language shall be understood in its most inclusive sense, for the benefit of the insured."[125]

In light of these guidelines, the court held that the policies were ambiguous. The court concluded that the policy language could mean damages at law or equitable monetary relief for damage to property.[126] "From the standpoint of the lay insured, 'damages' could well include any sum expended under sanction of law, including both money damages and sums paid out to an injured party in response to its claim for equitable relief."[127]

As a result, the *Aerojet* court rejected the insurers' argument that the "restitutionary" nature of such costs excludes them from the term "damages" in the CGL policy context.[128] The court agreed with the *Intel* court that the equitable nature of CERCLA relief "begins, not ends," the essential inquiry into the reasonable expectation of the insured regarding coverage.[129] Specifically, where the insured incurs direct out-of-pocket economic detriment, the question is whether the insured reasonably expects that such costs are insured as "damages because of injury to or loss, destruction or loss of use of property."[130] In the environmental

124. 211 Cal. App. 3d at 225, 257 Cal. Rptr. at 626 (citing Reserve Ins., 30 Cal. 3d 800, 807, 640 P. 2d 764, 770, 180 Cal. Rptr. 628, (1982); Ins. Co. of N. Am. v. Sam Harris Constr. Co., 22 Cal. 3d 409, 412, 583 P.2d 1335, 1337, 149 Cal. Rptr. 292 (1978)). *See also* State Farm Mut. Auto. Ins. Co. v. Jacober, 10 Cal. 3d 193, 197, 514 P.2d 953, 957, 110 Cal. Rptr. 1, 3 (1973); Bareno v. Employers Life Ins. Co., 7 Cal. 3d 875, 878, 500 P. 2d 889, 893, 103 Cal. Rptr. 865, 867 (1972); Harris v. Glen Falls Ins. Co., 6 Cal. 3d 699, 701, 493 P.2d 861, 862, 100 Cal. Rptr. 133, 134 (1972); Crane v. State Farm Fire Casualty Co., 5 Cal. 3d 112, 115, 95 Cal. Rptr. 513, 515 (1971); Continental Casualty Co. v. Phoenix Constr. Co., 46 Cal. 2d 423, 437, 296 P.2d 801, 809 (1956).

125. 211 Cal. App. 3d at 225, 257 Cal. Rptr. at 626 (citing Globe Indem. Co. v. State of Calif., 43 Cal. App. 3d 745, 750, 118 Cal. Rptr. 75 (1974), Continental Casualty Co. v. Phoenix Constr. Co., 46 Cal. 2d 423, 437-38, 296 P.2d 801 (1956)). *See also* State Farm Mutual Auto. Ins. Co. v. Partridge, 10 Cal. 3d 94, 101, 514 P. 2d 123, 128, 109 Cal. Rptr. 811, 816 (1973).

126. 211 Cal. App. 3d at 226, 257 Cal. Rptr. at 627.

127. *Id.*

128. *Id.* at 230, 232-35, 257 Cal. Rptr. at 630-32.

129. *Id.* at 230, 257 Cal. Rptr. at 630. *See also* Intel Corp. v. Hartford Acc. and Indem. Co., 692 F. Supp. 1171, 1187 (N.D.Cal. 1988) ("To describe response costs as 'economic loss' does not answer the question whether it is a loss which is compensable as a form of 'damages' under the law of the relevant state.").

130. *Id.* The *Aerojet* court also observed that the distinction between legal and equitable relief appears "blurred" in California. *Id.* at 230-31 n.8 (*citing* WITKIN, CAL. PROC. § 77, at 105 (3d ed. 1985)). The court's observation is accurate. California Code of Civil Procedure § 30 makes no distinction between legal and equitable actions ("A civil action is prosecuted by one party against another for the declaration, enforcement or protection of a

pollution context, where the insured damages another's property through pollution and is thereafter compelled by statute to incur response costs, the insured may reasonably expect that its insurance for property damage will cover these costs.[131]

Within months of the First Appellate District's decision in *Aerojet*, the California Court of Appeal for the Sixth Appellate District reached the opposite result in *AIU Insurance Co. v. Superior Court (FMC Corp.)*.[132] In *AIU*, FMC sought a declaratory judgment that its liability insurance policies provided coverage for its potential liability stemming from numerous state and federal environmental actions brought against it.[133] These actions sought to compel FMC to reimburse government agencies for response costs incurred in the cleanup of toxic pollution allegedly released from FMC sites nationwide.[134] The suits also sought to compel FMC to take action to abate the releases.[135] In reversing the trial court's

right, or the redress or prevention of a wrong."). In California, a party is entitled to whatever relief is warranted by the facts, regardless of how the pleadings are formed. *See* Dean v. Shingle, 198 Cal. 652, 660, 246 P.2d 1049, 1052 (1926). An automobile owner, for example, may incur out-of-pocket expenses to repair bumper damage inflicted by a negligent motorist; the owner's subsequent suit, although it could be characterized as equitable in nature in that it seeks to restore plaintiff to the *status quo ante*, is actually an action at law to recover "damages" not "restitution."

131. 211 Cal. App. 3d at 230-31, 257 Cal. Rptr. at 630. The court excepted from coverage expenditures made to prevent future pollution (i.e., pollution that had not yet occurred), as such costs are not causally related to property damage. *Id.* at 237. *Accord* AIU Ins. Co. v. Superior Court (FMC Corp.), 213 Cal. App. 3d 1219, 262 Cal. Rptr. 182 (1989), *rev'd*, 51 Cal. 3d 807, 842, 799 P.2d 1253, 1278, 274 Cal. Rptr. 820, 845; Intel Corp. v. Hartford Accident and Indem. Co., 692 F. Supp. 1171 (N.D. Cal. 1988); Hazen Paper Co. v. United States Fidel. and Guar. Co., 407 Mass. 689, 555 N.E.2d 576 (1990).

132. AIU Ins. Co. v. Superior Court (FMC Corp.), 213 Cal. App. 3d 1219, 262 Cal. Rptr. 182 (1989), *rev'd*, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990).

133. *Id.*

134. *Id.* Much of the pollution was apparently caused unknowingly. As the trial court observed:

> The history of coverage and the history of pollution damage alleged in this case goes back 40 or 50 years. As a matter of reality, most of the damage that FMC has now been charged with cleaning up was done by it during a period of time when the scientific community had very little knowledge of the overwhelmingly disastrous effects that this chemical pollution would have. It was not known, for example, how quickly chemicals would leach from an evaporation pond into the aquifer underlying the pond and seep there into adjoining and far distant properties . . . . [I]n none of the involved sites has FMC been charged any punitive sum [that would stem from deliberate acts].

AIU Memorandum, *supra* note 56 at 14 (emphasis by the court). *See also* United States v. Conserv. Chem. Co., 589 F. Supp. 59, 61-62 (W.D. Mo. 1984) (as a nonnegligent generator of hazardous materials disposed of by others, FMC was liable under CERCLA's strict liability provisions).

135. *AIU* Memorandum, *supra* note 56 at 2.

finding of coverage,[136] the California Court of Appeal for the Sixth Appellate District adhered to the *Maryland Casualty* and *NEPACCO* line of cases in holding that CGL policies be read technically to exclude governmentally compelled environmental cleanup costs.[137]

B. *The Conflict Resolved: The California Supreme Court's Decision in* AIU Insurance Co. v. Superior Court (FMC Corp.)

Since *AIU* directly conflicted with *Aerojet* on a matter of significant public interest, the California Supreme Court had little choice but to grant FMC's petition for review.[138] Rejecting *Mraz*, *Maryland Casualty* and *NEPACCO* as overly technical and as inconsistent with established rules of contract interpretation,[139] the

136. The trial court had denied the insurers' motion for summary judgment, finding instead:

> it is this Court's opinion that [*Maryland Casualty*], the seminal authority in the line of cases relied upon by the moving parties, is neither particularly cogently reasoned, nor consistent with California law on the construction of insurance contracts. This Court is not persuaded that the very technical meaning of the word "damages" adopted by [*Maryland Casualty*] and its progeny and urged here by the [insurers], is in line with the California case law requiring that terms in insurance policies be afforded their plain meaning.

Id.

137. The appellate court's decision in *AIU* was badly flawed. Much of the analysis focused on whether CGL policies should be read to cover costs of compliance with an exercise of the police power. 213 Cal. App. 3d at 1223, 262 Cal. Rptr. at 182. This issue had not been argued in the trial court, none of the parties had briefed the issue to the Court of Appeal, and no reported decision in the country had addressed this question. *See* Brief of *Amicus Curiae* Aerojet-General Corporation in Support of the Real Party in Interest, FMC Corporation at 8, AIU v. Superior Court (FMC Corp.), 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990) (No. SO12525) (filed Feb. 9, 1990) (The *AIU* court's opinion "is the first decision anywhere" that relies on a police power analysis to deny CGL coverage for CERCLA cleanup costs); Brief of *Amicus Curiae* Alumax Inc., *et al.*, in Support of Real Party, FMC Corporation at 28, AIU v. Superior Court (FMC Corp.), 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990) (No. SO12525) ("[T]he *AIU* court became the *only* court considering this issue to espouse a police power argument and to make a determination of coverage on that basis."). The court then summarily applied the *Armco* and *NEPACCO* holdings without ever determining whether they are consistent with California insurance law. 213 Cal. App. 3d at 1225-26, 262 Cal. Rptr. at 189-90. Finally, the court's decision mistakenly based its analysis on the policy language that had been before the *Aerojet* court. *Compare* 213 Cal. App. 3d at 1225-26, 262 Cal. Rptr. at 189-90 *with* 51 Cal. 3d at 827-28, 799 P.2d at 1268, 274 Cal. Rptr. at 835.

138. *See* Rule 29(a)(1) of the California Rules of Court (West 1990). The court could have "decertified" the case pursuant to Rule 976(d) of the California Rules of Court, thus removing the case from the California Official Reports. However, such action would have left the *AIU* parties in the same position as if FMC's Petition for Review had been denied. *Id.* at Rule 976(d).

139. *AIU*, 51 Cal. 3d at 830-34, 799 P.2d at 1270-72, 274 Cal. Rptr. at 837-39.

California Supreme Court reversed the appellate court's decision. The court construed the policy language according to the mutual intentions of the parties and its "plain and ordinary meaning, resolving ambiguities in favor of coverage."[140] Applying the same rules of contract interpretation as the *Aerojet* court, the court held that the CGL policies covered governmentally compelled environmental cleanup costs.[141]

The CGL policies at issue provided coverage for sums that FMC would become "legally obligated" to pay as "damages" incurred because of "property damage."[142] Thus, the court examined whether the types of relief sought in the underlying third party claims satisfied these requirements.[143] Specifically, the court examined: 1) whether adverse orders issued in the government actions against FMC "legally obligated" FMC to pay environmental cleanup costs; 2) whether the costs constituted "damages" under the policies; and 3) whether the costs were incurred because of "property damage."[144] The court observed that only if all three conditions were fulfilled would the insurers' duty to provide coverage arise.[145]

The *AIU* court noted that FMC's "obligation" to pay court-ordered relief would be clear if FMC were found liable in third party suits.[146] Thus, the only remaining question on the issue of whether FMC was "legally obligated" to pay environmental cleanup costs was whether FMC's obligation to pay court-ordered relief was "legal" under applicable rules of contract interpreta-

140. The *AIU* court expanded *Aerojet*'s list of rules of contract interpretation to include: 1) the mutual intention of the parties at the time the contract is formed governs interpretation; 2) the parties' intent is to be inferred, if possible, solely from the contract's written provisions; 3) the provisions are awarded their "ordinary and popular" meaning, unless used by the parties in a technical sense; 4) if a layperson would ascribe an unambiguous meaning, that meaning is appropriate; 5) where ambiguous provisions exist, they are interpreted in the sense that the insurer believed the promisee understood them at contract formation; 6) if application of the preceding rule does not eliminate the ambiguity, the ambiguous language is construed against the party who caused the uncertainty to exist; 7) in insurance cases, ambiguities are generally resolved in favor of coverage; and 8) coverage clauses are generally interpreted broadly, to protect the objectively reasonable expectations of the insured. *Id.* at 821-23, 799 P.2d at 1264-65, 274 Cal. Rptr. at 831-32.

141. *Id.* at 814, 799 P.2d at 1259, 274 Cal. Rptr. at 826.

142. *Id.* at 824-25, 799 P.2d at 1266, 274 Cal. Rptr. at 833.

143. *Id.*

144. *Id.* at 818, 799 P.2d at 1261, 274 Cal. Rptr. at 828.

145. *Id.*

146. *Id.* at 824-25, 799 P.2d at 1266, 274 Cal. Rptr. at 833.

tion.[147] The insurers contended that whether a trial court awarded injunctive relief or reimbursement to government agencies, that court would exercise "equitable" rather than "legal" authority.[148]

The *AIU* court rejected the insurers' argument, agreeing with the *Intel* and *Aerojet* courts that the "mere characterization of relief under federal law . . . is not dispositive of the proper construction of insurance policies under state law."[149] Noting that California had generally abandoned the distinction between courts of equity and courts of law, the *AIU* court observed that even a legally sophisticated policyholder might not anticipate that the term "legally obligated" precludes equitable relief.[150] Rather, because that relief is ordered by a court of law, empowered to hear both legal and equitable disputes, FMC might reasonably believe its obligation to pay was "legal" as that term is used in its broad, modern sense, taking into account the merger of law and equity.[151] Aligning itself with *Aviex*, the *AIU* court recognized the unfairness of allowing insurance coverage to turn on the fortuitous event of whether the state ordered the insured to remedy the contamination, or conducted the cleanup itself, then sued for cost recovery.

The heart of the *AIU* decision, however, is its treatment of the issue of whether the costs claimed constituted "damages" under the policies. The court's analysis rejected the insurers' narrow

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.* The court explicitly rejected the insurers' "sophisticated policyholder" argument that the policies should not be interpreted from a layperson's perspective, but rather be given their technical meanings in light of FMC's legal sophistication and substantial bargaining power. Even where the insured is a sophisticated purchaser of insurance, California courts construe ambiguous policy language against the insurer, the party who stands to profit from that ambiguity. *See, e.g.*, General Ins. Co. of Amer. v. City of Belvedes, 582 F. Supp. 88, 89 (N.D. Cal. 1984) (municipality); Admiralty Fund v. Peerless Ins. Co., 143 Cal. App. 3d 379, 385, 191 Cal. Rptr. 753, 756 (1983) (mutual fund); Century Bank v. St. Paul Fire & Marine Ins. Co., 4 Cal. 3d 319, 321, 482 P.2d 193, 194, 93 Cal. Rptr. 569, 570 (1971) (bank); Insurance Co. of N. Am. v. Electronic Purification Co., 67 Cal. 2d 679, 685, 433 P.2d 174, 178, 63 Cal. Rptr. 382, 386 (1967) (water purification company). Only if the insurer can demonstrate that the relevant policy language was negotiated can the insurer escape the rule that ambiguities are to be construed in favor of the insured. *See* Garcia v. Truck Ins. Exch., 36 Cal. 3d 426, 438, 682 P.2d 1100, 1106, 204 Cal. Rptr. 435, 440 (1984); Fireman's Fund Ins. Co. v. Fibreboard Corp., 182 Cal. App. 3d 462, 467, 227 Cal. Rptr. 203 (1986). However, nothing in *AIU* indicates that FMC negotiated the relevant policy language.

151. *AIU*, 51 Cal. 3d at 824-25, 799 P.2d at 1266, 274 Cal. Rptr. at 833.

definition of damages in favor of one that incorporates the "ordinary and popular" definition of the term. The court's reasoning mirrors the *Avondale* line, but its conclusion rests on established principles of contract interpretation codified in California statutory law favoring such a broad definition where none is provided in the policy.[152] Plainly troubled by the insurers' reliance on the undefined, inherently ambiguous term "damages" to *exclude* all but a narrow range of costs, the court held that ambiguities stemming from the insurers' use of that term must be construed in favor of coverage.

AIU also accepts *Intel*'s view that damages includes any "detriment" caused by the unlawful act or omission of another.[153] The *AIU* court noted that lay dictionaries, which courts often use to determine the plain meaning of insurance policy terms,[154] define "damages" generally,[155] as do the technical dictionaries utilized in the insurance industry.[156] The court observed that the insur-

152. *Id.* at 825-26, 799 P.2d at 1267, 274 Cal. Rptr. at 834. *See also* Cal. Civ. Code § 1644 (West Supp. 1985).

153. *See supra* notes 110-111 and accompanying text.

154. *See, e.g.*, Reserve Ins. Co. v. Pisciotta, 30 Cal. 3d 800, 810, 640 P.2d 764, 769-70, 180 Cal. Rptr. 628, 633-34 (1982) (use of dictionary to determine meaning of "family"); *Aerojet*, 211 Cal. App. 3d at 225-26, 257 Cal. Rptr at 626; Royal Globe Ins. Co. v. Whitaker, 181 Cal. App. 3d 532, 537 n. 5, 266 Cal. Rptr. 435, 437 n. 5 (1986) (use of dictionary to determine meaning of "accident"). *See also* National Indem. Co. v. United States Pollution Control, Inc., 717 F. Supp. 765, 767 (W.D. Okla. 1989) ([Webster's Third New International Dictionary] "makes no distinction between actions at law and actions in equity"); New Castle County v. Hartford Accident and Indem. Co., 673 F. Supp. 1359, 1365 (D. Del. 1987) (an ordinary dictionary definition of "damages" makes "no distinction between actions at law and actions in equity"); Chesapeake Utils. Corp. v. Amer. Home Assur. Co., 704 F. Supp. 551, 559 (D. Del. 1989) (following *New Castle*). In a concession to which the appellate court in *AIU* should have accorded greater weight, the court acknowledged that dictionaries define the term, "damages," without reference to the technical distinction of damages at law and equitable relief. *AIU*, 213 Cal. App. 3d at 1235, 262 Cal. Rptr at 190.

155. *See, e.g.*, WEBSTER'S NEW WORLD DICTIONARY at 348 (3d College ed. 1988) (defining damages as "cost or expense"); RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE at 504 (2d ed. 1987) (defining "damages" as the "estimated money equivalent for detriment or injury sustained"); WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY at 323 (1986) (defining "damage" as "loss or harm resulting from injury to person, property, or reputation. . . compensation in money imposed by law for loss or injury. . ."). *See also* THE AMERICAN HERITAGE DICTIONARY at 1217 (2d ed. 1982) (defining "suit" as "a court proceeding to recover a right or claim").

156. *See, e.g.*, MERRITT, GLOSSARY OF INSURANCE TERMS at 47 (1980) (defining "damages" as "[t]he amount required to pay for a loss"); RUBIN, BARRONS DICTIONARY OF INSURANCE TERMS at 71 (1987) (defining damages as "[s]um the insurance company is legally obligated to pay an insured for losses incurred"); DAVIDS, DICTIONARY OF INSURANCE at 85 (rev. ed. 1983) (defining damages as "[t]he estimated reparation in money for injury sustained"). Legal dictionaries also define "damages" broadly. *See, e.g.*, American Steve-

ers' definition of "damages" as sums paid as a result of "legal claims" would render the policy language inconsistent with an ordinary interpretation of damages.[157] The insurers' definition would also render redundant the phrase "legally obligated to pay."[158]

Yet, the *AIU* court stopped short of simply affirming *Aerojet*'s observation that "damages" could include *any* sum expended under sanction of law.[159] Such an interpretation would render the phrase "as damages" meaningless.[160]. CGL policies, the *AIU* court noted, cover "all sums which the insured becomes legally obligated to pay *as damages* because of property damage."[161] Consequently, to meet the "as damages" element of the CGL policies, an expenditure incurred by the policyholder must be "compensation" provided to an aggrieved party.[162] In light of this refinement of *Aerojet*'s definition of "damages," the *AIU* court held that government agencies suffer compensable "detriment" when they incur response costs under environmental statutes because: 1) the release of hazardous waste into groundwater or surface water harms state or federal ownership interests; and 2) the agencies' out-of-pocket expenses for investigation and remediation harms the public fisc.[163]

Additionally, the court rejected the insurers' argument based on *Mraz* that, because CERCLA distinguishes between environmental "response costs" and recovery of "damages to natural resources," such response costs are excluded from coverage.[164] Rather, the court viewed that distinction as immaterial to the contract interpretation issue presented, noting that the parties' intent in entering the policies "could not possibly have been influenced by the niceties of statutory language adopted many years after the policies were drafted."[165] Similarly, the court rejected as unduly

dores, Inc. v. Porello, 330 U.S. 446, 450 n.6 (1947) (quoting the BLACK'S LAW DICTIONARY of "damages" as compensation in money for a loss or damage), *quoted in* GARNER, A DICTIONARY OF MODERN LEGAL USAGE at 165 (1987).

157. *AIU*, 51 Cal. 3d at 827, 799 P.2d at 1268, 274 Cal. Rptr. at 835.

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.* (quoting Aerojet-General Corp. v. Superior Court (Cheshire), 211 Cal. App. 3d 216, 257 Cal. Rptr. 621, *reh'g denied*, 258 Cal. Rptr. 684 (1989)).

162. *Id.*

163. *Id.* at 828-29, 799 P.2d at 1269, 274 Cal. Rptr. at 836.

164. *Id.* at 830-31, 799 P.2d at 1270, 274 Cal. Rptr. at 837.

165. *Id.* at 831, 799 P.2d at 1271, 274 Cal. Rptr. at 838.

narrow *Maryland Casualty*'s view that environmental response costs are uninsurable. In doing so, the court noted that, under the ordinary view of "damages," a release of hazardous waste constitutes an "unlawful act or omission" causing "detriment" to government interests and therefore warrants compensation.[166] Significantly, the court deemed that response costs incurred to prevent damage from spreading to third party property were covered by CGL policies under the ordinary definition of damages.[167]

Finally, the *AIU* court also rejected the insurers' arguments that the restitutionary nature of environmental cleanup costs precluded a finding of coverage.[168] Rather, the court held that "[e]ven if recovery of response costs is technically 'restitution' rather than 'damages,' this fact is of little consequence to policy interpretation in the absence of evidence on the face of the policies that technical distinctions were intended."[169] Both restitution and compensatory damages were found to fall within the

166. *Id.* at 832-33, 799 P.2d at 1272, 274 Cal. Rptr. at 839.

167. *Id.* (citing the Aerojet-General Corp. v. Superior Court (Cheshire), 211 Cal. App. 3d 216, 257 Cal. Rptr. 621, *reh'g denied*, 258 Cal. Rptr. 684 (1989) citation of Globe Indem. Co. v. State, 43 Cal. App. 3d 745, 751, 118 Cal. Rptr. 75, 79 (1974) (it would "seem strangely incongruous" to the insured "that his policy would cover him for damages to tangible property destroyed through his negligence in allowing a fire to escape but not for the sums incurred in mitigating such damages by suppressing the fire")). *Accord* Broadwell Realty Serv., Inc. v. Fidelity & Casualty Co., 218 N.J. Super. 516, 525-26, 528 A.2d 76, 81 (1987) (cost of trenches and pumping wells necessary to prevent further loss to third parties constituted "damages"); Leebov v. United States Fidelity & Guar. Co., 401 Pa. 477, 480-81, 165 A.2d 82, 85 (1960) (insured building contractor entitled to reimbursement for preventative measures taken to stop landslide).

168. *AIU*, 51 Cal. 3d at 834-35, 799 P.2d at 1273, 274 Cal. Rptr. at 840. The insurers' position was not lacking in superficial appeal. Legal arguments aside, FMC did cause, or at least was legally responsible under CERCLA for the pollution and probably profited from whatever waste disposal practices led to its present liability. Thus, it is not difficult to intellectualize FMC's current cleanup costs stemming from past waste management practices simply as a cost of doing business. Also, the fact that CERCLA was non-existent when many of the policies were executed calls into question the fairness of holding that those policies nevertheless cover CERCLA cleanup costs. The superficial appeal of these points was rejected by the trial court, guided by rules of construction which mandate that insurance policy language be construed in its plain and ordinary sense, as a layman would read it, "with any ambiguity construed against the insurance carrier." *AIU* Memorandum, *supra* note 56, at 7. By properly focusing on the insured's reasonable expectations of comprehensive coverage, the trial court rendered irrelevant FMC's past waste management-related profits or CERCLA's non-existence at policy execution. *See also AIU*, 51 Cal. 3d at 822 n.8, 799 P.2d at 1264 n.8, 274 Cal. Rptr. at 831 n.8 (under California law, comprehensive liability insurance covers newly-created forms of liability, *citing* Travelers Ins. Co.v. Industrial Indem. Co., 18 Cal. App. 3d 628, 96 Cal. Rptr. 191 (Cal. Ct. App. 1971)).

169. *AIU*, 51 Cal. 3d at 834-35, 799 P.2d at 1273, 274 Cal. Rptr. at 840.

ordinary definition of "damages."[170] Similarly, because the policies were silent as to coverage for costs of injunctive relief, the *AIU* court held that they, too, fell within the meaning of "damages."[171]

Finally, addressing the issue of whether the claimed costs were incurred because of "property damage," the *AIU* court agreed with *Port of Portland*, *Intel*, *Aerojet*, and others,[172] in holding that environmental contamination constitutes property damage. In particular, the court noted that the fact that government agencies may have sought reimbursement of response costs without themselves having suffered tangible harm to a proprietary interest "does not exclude recovery of cleanup costs from coverage under the 'damages' provision of CGL policies."[173] As such costs were incurred "because of" property damage, the third and final requisite element for coverage was met.[174]

V. A Proposed Resolution of the Nationwide Environmental Liability Dilemma

The *AIU* decision provides a model that courts faced with the issue of who should finance governmentally compelled environmental cleanups may find useful for a number of reasons. First, *AIU*'s conclusion that the language of CGL policies is ambiguous is persuasive, since policies typically do not define the relevant language.[175] It is therefore not reasonable to expect that laypersons, corporations, attorneys and insurers who confront the term "damages" in a myriad of contexts would all attach a common, single meaning to that term. Under most states' insurance law, a court must find the insurers' definition to be the "*only* reasonable construction of the contract" in order for it to determine that no

170. *Id.* at 835-36, 799 P.2d at 1274, 274 Cal. Rptr. at 841.

171. *Id.* at 837-42, 799 P.2d at 1275-78, 274 Cal. Rptr. at 842-45.

172. *Id.* at 842-43, 799 P.2d at 1279, 274 Cal. Rptr. at 846. *See also, e.g.*, Chesapeake Utils. Corp. v. Am. Home Assur. Assoc., 704 F. Supp. 551, 566 (D. Del. 1989); New Castle County v. Hartford Accident & Indem. Co., 673 F. Supp. 1359, 1366 (D. Del. 1987).

173. *AIU*, 51 Cal. 3d at 842, 799 P.2d at 1279, 274 Cal. Rptr. at 846.

174. *Id.* Like the *Aerojet* court, the *AIU* court excepted from coverage environmental injunctions that are purely prophylactic in nature, that is, costs not incurred "because of property damage." *Id.* at 841-42, 799 P.2d at 1278, 274 Cal. Rptr. at 845. Such costs might include "altering dumping practices to prevent recurrences of leakage." *Id.*

175. *Id.* at 814, 799 P.2d at 1259, 274 Cal. Rptr. at 826.

ambiguity exists.[176] However, if a court determines that ambiguity does exist, local insurance law requires the court to accept the insured's interpretation provided it is "semantically permissible."[177] Clearly, the generic nature of the term "damages" and the various meanings attributed to it[178] should influence courts to find the term to be ambiguous.

Second, *AIU*'s analysis is grounded in well-accepted principles of insurance law.[179] To reach its decision, the *AIU* court did not rely on internally inconsistent analysis or depart from established precedent. By contrast, many cases finding against coverage are suspect because their conclusions fail to square with their analyses, as in *NEPACCO*,[180] or because their analyses depart from established precedents in their respective jurisdictions, as in *Mraz* and *Maryland Casualty*.[181]

Third, *AIU*'s determination that "damages" includes governmentally compelled environmental response costs comports with the common-sense notion that comprehensive general liability coverage protects the insured against all liabilities that are not specifically excluded.[182] Consequently, *AIU* recognizes as unreasonable the insurers' argument that the undefined term "damages" located in the policies' *coverage* section could operate as an

176. *See, e.g.*, McLaughlin v. Connecticut Gen. Life Ins. Co., 565 F. Supp. 434, 441, 447-49 (N.D. Cal. 1983) (emphasis added). *See also* Steven v. Fidelity and Casualty Co., 58 Cal. 2d 862, 875, 377 P.2d 284, 290, 27 Cal. Rptr. 172, 178 (1962).

177. *See* Crane v. State Farm Fire & Casualty Co., 5 Cal. 3d 112, 115, 485 P.2d 1129, 1130, 95 Cal. Rptr. 513 (1971). *See also* State Farm Mut. Auto. Ins. Co. v. Jacober, 10 Cal. 3d 193, 197, 514 P.2d 953, 954, 110 Cal. Rptr. 1,3 (1973) ("[S]o long as coverage is available under any reasonable interpretation of an ambiguous clause, the insurer cannot escape liability.").

178. When a restaurant patron asks of a waiter, "what's the damage?," "damage" means something entirely different than when a judge asks a plaintiff to estimate the "damage" to reputation occasioned by a libelous newspaper article. *See* WEBSTER'S NINTH COLLEGIATE DICTIONARY 323 (1986).

179. *See supra* note 139-45 and accompanying text.

180. *See supra* notes 65-74 and accompanying text.

181. *See supra* notes 49-51, 56-59 and accompanying text.

182. It is well-established that the purchaser of a "comprehensive" policy intends or reasonably expects coverage for all unanticipated liabilities except those specifically excluded. *See, e.g.*, Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 272, 419 P.2d 168, 173, 54 Cal. Rptr. 104, 109 (1966) ("comprehensive" policy represents a "wide promise" of "general protection"). *See also* Goodyear Rubber & Supply, Inc. v. Great Am. Ins. Co., 545 F.2d 95 (9th Cir. 1976) (court held that cost of salvage operation, which prevented property damage covered by the policy, was also covered).

exclusion.[183] In light of standard insurance industry practice to separate coverage and exclusions sections in CGL policies, the *AIU* court's view is a fair one.

Fourth, *AIU*'s rejection of the argument that equitable remedies are excluded from coverage correctly shifts the coverage inquiry away from semantic characterizations of the type of relief sought.[184] Rather, *AIU* correctly focuses on whether, under established rules of contract interpretation, the critical policy language is ambiguous.[185] Indeed, to adopt the insurers' argument that "damages" excludes equitable relief forces the policyholder to delay action regarding environmental pollution until the government or another third party brings a traditional tort action for legal "damages," which would be covered under the CGL policy language. However, if the insured, either voluntarily or at the direction of the court, went ahead and cleaned up the pollution by itself, "damages" would not be incurred, and therefore coverage would not be provided under the CGL policy. In other words, coverage would turn on a "fortuitous" event: whether the state decided to order the insured to remedy the contamination or to conduct the cleanup itself and then sue for recovery of those costs.[186] However, this rule results in the awkward paradox that policyholders who act swiftly to remedy environmental damage before it worsens are denied coverage while recalcitrant policyholders who are sued for damages to natural resources are

183. *See also* Aerojet-General Corp. v. Superior Court (Cheshire), 211 Cal. App. 3d 21, 226, 257 Cal. Rptr. 621, 626-27 (1989); State Farm Mutual Auto. Ins. Co. v. Jacober, 10 Cal. 3d 193, 201, 514 P.2d 953, 110 Cal. Rptr. 1 (1973) ("[A]ny exception to the performance of the basic underlying obligation must be so stated as clearly to apprise the insured of its effect."); Crane v. State Farm Fire & Cas. Co., 5 Cal. 3d 112, 115-16, 485 P.2d 1129, 1130, 95 Cal. Rptr. 513, 514 (1971) ("An exclusionary clause must be conspicuous, plain and clear. . ."); Boeing Co. v. Aetna Casualty and Sur. Co., 113 Wash. 2d 869, 877, 784 P.2d 507, 511 (1990) (" '[D]amages' is sandwiched into the general coverage provisions of policyholders' insurance contracts. This is an odd place to look for exclusions of coverage.").

184. *See supra* notes 172-174 and accompanying text.

185. *See supra* note 152-158 and accompanying text.

186. United States Aviex Co. v. Travelers Ins. Co., 125 Mich. App. 579, 590, 336 N.W.2d 838, 843 (Mich. App. 1983). *Accord* United States Fidelity & Guar. Co. v. Specialty Coatings Co., 180 Ill. App. 3d 378, 394, 535 N.E.2d 1071, 1081 (1st Dist.), *appeal denied*, 129 Ill. 2d 306, 545 N.E.2d 133 (1989) ("Whether the insured must reimburse a party for the cost of cleaning the property or undertake measures itself to cure the injury inflicted upon the environment, the basis [for damages] is the same; the amount of money spent to remedy property damage caused by the policyholder.").

granted coverage.[187] Such a paradox makes little sense as it discourages swift remedial action by responsible parties.

Fifth, *AIU*'s analysis is consistent with explicit Congressional intent that insurers not be excluded from CERCLA's cleanup scheme.[188] The analyses put forward by the *Mraz*, *Maryland Casualty* and *NEPACCO* courts essentially protect insurers from the need to reimburse insureds for CERCLA cleanup costs. However, to the extent that liability insurance is specifically preserved in CERCLA remediation actions, CERCLA makes clear that insurers are an integral part of cleanup actions.[189] To remove insurers from the equation might therefore frustrate Congress' goal in enacting CERCLA.

Sixth, *AIU*'s result is consistent with sound public policy favoring prompt remediation of environmental pollution. Although the *AIU* court correctly declines to base its decision on public policy considerations,[190] an insured polluter nevertheless tends to commence cleanup activities "sooner and with greater cooperation with government."[191] Such cooperation, in turn, frees government resources for direction toward abandoned sites or those where private funds are not forthcoming. Privately-funded cleanups of the type contemplated by and encouraged in *Aerojet*[192] are plainly favored under federal and state environmental laws.[193]

Reliance by courts on *AIU* as a model means that insureds' claims will be addressed in the context of policy deductibles, lim-

187. *See* Globe Indem. Co. v. State of California, 43 Cal. App. 3d 745, 751-52, 118 Cal. Rptr 75, 79 (1974).

188. CERCLA § 107(e)(1), 42 U.S.C. § 9607(e)(1) (1988) provides:

> No indemnification, hold harmless, or similar agreement or conveyance shall be effective to transfer from the owner or operator of any vessel or facility or from any person who may be liable for a release or threat of release under this section, to any other person the liability imposed under this section. *Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party for any liability under this section.* (emphasis added)

189. *Id.*

190. *AIU*, 51 Cal. 3d at 818, 799 P.2d at 1262, 274 Cal. Rptr. at 829.

191. *Aerojet*, 211 Cal. App. 3d at 237, 257 Cal. Rptr. at 634. *Aerojet*'s public policy discussion is set forth in *dicta*, which indicates that the court did not *rely* on public policy concerns in interpreting the policy. Thus, *Aerojet* does not commit the same error made in *Intel*. *See supra* note 114.

192. *Aerojet*, 211 Cal. App. 3d at 237, 257 Cal. Rptr. at 634.

193. *See* CERCLA § 122, 42 U.S.C. § 9622 (1988) (setting forth the procedures for formalizing settlements with responsible parties); Cal. Health and Safety Code § 25355.5(a) (West 1990) (specifying that the state must first attempt to obtain the cooperation of responsible parties prior to spending state "superfund" monies).

its and exclusions. Thus, a determination that "damages" in CGL policies covers governmentally compelled environmental response costs would not automatically mean that insurers must pay those costs. Nevertheless, California's *AIU* decision provides a well-reasoned, useful model that merits the attention of other state courts that are confronted with the same issue of whether insureds or their CGL carriers should finance environmental remediation.