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Articles

9 New Wave of 'As Damages' Issues

by Nancer H. Ballard and Charles N. Le Ray

The new wave of second generation damages issues generally involve disputes over whether certain response costs are incurred "because of property damage" and whether certain costs incurred by an insured should be allocated to defense or indemnity.

16 *Vive La Difference!* New York Confirms That the Standard for Notice To Excess Insurers Differs from That For Notice to Primary Insurers

by Lorelie S. Masters

The reasons behind the "no prejudice" exception carved out of the general rules of contract for primary insurers are inapplicable to the claim brought by an excess insurance carrier against another excess insurance carrier.

27 Current Trends in First Party Insurance Law

by Joshua L. Mallin and Jesse R. Dunbar

Recent developments in the timing of asserting misrepresentation, and in the fortuity defense.

32 Intentional Acts and Injuries for Purposes of Insurance Coverage—Emerging Issues

by Danne W. Webb

When accidents happen, who bears the cost? State and federal courts in Missouri have struggled in recent years to answer this question and explore the premise of exactly what constitutes an "accident" for purposes of insurance coverage.

39 Book Review: *Litigation and Prevention of Insurer Bad Faith*

by John C. Tollefson

An Affair to Forget—Texas Supreme Court Drives a Stake into Sweetheart Deals

by Michael W. Huddleston

The Texas Supreme Court, in *State Farm Fire & Casualty Co. v. Gandy*,[1] has dramatically altered the insurance landscape in Texas by eliminating the use of "sweetheart" or "set-up" arrangements involving assignments and covenants not to execute. The majority opinion written by Justice Nathan Hecht,[2] joined in by eight justices with one additional justice concurring, is by no means parochial. The court appears to have been writing for a national audience in its detailed efforts to discuss the perils to the integrity of the judicial system presented by such agreements. The decision makes clear that in a few short years the Texas Supreme Court has evolved from a liberal and sometimes discredited institution into a national leader in bringing reason to insurance bad faith law.

Background

The legal world described by Charles Dickens in *Bleak House* looks amazingly simple when compared to the Byzantine facts and legal maneuvering in *Gandy*. The case begins with a tragedy. The claimant, Julie Kathleen Gandy, was sexually molested by her step-father, a service station operator named Ted Pearce, over a lengthy period of time. Gandy subsequently sued both the step-father and her mother. Gandy alleged that her mother failed to warn her of her father's propensity to engage in such behavior. Pearce hired a local attorney, E. Ray Andrews, who was well known to Pearce. Andrews was hired to defend the civil suit

(continued on page 3)

New Wave of 'As Damages' Issues

by Nancer H. Ballard and Charles N. Le Ray

General liability policies provide that an insurer must "pay on behalf of the insured all sums that the insured shall become legally obligated to pay as *damages* because of *bodily injury* or *property damage*"[1] caused by an occurrence. Most general liability policies do not define the word "damages."[2] During the past decade, insurers and insureds have vigorously contested whether environmental response costs are damages within the meaning of a general liability policy.

Insurers have contended that their obligation to pay damages does not include environmental response costs because response costs are restitutionary or restorative and, according to insurers, general liability policies only cover compensatory "at law" damages. Policyholders have argued that a lay person purchasing an insurance contract would expect coverage for any loss incurred under compulsion of law and that the word "damages" either unambiguously includes response costs or is ambiguous and should be construed against insurers.[3]

A substantial majority of courts to address the issue have held that environmental response costs *are* damages within the meaning of a general liability policy.[4] Although the frenzy of litigation over whether response costs are damages has subsided somewhat in the last two years, a number of "second generation" damages issues now are receiving increased attention. The new wave of second generation damages issues generally involve disputes over whether certain response costs are incurred "because of property damage" and whether certain costs incurred by an insured should be allocated to defense or indemnity. This article addresses these emerging "second generation" damages issues.

Nancer H. Ballard is a partner in the Environmental Department at Goodwin, Procter & Hoar, and chairperson of the firm's Insurance Practice Group. Charles N. Le Ray is an associate in the Environmental Department at Goodwin, Procter & Hoar, and a member of the firm's Insurance Practice Group. The views and opinions expressed herein do not necessarily reflect those of the authors, Goodwin, Procter & Hoar, or its clients. Goodwin, Procter & Hoar, Exchange Place, Boston, MA 02109

Whether Damages Are 'Because of Property Damage': The Remedial Versus Preventative Dispute

The Comprehensive Environmental Response Compensation Liability Act (CERCLA) and its state analogs give the United States Environmental Protection Agency (EPA) and state environmental agencies the power to respond to releases or threatened releases of hazardous substances.[5] Where a release of hazardous substances has occurred, the EPA may order removal or cleanup of soil at the facility, remediation of groundwater underneath the facility, remediation of soil and groundwater beyond the facility boundaries, and on-site and off-site[6] monitoring. The government also has the power to order removal of hazardous substances from areas or containers from which there has been no release. Response and removal actions may be based on public health concerns, or on the protection of the environment and natural resources.[7] Environmental agency administrative orders, correspondence, and consent decrees often reflect a combination of these goals.

Insurers looking to limit their exposure for response costs contend that they are not responsible for response costs that are "preventative," rather than "remedial." Because most policies do not use the words preventative and remedial, policyholder/insurer disputes in this area really revolve around whether the insured's liability to pay damages is *because of property damage*. Disputes can arise in a variety of factual contexts. For instance:

1. A potentially responsible party (PRP) may be directed to respond to a threatened release of hazardous substances in the absence of evidence confirming that an actual release has taken place;

2. A PRP may face liability for measures intended to prevent migration of contaminants or otherwise avert further damage;

3. The government may order (or undertake and recoup from PRPs the cost of) measures to prevent harm from another potential source that is related

or unrelated to the source of a release that has already caused third-party property damage; and

4. A PRP may be obligated to pay for various consequential expenses such as perimeter fences, oversight costs, or land acquisition or easement costs in order to conduct remediation.

Threatened Release in the Absence Of Any Actual Release of Hazardous Substances

Coverage disputes over liability for response actions in the absence of any release of hazardous substances are extremely rare.[8] When such disputes do arise, insurers may be expected to argue that they have no liability because their policies cover only damages *because of property damage*, not damages because of the threat of property damage. The decisions of several courts that have ruled that response costs associated with the actual release of contaminants are "damages" covered by general liability policies lend support to the insurers' view.[9]

On the other hand, where a policyholder incurs expense to avert imminent bodily injury or property damage, it seems unfair to deny the insured reimbursement for expenses that have saved the insurer from much greater exposure.[10] A few courts, perceiving the inequity in forcing policyholders to bear the entire cost of response activities that spare insurers liability for potentially enormous losses, have required insurers to pay for measures taken by policyholders to remedy perilous situations. For instance, in *Leebov v. United States Fidelity & Guaranty Co.*, the Pennsylvania Supreme Court required an insurer to pay costs incurred by a policyholder in hiring an expert and shoring up an excavation to prevent a landslide.[11] The Court noted:

> If the plaintiff had not taken immediate and substantial measures to remedy the perilous situation, disastrous consequences might have befallen the adjoining and nearby properties. If that had happened, the [insurer] would have been required to pay considerably more than is involved in the present lawsuit. It would be a strange kind of argument and an equivocal type of justice which would hold that the [insurer] would be compelled to pay out if the plaintiff had not prevented what would have been inevitable, and yet not be called upon to pay the smaller sum which the plaintiff actually expended to avoid a foreseeable disaster. ... It is folly to argue that if a policy owner does nothing and thereby permits the piling up of mountainous claims at the eventual expense of the insurance carrier, he will be harmless of all liability, but if he makes a reasonable expenditure and prevents a catastrophe he must do so at his own cost and expense.[12]

When the Maryland Supreme Court faced the issue of policyholder expenses that had saved the insurer from greater exposure, the court held in *W.M. Schlosser Co., Inc. v. Insurance Co. of North America*, that a policyholder could not recover costs it had incurred in advance of any property damage under the language of its policy, but suggested that a policyholder could seek the cost of prophylactic measures under a quasi-contract theory.[13]

Response Action to Prevent Further Property Damage

Insurers sometimes assert that measures taken on a policyholder's own property to prevent further migration of contamination into groundwater or off-site are preventative rather than remedial and therefore do not constitute "damages" covered by a general liability policy. The great majority of courts to address the issue have held that an insurer's obligation to pay damages *because of* property damage includes the costs of mitigation measures taken on a policyholder's property to prevent *further* damage to groundwater or the property of other private parties. For instance, in *Signo Trading International v. New Jersey*, the New Jersey Supreme Court noted that, "there is no novelty to the proposition that in a conventional tort action, once some present injury has been proved, the plaintiff's damages may include the cost of measures intended to prevent future injury."[14] Similarly, in *Northern States Power Co. v. Fidelity & Casualty Company of New York*, the Minnesota Court of Appeals held that general liability policies cover all expenditures necessary to clean up groundwater, including the cost of cleaning contaminated soil causing groundwater pollution and other expenses causally related to remedying the groundwater pollution.[15] In short, "preventive" measures taken on policyholders' property—such as soil removal or remediation, or the construction of containment caps, slurry walls, interceptor trenches and observation/recovery wells—should be covered if the measures are undertaken to prevent further groundwater or other off-site property damage.

Measures Taken to Prevent Harm from a Potential Source in the Course of Responding to Actual Property Damage

In the course of holding that environmental response costs are damages, several courts have suggested that actions taken to prevent potential harm

from other potential sources would not be covered.[16] In the real world, however, it is not always easy to distinguish remedial and mitigation efforts from purely prophylactic ones. Potential sources of harm may be intermingled with actual sources of contamination. Intact barrels and leaking barrels may be stored together. Barrels, tanks or solid waste disposal areas may have to be removed to gain access to tanks or barrels that have leaked, or to undertake soil or groundwater remediation. Additionally, the EPA may require removal of a currently intact treatment, storage, or disposal unit located adjacent to one of similar construction that has failed.

> Potential sources of harm may be intermingled with actual sources of contamination.

Certainly, liability for the removal of structures or units required to conduct remediation of the identified property damage is "because of property damage."[17] Policyholders also can legitimately claim that once the EPA or a state agency concludes that a site is contaminated and that it presents an actual hazard most, if not all, of the agency's actions to eliminate hazards flow from that determination. Thus, it is likely that most or all of a PRP's obligation for response costs can be causally linked to the identified property damage. A more restrictive approach invites protracted litigation over each barrel or each shovelful of soil removed and ultimately leads to arbitrary and elusive distinctions.[18]

Consequential Expenses

PRPs are frequently obligated to pay for measures which are not strictly remedial or mitigative. These mandated consequential expenses may include such things as perimeter fences, acquisition of land or easements on which to conduct monitoring or remediation, costs associated with placing deed restrictions or covenants on contaminated land, and EPA oversight costs. Insurers have sometimes argued that these costs are outside the insuring agreement because they do not remedy property damage.[19]

Usually such measures are either causally related to property damage for which the insured is being held liable, or are being undertaken to reduce an otherwise greater loss.[20] Some measures have a mitigative purpose, such as perimeter fences that prevent unauthorized access that could lead to disturbance of the area and could result in additional property damage, bodily injury, or interference with remediation efforts. The cost of items such as land acquisition or access rights may be required to implement the cleanup or to reduce the scope or duration of the PRPs' remedial obligations. EPA oversight charges may not serve either purpose, but a PRP's liability for such costs is causally related to the PRP's liability for property damage.

Allocation of Costs Between Defense and Indemnity

In most states, an insurer's duty to defend is triggered if any of the allegations made against the policyholder, if proven, could *possibly* fall within the policy coverage.[21] Thus, the insurer's duty to defend is broader than the duty to indemnify and an insurer can be obligated to pay defense costs although it ultimately has no indemnity obligation. Under most standard-form general liability policies, defense costs do not count against policy limits, and defense costs can exceed policy limits by several magnitudes. Thus, an insurer facing claims for environmental response costs has an interest in allocating as much of the insured obligation as possible to indemnity.[22] The insured, on the other hand, has an interest in allocating as many costs as possible to defense to secure the broadest possible protection and to avoid exhaustion of limits.[23] The majority of disputes over the allocation of costs between defense and indemnity arise because environmental agencies have the power to impose obligations upon PRPs the cost of investigations which PRPs may use to develop defenses, minimize their liability, and allocate liability among PRPs/defendants.[24]

Typically, upon learning of potential site contamination, the EPA conducts an initial investigation to determine whether the site should be listed on the National Priority List (NPL), and remediated in accordance with the National Oil and Hazardous Substances Pollution Contingency Plan. This investigation may involve soil and water sampling, risk analysis, contaminant plume analysis and other steps for which the EPA will seek eventual reimbursement from PRPs. After a site is listed on the NPL, several more investigatory and analysis phases are usually undertaken before overall site remediation begins.[25] First, the EPA identifies some or all the PRPs and notifies them of their alleged liability. Frequently the agency also sends information requests pursuant to CERCLA § 104 (104(e) letters) to PRPs and to parties that the EPA believes may be PRPs. At some point, the EPA or some or all of the PRPs undertakes one or more Remedial Investigation / Feasibility Studies (RI/FS) to determine the nature and extent of contamination and to evaluate remediation options.[26] Regardless of how the

process unfolds, the EPA will ultimately seek to impose upon PRPs the cost of all investigatory work.

> Whether a policyholder's liability is 'damages because of property damage' should be based on whether the cost is intended to mitigate existing property damage, enable remediation to be conducted more efficiently, or because of identified property damage.

Policyholders and insurers generally agree that costs incurred by a PRP in responding to initial PRP notices and 104(e) letters, and the organizational costs of assembling a joint PRP defense committee, are properly allocated to defense. The agreement may begin to break down once remedial investigation obligations begin. Insurers argue that RI/FS costs should be allocated to indemnity because RI/FS tasks are usually set forth or incorporated by reference into an administrative order or consent decree.[27] Insurers further argue that such RI/FS costs should be classified as indemnity because the EPA or the state agency exercises substantial control over the scope and consent of the investigation and can impose sanctions on nonperforming PRPs. Policyholders have argued that RI/FS costs should be allocated to defense because the purpose of the RI/FS is to investigate the nature and scope of the PRPs' liability, a classic defense undertaking in traditional tort contexts. Policyholders also observe that insurers generally agree to allocate investigation and organization costs incurred before the RI/FS process to defense, and argue that the entry of an order for specific investigation does not justify allocating functionally similar or related costs to indemnity.

The insurers' argument that all RI/FS costs must be indemnity expenses because they are incurred under the threat of a legal sanction is flawed. Parties in civil law suits often disagree over the scope of their discovery obligations and are ordered by courts to produce documents, answer interrogatories, or produce deponents. Insurers do not claim that the cost of responding to court ordered discovery is indemnity merely because the insured is under a legal obligation to perform. On the other hand, the duty to defend non-environmental litigation clearly encompasses investigation of facts that bear on the alleged liability and investigations designed to produce or generate evidence that limits a policyholder's potential exposure.[28] It is difficult to think of a nonenvironmental context in which costs incurred to disprove or limit a party's ultimate liability are treated as indemnity. Moreover, because CERCLA severely restricts PRPs' opportunities for challenging the EPA's selected remedy,[29] even if participation in the RI/FS process were not mandated, PRP input is essential to ensure that the remedy selected is the least expensive acceptable option.[30]

PRPs involved at large, multi-party sites often establish an organizational structure to undertake or comment on the RI/FS and ROD, or to implement the remedy ultimately selected. PRPs that assume RI/FS or cleanup obligations believe that doing so will reduce their overall liability—either because the EPA will not offer the PRPs a fixed dollar settlement or because the PRPs believe that they can effectuate the cleanup more cheaply or more efficiently than the government can. To facilitate this joint effort, the PRPs formally or informally establish various committees such as steering, technical, and allocation committees.[31] Insurers may argue that the organizational costs incurred by PRPs undertaking cleanup responsibility are indemnity expense because the costs are incurred pursuant to a consent decree authorizing the PRPs' activities. Policyholders contend that the organizational costs should be treated as defense because they are undertaken to limit total liability.

Technical committee costs and the cost of outside counsel negotiations with contractors and the EPA should be treated as defense if their purpose is to reduce the PRP's total cleanup liability. Steering committee and allocation costs associated with establishing, managing and replenishing a trust or other fund-pooling mechanism intended to efficiently spread loss among the maximum number of PRPs should also qualify as defense since each PRP is participating in the process to minimize its own share of the total joint and several liability.[32]

Conclusion

The determination of whether a policyholder's liability is "damages because of property damage" should be based on a determination of whether the cost is intended to mitigate existing property damage, enable remediation to be conducted more efficiently, or is being imposed because of identified property damage. Costs which are incurred by policyholders to resist, reduce or limit liability are treated as defense costs in the non-environmental context, and the same standard should be used in the environmental area to identify which costs are treated as defense.

NOTES

1. Standard form policies typically define "Property damage" as:

(1) Physical injury to or destruction of tangible property, which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or

(2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

2. The standard general liability policy forms in use between 1966 and 1972 include a definition of the word "damages" designed to make clear that broad consequential, as well as direct, damages are covered by general liability policies. This definition states: "Damages includes damages for death and for care and loss of services resulting from bodily injury and damages for loss of use of property resulting from property damaged." See, e.g., Jordan S. Stanzler & Charles A. Yuen, Coverage for Environmental Cleanup Costs: History of the Word "Damages" in the Standard Form Comprehensive General Liability Policy, 1990 Colum. Bus. L. Rev. 449, 457–77 (1990). The definition of damages was deleted from the standard form CGL policy jacket in 1973 when the definitions of "bodily injury" and "property damage" were broadened to expressly include the consequential losses that had been listed in the definition. See National Underwriter Company, Liability Changes—A Review 1973 Revised Standard Provisions, Fire, Casualty & Surety Bulletin, Casualty & Surety Volume, Public Liability, October 1972, at A-1.

Some excess policies also define the word "damages." For example, a commonly used excess liability form policy states that the insurer agrees to pay "damages, direct or consequential and expenses all as more fully defined by the term 'ultimate net loss.'" "Ultimate net loss" is then defined to include: ""the total sum which the Insured ... becomes obligated to pay by reason of personal injury, property damage or advertising liability claims, either through adjudication or compromise, and shall also include ... 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 ...."

3. See Susan M. Cooke, The Law of Hazardous Waste § 19.05[3][c] (1994).

4. Courts that have found environmental response costs to be damages include Supreme Courts in California, Iowa, Illinois, Massachusetts, Minnesota, New Hampshire, North Carolina and Washington, and the Second, Third, Ninth and D.C. Circuit Court of Appeals. The Maine and Wisconsin Supreme Courts and the Eighth Circuit have held that environmental response costs are not "damages" covered by a general liability policy. Compare AIU Ins. Co. v. Superior Court, 51 Cal. 3d 807, 274 Cal. Rptr. 820, 799 P.2d 1253 (1990) and Outboard Marine Corp. v. Liberty Mut. Ins. Co., 154 Ill. 2d 90, 180 Ill. Dec. 691, 607 N.E.2d 1204 (1992) and A.Y. McDonald Indus., Inc. v. Insurance Co. of N. Am., 475 N.W.2d 607 (Iowa 1991) and Hazen Paper Co. v. United States Fidelity & Guar. Co., 407 Mass. 689, 555 N.E.2d 576 (1990) and Minnesota Mining Co. v. Travelers Indemnity Co., 457 N.W.2d 175 (Minn. 1990) and Coakley v. Maine Bonding & Casualty Co., 618 A.2d 777 (N.H. 1992) and C.D. Spangler Constr. Co. v. Industrial Crankshaft & Eng'g Co., 326 N.C. 133, 388 S.E.2d 557 (1990) and Boeing Co. v. Aetna Casualty & Sur. Co., 113 Wash. 2d 869, 784 P.2d 507 (1990) and Aetna Casualty & Sur. Co., Inc. v. Pintlar Corp., 948 F.2d 1507 (9th Cir. 1991) (Idaho law) and Gerrish Corp. v. Universal Underwriters Ins. Co., 947 F.2d 1023, 1030 (2d Cir. 1991) (Vt. law) and Independent Petrochem. Corp. v. Aetna Casualty & Sur. Co., 944 F.2d 940 (D.C. Cir. 1991) (Mo. law) and New Castle County v. Hartford Accident & Indem. Co., 933 F.2d 1162 (3rd Cir. 1991) (Del. law) and Avondale Indus., Inc. v. Travelers Indem. Co., 887 F.2d 1200 (2d Cir. 1989) (N.Y. law) with Continental Ins. Co. v. Northeastern Pharmaceutical & Chem. Co., 842 F.2d 977 (8th Cir.), cert. denied, 488 U.S. 821 (1988) (NEPACCO) and Patrons Oxford Mut. Ins. Co. v. Marois, 573 A.2d 16 (Me. 1990) and City of Edgerton v. General Casualty Co. of Wis., 517 N.W.2d 463 (Wis. 1994).

5. See, e.g., 42 U.S.C. § 9604, CERCLA § 104 (1988); Mass. Gen. Laws ch. 21E § 3 (1983).

6. A "site" designated by the EPA or a state environmental agency can be a portion of a facility or can encompass multiple facilities or properties.

7. See, e.g., 42 U.S.C. § 9604, CERCLA § 104 (1988).

8. Any site listed on the National Priorities List (NPL) will involve actual releases of contamination. A site is only eligible for listing on the NPL after a detailed analysis and scoring of factors including groundwater migration pathways, surface water migration pathways, observed releases, toxicity, effects on human health and the human food chain, and the effect on natural resources. See 55 Fed. Reg. 51532, 51569 (Dec. 14, 1990); 40 C.F.R. § 300, Appendix A (1994). As of 1991, there were no reported state or federal decisions expressly granting or denying coverage for "cleanup to avert a 'solely threatened release.'" Scott D. Patterson & Paul M. Hummer, An Ounce of Prevention: Comprehensive General Liability Insurance Coverage for 'Preventive' Expenses at Superfund Sites, Environmental Reporter (BNA March 12, 1991) 2239, 2241.

9. See AIU Ins. Co., 51 Cal.3d 807, 799 P.2d at 1272 (orders for purely prophylactic measures to prevent future releases not covered by CGL policies) (dicta); Hazen

Paper Co., 407 Mass. 609, 555 N.E.2d at 580, 582 (claim for removal of hazardous material, absent allegation of release, not damages under CGL policy); Boeing Co., 113 Wash. 869, 784 P.2d at 516 ("damages" does not cover safety measures or other preventative costs taken in advance of any damage to property).

10. This issue is most likely to arise in the context of an environmental impairment or pollution policy because standard form general liability policies now contain an "absolute" pollution exclusion.

11. 401 Pa. 477, 165 A.2d 82 (1960).

12. Id. at 477, 165 a.2d at 84.

13. 325 Md. 301, 600 A.2d 836, 839 (Md. 1992).

14. 130 N.J. 51, 612 A.2d at 938.

15. 504 N.W.2d 240, 246 (Minn. Ct. App. 1993). See also Allstate v. Quinn Constr. Co., 713 F. Supp. 35, 41 (D. Mass. 1989) (vacated due to settlement) ("[I]n the unique context of environmental contamination, where prevention can be far more economical than post-incident cure, it serves no logical purpose to assert that soil and groundwater pollution must be allowed to spread over boundary lines before [an insurer will cover the cost of remediation].").

16. See, e.g., Hazen Paper Co., 555 N.E.2d at 582 (costs of removing materials stored in overpacked drums at Superfund site are not "damages"); AIU Ins. Co. 799 P.2d at 1272 (prophylactic costs incurred to pay for measures taken in advance of any release of hazardous waste [whether or not on the waste site]—are not incurred "because of property damage"); Northern States Power Co., 504 N.W.2d at 246 ("[E]xpenditures to prevent future pollution of a type which has yet to occur or from a source which has yet to cause pollution are not covered because the costs are not causally related to the property damage.").

17. Sources of threatened harm that are similar or intermingled with sources of contamination, are more likely to be considered covered mitigation efforts, than potential sources that are geographically distinct or different in type.

18. For a discussion of the difficulties of breaking remedial activities into smaller analytical portions, see Patterson & Hummer, supra note 8, at 2241–43. In other environmental insurance contexts, courts have refused to micro-analyze environmental sites where such an inquiry would result in increased litigation, administrative and judicial costs. See Lumbermens Mut. Casualty Co. v. Belleville Indus., Inc., 938 F.2d 1423, 1427 (1st Cir. 1991) (declining to undertake "the Augean labors inherent in microanalysis" that would result from basing a coverage finding on classification of individual contaminant releases).

19. Commentators have noted, however, that insurers' arguments against coverage for consequential environmental damages are inconsistent with the drafting history of standardized CGL policies since the late 1930s. See Stanzler & Yuen, supra note 2, at 457–77.

20. See, e.g., Intel Corp. v. Hartford Accident & Indem. Co., 692 F. Supp. 1171, 1194 (N.D. Cal. 1988) (all expenses incurred pursuant to consent decree and all pre-consent decree response costs that are consistent with, or that formed foundation for, the consent decree are covered under policy).

21. See, e.g., City of Johnstown v. Bankers Standard Ins. Co., 877 F.2d 1146, 1148 (2nd Cir. 1989).

22. Once an insurer's limits are exhausted, an insurer usually is allowed to cease defending where its policy provides that its obligations shall cease upon exhaustion of its limits, or where there are other insurers available to take up the defense or pay defense costs. See, e.g., Aetna Casualty & Sur. Co. v. Certain Underwriters at Lloyds of London, 56 Cal App.3d 791, 129 Cal. Reporter 47, 52, 54 n.5 (1976) (obligation of excess insurer to defend is implied once monetary limits or primary policy are exhausted); New Castle County v. Continental Casualty Co., 725 F. Supp. 800, 808, 818 (D. Del. 1989) (exhaustion of primary policy triggers excess policy's defense coverage obligation); Zurich Ins. Co. v. Ray Mark Indus., 144 Ill. App.3d 943, 98 Ill. Dec. 508, 494 N.E.2d 630, 633 (1986) (excess carriers are necessary parties to primary carrier's action seeking declaration that policy exhaustion ended its duty to defend), aff'd 118 Ill.2d 23, 112 Ill. Dec. 684, 514 N.E.2d 159 (1987).

23. If coverage is available only under policies issued before the early 1970s, the policyholder may face exposure in excess of its available policy limits. Since the majority of jurisdictions have held that insurer's obligation to defend a potentially covered risk is either several or joint and several, an insured also may want to allocate as many costs as possible to defense to minimize the effect of missing policies, insolvent insurers, or retrospectively rated policies in which the retrospective premium applies only to indemnity payments.

24. Policyholders and insurers generally agree that actual remediation costs should be treated as indemnity. A consent decree may include consequential expenses not related to the remediation of third-party property damage, such as perimeter fences, protective caps over contaminated soil and EPA oversight charges. Here, too, the parties agree that covered costs should be allocated to indemnity expense although, as discussed in Section I.D, they may disagree over whether coverage exists for certain consequential expenses.

25. The exact sequence of investigative and remedial measures at a particular site is determined by many fac-

tors including the availability of information on the nature and sources of contamination, the severity of the risk presented, and the interaction between PRPs and the EPA.

26. 40 C.F.R. § 300.430 (1994). The EPA may begin the RI/FS before notifying any PRPs, particularly if the agency is unsure who the PRPs are or if there are few, or no, "deep pocket" PRPs. The RI/FS may be undertaken by one or more PRPs pursuant to a consent order and EPA supervision, or may be initiated by the EPA during the PRP notification process. Once the RI/FS is complete, the EPA selects the remedy (often with substantial input from the PRPs) and issues a Record of Decision (ROD). The ROD can be implemented pursuant to a consent decree between the government and PRPs, ordered in an abatement action, or undertaken by the EPA and paid for by PRPs. See 40 C.F.R. § 300.430(f)(4); 42 U.S.C. §§ 9606(a), 9607(a), 9622, CERCLA §§ 106(a), 107(a), 122 (1988).

27. See, e.g., General Accident Ins. Co. of Am. v. N.B. Fairclough & Sons, Inc., No. L-010592-87 (N.J. Super. Ct. Law Div. March 14, 1994) (Transcript of oral argument at 15), available in 8 Mealey's Litig. Rep.: Insurance (Mealey Publications, Inc.) No. 28, at G-7 (May 24, 1994).

28. E.g., Higgins Indus., Inc. v. Fireman's Fund Ins. Co., 730 F. Supp. 774, 777 (E.D. Mich. 1989). Occasionally, an RI/FS results in the EPA deciding that a PRP is not responsible for the contaminants of concern and that, therefore, no remedial liability will be imposed upon the PRP. See, e.g., American Bumper & Mfg. Co. v. Hartford Fire Ins. Co., 207 Mich. App. 60, 523 N.W.2d 841, 845 (Mich. App. Ct. 1994) (duty to defend continues throughout RI/FS process; PRP ultimately found not liable for contamination).

29. See 42 U.S.C. §§ 9613(h) & (j), CERCLA §§ 113(h) & (j) (1988).

30. In some instances, proposed remedial measures are tested in pilot studies during the RI/FS process. Courts have found that allocating the cost of pilot studies to defense or indemnity is no easier than allocating other RI/FS costs. See, e.g., Polaroid Corp. v. Travelers Indem. Co., No. 88-5208 (Mass. Super. Ct. Jan. 2, 1992) at 6–7 (deferring ruling on allocation of pilot study costs until parties present further evidence on the matter), available in 6 Mealey's Litig. Rep.: Insurance (Mealey Publications, Inc.) No. 11, at A-1, A-3 to A-4 (Jan. 21, 1992).

31. The technical committee typically monitors contractor efforts to ensure a cost-effective cleanup; the allocation committee determines each party's share of the funding obligation; and the steering/executive committee assumes overall responsibility and pays ongoing cleanup expenses.

32. While the allocation process does not change the group's total liability, it can have an enormous effect on an individual PRP's liability. The major reason an individual PRP participates in the allocation process is to limit its own liability. Therefore, allocation-related costs should be treated as defense costs.