

Notes

AIU Ins. Co. v. Superior Court: Insurers Liable for Environmental Response Costs

I. INTRODUCTION

Pervasive, devastating pollution of our natural resources is a crucial and life-threatening problem.¹ Cleanup is essential, but the cost is staggering.² Thus, who cleans up, when and how, and who pays are critical questions. Many answers have been supplied in state and federal statutes, most notably the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA).³

Many companies identified by the government as parties responsible for past hazardous waste releases were insured under Comprehensive General Liability (CGL) policies.⁴ When ordered to

1. For example, the Environmental Protection Agency estimates the United States produces 280 million metric tons of hazardous waste each year. Chappie, D'Angelo, Johnson, Kimmel, Mahoney, Minis, Ware, *Pollution Control 20 Years After Earth Day: A Retrospective on Federal Environmental Programs*, 21 ENVTL. REP. 123, 126 (1990) [hereinafter *Federal Environmental Programs*]. While 87 percent of the nation's sewage systems now have secondary treatment, San Diego and Los Angeles are among large coastal cities without secondary sewage treatment systems. *Id.* at 127.

2. EPA estimated the average cost of cleanup per site at \$8.1 million. OFFICE OF EMERGENCY AND REMEDIAL RESPONSE, U.S. ENVIRONMENTAL PROTECTION AGENCY, EXTENT OF THE HAZARDOUS RELEASE PROBLEM AND FUTURE FUNDING NEEDS, CERCLA 301 (A) (1) (C) STUDY 4-3 (1984). According to a project director of the Congressional Office of Technology Assessment, more than \$10 billion of federal, state and private industry money has been spent on Superfund site cleanup in the 1980s. *Federal Environmental Programs*, *supra* note 1, at 127.

3. 42 U.S.C. §§ 9601-9675 (1988).

4. The standardized CGL insurance contract has been used by business insurers since the 1880s. The industry-wide standard form policy, issued in 1940, was revised in

reimburse the government for costs of monitoring and cleanup of hazardous waste sites or to clean sites themselves, these companies filed insurance claims. Insurers refused to pay, arguing that the policies did not cover equitable, as opposed to legal relief, and that restitution and mitigation did not qualify as "damages."⁶

In November 1990, California became the sixth state⁶ whose highest court decided whether environmental response costs and costs of compliance with injunctions are covered as damages under CGL policies.⁷ In *AIU Ins. Co. v. Superior Court*,⁸ the California Supreme Court unanimously held that the standard-form CGL policies issued to the real party in interest, FMC Corporation (FMC), "cover the costs of reimbursing government agencies and complying with injunctions ordering cleanup under CERCLA and similar statutes."⁹

This Note will examine the California Supreme Court's decision in *AIU Ins. Co. v. Superior Court* covering the "new" environmental liability. Section II will examine the state of the law nationwide and in California at the time of the decision. Section III will examine the facts of *AIU* and the court's opinion. Section IV will analyze the impact and implications of the decision.

II. BACKGROUND

A. Environmental Response Costs Under CERCLA

Congress enacted the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA)¹⁰ to respond to pollution caused by hazardous waste, an increasingly evident national disaster. Among other things, CERCLA imposes retroactive strict liability on parties who have improperly released hazardous wastes in violation of federal and state statutes.¹¹

Responsible parties are liable, but cleanup costs are astronomical.¹² Congress created the Hazardous Substance Superfund to en-

1943, 1955, 1966 and 1973. GENERAL LIABILITY INSURANCE — 1973 REVISIONS 3 (F. Bardenwerper & D. Hirsch eds. 1974) [hereinafter F. Bardenwerper & D. Hirsch].

5. *Maryland Casualty Co. v. Armco* is a typical decision, in which the court agreed with the insurer's claim of this narrow, technical definition of damages. 822 F.2d 1348 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (1988).

6. The first five states are Washington, North Carolina, Maine, Minnesota and Massachusetts. The highest court of each of these states decided this issue between January and June, 1990. Only Maine decided in favor of the insurer. *See infra* notes 29 and 30 and accompanying text.

7. *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990).

8. *Id.*

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

10. Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C. §§ 9601-9675 (1988)).

11. 42 U.S.C. § 9607(a) (1988).

12. *See supra* note 2.

sure that funds are available to investigate hazardous waste sites and, if necessary, to initiate cleanup.¹³ If the government incurs costs of responding to assessment and cleanup of hazardous waste sites, it sues the responsible parties for reimbursement.¹⁴ Alternatively, under CERCLA the government can request voluntary compliance or issue injunctions against responsible parties, requiring them to clean sites and to mitigate damages.¹⁵

Superfund has limited resources which will not even begin to cover all the necessary cleanup costs. Companies responsible for their own cleanup or for reimbursing the government have sought coverage from their Comprehensive General Liability (CGL) insurance policies. CGL policies are widely used standard-form policies.¹⁶ When insurers refuse to cover policy holders' claims for pollution response costs, the issue is whether such costs are "damages" under the policies.¹⁷

B. Insurers' Liability: Judicial Response Nationwide

While a few courts were asked in the 1970s to interpret environmental cleanup as damages,¹⁸ the first court holding that damages under CGL policy language covered government-ordered cleanup was a 1983 Michigan court of appeals in *United States Aviox Co. v. Travelers Insurance Co.*¹⁹ Three years later, in *Maryland Casualty*

13. 42 U.S.C. § 9611(a) (1988). Superfund has up to \$8.5 billion available for the five-year period beginning October 17, 1986. *Id.*

14. 42 U.S.C. § 9604.

15. *Id.*

16. *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 815, 823 n.9, 799 P.2d 1253, 1259, 1265 n.9, 274 Cal. Rptr. 820, 826, 832 n.9 (1990).

17. Coverage provisions in FMC's sixty plus primary and excess policies were adopted verbatim from standard CGL policies. All policies cover FMC for one of the following: "all sums which [FMC] shall become legally obligated to pay as damages because of . . . property damage to which this policy applies," 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 . . .," or 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 . . ." *Id.* at 814-15, 799 P.2d at 1259, 274 Cal. Rptr. at 826.

18. *See, e.g., Lansco, Inc. v. Dep't of Envl. Protection*, 138 N.J. Super. 275, 350 A.2d 520 (1975) (coverage under CGL policy extended to statutory liability for damages recoverable by the state for damage caused by oil spill from insured's property), *aff'd*, 145 N.J. Super. 433, 368 A.2d 363 (1976), *cert. denied*, 73 N.J. 57, 372 A.2d 322 (1977); *Chemical Applications Co. v. Home Indem. Co.*, 425 F. Supp. 777 (D. Mass. 1977) (insured who was responsible for oil spill cleanup could be reimbursed by insurer for insured's own cleanup work rather than waiting for more costly work by government).

19. 125 Mich. App. 579, 336 N.W.2d 838 (1983).

Co. v. Armco,²⁰ the Court of Appeals for the Fourth Circuit adopted a narrow, technical definition of insurance damages to exclude coverage of environmental response costs.²¹ In *Armco*, the Fourth Circuit maintained the distinction between damages at law and at equity.²² The reasonable insured, the court asserted, would infer that a damages policy would not cover equitable remedies of restitution and injunction.²³ *U.S. Aviex* and *Armco* established the ends of the spectrum, with far more courts following the *U.S. Aviex* pro-coverage stance.

In fact, the California Supreme Court noted in *AIU* that it had found only one prior appellate court decision which held that reimbursement of *response costs* was not damages under CGL policies.²⁴ Likewise, the court found only one appellate decision concluding, in dictum, that *injunctive relief* was not covered under CGL policies.²⁵

Federal courts have not been as consistent. *Armco* and an Eighth Circuit decision²⁶ have dominated the narrow view of damages that excludes coverage by CGL policies. Other federal courts have interpreted state law to include remediation and injunctive relief as damages.²⁷

It was a New Jersey court that first relied extensively on principles of insurance policy interpretation when construing the term "damages" in CGL policies.²⁸ All five of the highest state courts, including California, that have decided the CGL insurance issue in favor of coverage relied on established principles²⁹ of contract interpretation.³⁰ Only one state supreme court has decided in favor of the insurer,³¹ relying on the technical interpretations of *Armco*³² and

20. *Maryland Casualty Co. v. Armco, Inc.*, 822 F.2d 1348 (4th Cir. 1987).

21. *Id.* at 1352.

22. *Id.* at 1352-53.

23. *Id.* at 1352.

24. *AIU*, 51 Cal. 3d at 819, 799 P.2d at 1262, 274 Cal. Rptr. at 829 (citing *Braswell v. United States Fidelity & Guar. Co.*, 300 N.C. 338, 387 S.E.2d 707 (1989)).

25. *AIU*, 51 Cal. 3d at 820, 799 P.2d at 1263, 274 Cal. Rptr. at 830 (citing *CPS Chem. Co. v. Continental Ins. Co.*, 222 N.J. Super. 175, 536 A.2d 311 (1988)).

26. *Continental Ins. v. Northeastern Pharmaceutical & Chem. Co.*, 842 F.2d 977 (8th Cir. 1988) [hereinafter *NEPACCO*].

27. See, e.g., *Avondale Indus., Inc. v. Travelers Indem. Co.*, 887 F.2d 1200 (2d Cir. 1989); *Chesapeake Utils. Corp. v. American Home Assurance Co.*, 704 F. Supp. 551 (D. Del. 1988); *New Castle County v. Hartford Accident & Indem. Co.*, 673 F. Supp. 1359 (D. Del. 1987).

28. *Broadwell Realty Servs. v. Fidelity & Casualty Co. of N. Y.*, 218 N.J. Super. 516, 528 A.2d 76 (1987).

29. E.g., see *infra* note 70.

30. *Boeing Co. v. Aetna Casualty & Sur. Co.*, 113 Wash. 2d 869, 784 P.2d 507 (1990); *Spangler Const. v. Industrial Crankshaft & Engr. Co.*, 326 N.C. 133, 388 S.E.2d 557 (1990); *Minnesota Mining & Mfg. v. Travelers Indem. Co.*, 457 N.W.2d 175 (1990); *Hazen Paper Co. v. United States Fidelity & Guar. Co.*, 407 Mass. 689, 555 N.E.2d 576 (1990); *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990).

31. *Patrons Oxford Mut. Ins. v. Marios*, 573 A.2d 16 (1990).

32. 822 F.2d 1348 (4th Cir. 1987).

NEPACCO.³³

C. CGL Coverage in California

Prior to the California Supreme Court decision in *AIU*, California courts of appeal were split on the issue, with one very broad, pro-coverage decision³⁴ and the court of appeal's very narrow interpretation in *AIU*.³⁵ Interestingly, it was a federal district court in 1988 that accurately predicted the California Supreme Court's decision.³⁶ In *Intel Corp. v. Hartford Accident & Indemnity Co.*,³⁷ the district court emphasized the importance of applying *state* law rather than basing the decision on federal statutory language.³⁸ The *Intel* court applied California contract interpretation principles and case law.³⁹ However, *Intel* went one step further and considered public policy a reason to recognize coverage of response costs.⁴⁰ Both federal and state interests in effecting prompt, efficient cleanup are frustrated, according to *Intel*, without the *essential* cooperation of responsible

33. 842 F.2d 977 (8th Cir. 1988).

34. *Aerojet-General Corp. v. Superior Court*, 211 Cal. App. 3d 216, 257 Cal. Rptr. 621 (1989).

35. *AIU Ins. Co. v. Superior Court*, 213 Cal. App. 3d 1219, 262 Cal. Rptr. 182 (1989).

36. *Intel Corp. v. Hartford Accident & Indem. Co.*, 692 F. Supp. 1171 (N.D. Cal. 1988).

This Court concludes that the California Supreme Court would hold that costs incurred by an insured in investigating and cleaning up pollution (in particular, hazardous waste) that is damaging public property and posing an established threat to public health are covered by the terms of a comprehensive general liability policy.

Id. at 1192.

37. 692 F. Supp. 1171 (N.D. Cal. 1988).

38. *Id.* at 1187.

39. The *Intel* court relied heavily on California's doctrine of mitigation expressed in *Globe Indem. Co. v. State of California*, 43 Cal. App. 3d 745, 118 Cal. Rptr. 75 (1974). In *Globe Indemnity*, a California court of appeal examined whether an insured's expenses, incurred to mitigate damage by fire to third parties' property, covered under a CGL policy. The court held the insured was covered for prevention of damage for which coverage was provided if the damage was allowed to occur. *Id.* at 751-52, 118 Cal. Rptr. at 79-80.

The California Insurance Code has a similar provision: "An insurer is liable: . . . (b) If a loss is caused by efforts to rescue the thing insured from a peril insured against." CAL. INS. CODE § 531 (West 1972).

Thus, the insurance policy exclusion for "owned property" probably will not survive after the *AIU* decision. The insurer appears to be liable for the cost of damage to the insured's own land if the damage threatens to spread to another's property.

40. *Intel*, 692 F. Supp. at 1193.

parties.⁴¹ The government simply lacks the resources to accomplish the monumental task without industry cooperation.⁴² Denial of insurance coverage for costs of complying with cleanup, the *Intel* court said, would deter compliance and mitigation of damages until responsible parties are sued for reimbursement of agencies' cleanup expenses.⁴³

The same public policy issue is raised in the two conflicting California courts of appeal cases. While the *Aerojet* decision is based on contract interpretation and California's mitigation of damages doctrine, the court says coverage "is also supported by sound public policy."⁴⁴ Because coverage would encourage companies in earlier, more cooperative cleanup, "in the long run insurance coverage would seem to enhance the quality of environmental protection."⁴⁵ FMC argued the same policy to the court of appeal in *AIU*, but that court declined to "assume the role of legislators."⁴⁶

Likewise, the California Supreme Court declined to consider public policy in its analysis.⁴⁷ However, the high court acknowledged the same deterrence problem identified by the *Intel* and *Aerojet* courts and cited with approval the "underlying rationale" of some courts' decisions stated in terms of public policy.⁴⁸

The California Supreme Court agreed to decide the issue of whether standard-form comprehensive liability insurance policies cover reimbursement of environmental response costs incurred by the government or insureds' compliance with injunctions to remedy and mitigate damages. Only five other states' highest courts had decided the same issue — four in favor of coverage, one against.⁴⁹ Within five months, two California courts of appeal had reached opposite conclusions based on their interpretations of the policies.⁵⁰

III. AIU INS. CO. V. SUPERIOR COURT

A. Facts

FMC allegedly contaminated seventy-nine hazardous waste disposal sites, surface water surrounding the sites, and groundwater and aquifers beneath the sites and the adjoining property.⁵¹ The United

41. *Id.*

42. *Id.*

43. *Id.*

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

45. *Id.*

46. *AIU*, 213 Cal. App. 3d at 1237, 262 Cal. Rptr. at 193.

47. *See infra* notes 110-12 and accompanying text.

48. *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 840-41, 799 P.2d 1253, 1278, 274 Cal. Rptr. 820, 845. For cases, *see infra* note 95 and accompanying text.

49. *See supra* notes 30-31 and accompanying text.

50. *See supra* notes 34-35 and accompanying text.

51. *AIU*, 51 Cal. 3d at 815, 799 P.2d at 1260, 274 Cal. Rptr. at 827.

States and local administrative agencies filed suits against FMC for statutory violations.⁵² They sought two types of relief. First, the agencies sought injunctions requiring FMC to halt disposal of hazardous wastes.⁵³ Second, they sought reimbursement of response costs for investigating, monitoring and initiating cleanup.⁵⁴

FMC sought declaratory relief in Superior Court in Santa Clara County to establish coverage for environmental response and remediation costs under its more than sixty standard-form GCL insurance policies carried by several insurers. The trial court denied the insurers' motion for summary adjudication, saying the CGL policies should be interpreted nontechnically, according to established principles of insurance interpretation.⁵⁵ Thus, it construed environmental cleanup costs, whether by injunction or by reimbursing government agencies, as "damages" or "ultimate net loss" under the policies.⁵⁶

The insurers requested a writ of mandate. The court of appeal granted the writ and ordered the trial court to grant insurers' motion for summary adjudication.⁵⁷ The court of appeal noted that until recent environmental suits, CGL policies were not expected to cover costs their insureds incurred to comply with governmental police power or respond to injunctions.⁵⁸ Thus, the court reasoned, FMC and its insurers could not have expected the coverage requested in the instant suit.⁵⁹ The court based its narrow, technical reading of the policies on *Armco*⁶⁰ and *NEPACCO*,⁶¹ decided in the Fourth and

52. *Id.* FMC allegedly violated CERCLA, 42 U.S.C. §§ 9601-9675 (1988); Resource Conservation and Recovery Act (RCRA), 42 U.S.C. §§ 6901-6992 (1988); the Clean Water Act, 33 U.S.C. §§ 1251-1387 (1988); the Safe Drinking Water Act, 42 U.S.C. §§ 300f-300j-26 (1988); and the California Hazardous Substance Account Act (CAL. HEALTH & SAFETY CODE §§ 25300-25367 (West 1984 & Supp. 1991).

53. *AIU*, 51 Cal. 3d at 815-16, 799 P.2d at 1260, 274 Cal. Rptr. at 827. Injunctive relief is available under all statutes on which the agencies sued: 42 U.S.C. § 9606(a) (1988); 42 U.S.C. § 6973(a) (1988); 33 U.S.C. § 1364(a) (1988); 42 U.S.C. § 300i(a) (1988); CAL. HEALTH & SAFETY CODE § 25358.3(a) (West 1984 & Supp. 1991).

54. *AIU*, 51 Cal. 3d at 816, 799 P.2d at 1260, 274 Cal. Rptr. at 827. Two statutes authorize recovery of response costs. CERCLA, 42 U.S.C. § 9607(a)(4)(A) (1988); and the Hazardous Substance Account Act, CAL. HEALTH & SAFETY CODE § 25360 (West 1984 & Supp. 1991).

55. *AIU*, 51 Cal. 3d at 817, 799 P.2d at 1261, 274 Cal. Rptr. at 828.

56. *Id.*

57. *AIU Ins. Co. v. Superior Court*, 213 Cal. App. 3d 1219, 1238, 262 Cal. Rptr. 182, 194 (1989).

58. *Id.* at 1223, 262 Cal. Rptr. at 183.

59. *Id.*

60. *Maryland Casualty Co. v. Armco, Inc.*, 822 F.2d 1348 (4th Cir. 1987). See *supra* text accompanying notes 20-21.

61. *Continental Ins. v. Northeastern Pharmaceutical & Chem. Co.*, 842 F.2d 977

B. Opinion

The California Supreme Court unanimously reversed.⁶³ Applying ordinary rules of insurance policy construction, the court held that the comprehensive liability policies covered FMC's costs to reimburse the government and to comply with injunctions under CERCLA and other environmental statutes.⁶⁴

Writing for the court, Chief Justice Lucas said the issue before the court was not one of public policy.⁶⁵ Because CERCLA and the Hazardous Substance Account Act allow parties to insure against the costs of relief those statutes authorize, Congress and the California Legislature already have considered and incorporated relevant public policy, according to the court.⁶⁶ Thus, the court's task was to find the answer to the coverage question in the *language* of the insurance policies.⁶⁷ The court used a two-step analysis: (1) it determined what rules of insurance policy interpretation applied to this suit under California law; and (2) it used the applicable rules to interpret the CGL policies in question.⁶⁸

In the first step of its analysis, the court examined statutory rules of contract interpretation, enacted in California in 1872.⁶⁹ Insurance policies' plain, ordinary meaning is to be used to determine the parties' mutual intention at the time they entered the contract.⁷⁰ Envi-

(8th Cir. 1988). *See supra* text accompanying note 26.

62. *AIU*, 213 Cal. App. 3d at 1227, 262 Cal. Rptr. at 186.

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

64. *Id.*

65. *Id.* at 818, 799 P.2d at 1262, 274 Cal. Rptr. at 829.

66. *Id.* The court continued:

Thus, because Congress and the Legislature already have made the relevant public policy determinations, the issue before this Court is not whether CGL policies *may* provide the coverage sought, but whether they *do* provide it according to their terms. The answer is to be found solely in the language of the policies, not in public policy considerations.

Id. (emphasis in original).

See 42 U.S.C. § 9607(e) (1988) and CAL. HEALTH & SAFETY CODE § 25364 (West 1984 & Supp. 1991).

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

68. *Id.* at 818, 799 P.2d at 1261-62, 274 Cal. Rptr. at 828-29. The *AIU* court did not consider exclusions contained in many of the policies. *Id.* at 814, 799 P.2d at 1259, 274 Cal. Rptr. at 826. Thus, exclusion clauses are beyond the scope of this Note. However, for a consideration of the inadequacy of traditional insurance policy interpretation in asbestos litigation and a hint of tough decisions to come, see Note, *Adjudicating Asbestos Insurance Liability: Alternatives to Contract Analysis*, 97 HARV. L. REV. 739 (1984).

69. *Id.* at 822, 799 P.2d at 1264, 274 Cal. Rptr. at 831 (citing CAL. CIV. CODE § 1644 (West 1985)).

70. CAL. CIV. CODE § 1636 (contract interpreted to give effect to mutual intention of the parties); § 1638 (language of a contract governs its interpretation); § 1639 (inten-

ronmental cleanup imposed by federal and state law was a new liability, incurred since the policy was written. However, the court pointed out that insurance policies are interpreted broadly, to protect the insured's *expectations*.⁷¹ "The sole relevant inquiry in determining whether such types of liability are covered is whether, in view of the reasonable expectations of the insured, policy language can be interpreted to embrace the liability that may accrue under new statutory schemes."⁷²

Moreover, ambiguities in policy language usually are construed against the insurer, who drafted the language.⁷³ Although FMC is a sophisticated company not lacking in bargaining power, the court had no evidence the policy provisions were negotiated or the language specially drafted with both parties' involvement.⁷⁴ Thus, because the policies were standard-form, used throughout the country, the court adhered to ordinary principles of insurance policy interpretation and construed ambiguities against the insurers.⁷⁵

In the second part of its analysis, the court applied principles of policy interpretation to FMC's policies to determine whether they covered response costs requested by third parties. The policies had to meet three requirements for coverage: (1) that FMC was "legally obligated" to pay the costs; (2) that the legal obligation was for "damages"; and (3) that the damages resulted from "damage to property."⁷⁶

First, applying the plain meaning of the language, the court said "legally obligated" covers injunctive relief and recovery of response costs.⁷⁷ Conceding insurers' argument that response costs and injunctions can be considered equitable relief, the court pointed out that California law rarely distinguishes between courts of law and equity. An insured certainly would not make such a distinction in

tion of parties to written contract to be ascertained from the writing alone if possible); § 1641 (whole of a contract to be taken together to give effect to every part); § 1644 (words of a contract to be understood in their ordinary and popular sense); § 1649 (ambiguous term to be interpreted in sense promisor believed promisee understood it at time of contracting); § 1654 (in case of uncertainty, language of a contract to be interpreted against party who caused the uncertainty) (West 1985).

71. *AIU*, 51 Cal. 3d at 822, 799 P.2d at 1264, 274 Cal. Rptr. at 831.

72. *Id.* at 822 n.8, 799 P.2d at 1265 n.8, 274 Cal. Rptr. at 832 n.8.

73. *Id.* at 822, 799 P.2d at 1264, 274 Cal. Rptr. at 831 (citing CAL. CIV. CODE § 1654 (West 1985)).

74. *AIU*, 51 Cal. 3d at 823, 799 P.2d at 1265, 274 Cal. Rptr. at 832.

75. *Id.*

76. *Id.* at 824, 799 P.2d at 1266, 274 Cal. Rptr. at 833.

77. *Id.* at 825, 799 P.2d at 1266, 274 Cal. Rptr. at 833.

contemplating coverage.⁷⁸

Second, after extensive analysis, the court concluded that both reimbursement of government response costs and cost of compliance with injunctions are “damages” under the CGL policies. The court struck a middle ground between the highly technical definition of damages the *AIU* court of appeals followed⁷⁹ and the very broad view of *Aerojet*.⁸⁰ A technical reading of insurance policies does not comport with California law, which uses plain language to find an insured’s reasonable expectations. On the other hand, the court said the *Aerojet* approach that “the insured may reasonably expect coverage for any sums expended”⁸¹ negated the phrase “as damages.”⁸²

Because the term damages was not defined in the policies, the court looked to dictionary and statutory definitions.⁸³ The court then applied the common elements of these definitions⁸⁴ to determine if the claimed relief constituted damages.⁸⁵ First, the court considered whether reimbursement of government agencies could be construed as damages. Contamination of surface and groundwater in California constitutes detriment to a state interest.⁸⁶ FMC’s acts allegedly caused the harm for which federal and state agencies incurred expenses to investigate and initiate cleanup. Thus, the court reasoned, reimbursing the government for expenses incurred because of FMC’s

78. *Id.* Indeed, the court quoted from *Aerojet*: “It would come as an unexpected, if not incomprehensible, shock to the insureds to discover that their insurance coverage was being denied because the plaintiff chose to frame his complaint in equity rather than in law.” *Aerojet-General Corp. v. Superior Court*, 211 Cal. App. 3d 216, 228, 257 Cal. Rptr. 621, 628 (1989).

79. *AIU Ins. Co. v. Superior Court*, 213 Cal. App. 3d 1219, 1235, 262 Cal. Rptr. 182, 186 (1989).

80. *Aerojet*, 211 Cal. App. 3d at 226, 257 Cal. Rptr. at 626-27.

81. *Id.* at 226, 257 Cal. Rptr. at 627 (emphasis added).

82. *AIU*, 51 Cal. 3d at 828, 799 P.2d at 1268, 274 Cal. Rptr. at 835.

83. *AIU*, 51 Cal. 3d at 825-26, 799 P.2d at 1267, 274 Cal. Rptr. at 834. For example, the Civil Code provides: “Every person who suffers detriment from the unlawful act or omission of another, may recover from the person at fault a compensation therefor in money, which is called damages.” CAL. CIV. CODE § 3281 (Deering 1984).

Dictionaries the court relied on define damages in two ways. The first method defines damages as “the estimated reparation in money for detriment or injury sustained: compensation or satisfaction imposed by law for a wrong or injury caused by a violation of a legal right.” WEBSTER’S NEW INTERNATIONAL DICTIONARY 581 (3d ed. 1981). The second method defines damages as “[a] pecuniary compensation or indemnity, which may be recovered in the courts by any person who has suffered loss, detriment, or injury, whether to his person, property, or rights, through the unlawful act or omission of another.” BLACK’S LAW DICTIONARY 466 (4th ed. 1951).

84. “Each [definition] requires there to be ‘compensation,’ in ‘money,’ ‘recovered’ by a party for ‘loss’ or ‘detriment’” *AIU*, 51 Cal. 3d at 826, 799 P.2d at 1267, 274 Cal. Rptr. at 834 (note omitted).

85. *Id.*

86. *Id.* at 829, 799 P.2d at 1269, 274 Cal. Rptr. at 836. The Water Code provides: “All water within the State is the property of the people of the State, but the right to the use of water may be acquired by appropriation in the manner provided by law.” CAL. WATER CODE § 102 (West 1971).

harm to the environment is compensating the agencies for a loss they suffered. Plain reading of FMC's insurance policies, therefore, permits compensation for damages.⁸⁷

The court rejected the insurers' three arguments to the contrary. First, while CERCLA distinguishes between response costs and damages to natural resources, the court deemed itself not bound by federal statutory distinctions which did not exist at the time the parties contracted for the policies and thus could not possibly have reflected the parties' intent.⁸⁸

Second, the court rejected the argument that reimbursing government response costs is merely a cost of doing business. Loss or detriment incurred for remediation and for mitigation of further harm is compensable even though it is regulatory.⁸⁹ However, the court agreed that purely prophylactic measures to prevent *future* harm are not covered by CGL policies, as costs of those measures are not occasioned by actual damages.⁹⁰

Finally, insurers argued restitutive relief is inappropriate for insurance coverage. The court distinguished between restitution for punitive purposes, prohibited by the insurance code,⁹¹ and reimbursement of response costs, which it did not construe in the narrow, punitive sense.⁹²

87. *AIU*, 51 Cal. 3d at 829, 799 P.2d at 1269-70, 274 Cal. Rptr. at 836-37.

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

89. *Id.* at 832, 799 P.2d at 1272, 274 Cal. Rptr. at 839. Also see *supra* note 39.

90. *AIU*, 51 Cal. 3d at 832, 799 P.2d at 1271, 274 Cal. Rptr. at 838. A prophylactic measure is one aimed at prevention of future harm. For example, installing fire extinguishers is a purely prophylactic measure to prevent fire damage. Changing dumping practices might be a prophylactic measure to prevent future pollution.

91. *Id.* at 837 n.15, 799 P.2d at 1275 n.15, 274 Cal. Rptr. at 842 n.15. The Insurance Code provided: "No policy of insurance shall provide, or be construed to provide, any coverage or indemnity for the payment of any fine, penalty, or restitution in any civil or criminal action or proceeding . . ." CAL. INS. CODE § 533.5 (West 1988). However, section 533.5 was amended, effective January 1, 1991, stating the legislature's intent in enacting the section was "(b) Not to affect the existence, or nonexistence, of insurance coverage, or the duty to defend in actions such as, but not limited to, actions brought by any entity pursuant to Section 25360 of the Health and Safety Code . . . or any similar federal law." CAL. INS. CODE § 533.5 (West 1991) [Historical & Statutory Notes].

Section 25360 of the Health and Safety Code allows the state to recover "[a]ny costs incurred and payable from the state account or the Hazardous Substance Cleanup Fund . . ." CAL. HEALTH & SAFETY CODE § 25360(a) (West 1984 & Supp. 1991). Section 25364 permits "any agreement to insure, hold harmless, or indemnify a party to the agreement for any costs or expenditures under this chapter." CAL. HEALTH & SAFETY CODE § 25364 (West 1984 & Supp. 1991). Thus, reimbursement for response costs is not a penalty for which insurance is forbidden by section 533.5 of the Insurance Code. *Id.*

92. *AIU*, 51 Cal. 3d at 836, 799 P.2d at 841-42, 274 Cal. Rptr. at 1274-75. The court distinguishes *Jaffe v. Cranford Ins. Co.*, 168 Cal. App. 3d 930, 935, 214 Cal. Rptr. 567, 571 (1985) (limiting restitution "to situations in which the defendant is required to

Next, the court applied the common definitions of damages to costs of compliance with injunctions. Costs of injunctive relief do not as clearly fit the definition of damages because they are not paid to an aggrieved third party but to company employees. However, the court refused to elevate form over substance by covering one remedy but not the other.⁹³ In the case of response to environmental harm, the *purpose* both of reimbursing the government for cleanup and of requiring a responsible party to address the harm is the same. The only difference in *effect* is that the responsible party probably can clean up less expensively and sooner than the government can. The justices agreed with courts that had reasoned that the parties could reasonably expect such costs to be considered damages.⁹⁴ Slipping from its resolve not to examine policy concerns, the justices also agreed with the rationale of courts that had argued public policy.⁹⁵ Those courts argued that policy concerns required that costs of compliance be viewed as damages to avoid constraining the choice of cleanup means based on whether insurance would cover (or, conversely, causing coverage to be denied based on "mere fortuity" of choice).⁹⁶ Thus, the California Supreme Court said the policy language was ambiguous as applied to costs incurred for injunctive relief and must, therefore, be construed in favor of coverage.⁹⁷

Finally, the court addressed the requirement that coverage be for damages "because of property damage."⁹⁸ Contamination of the environment, the court said, is property damage.⁹⁹ This is true whether the government's motivation in seeking relief is regulatory or proprietary and no matter who owns the polluted property.¹⁰⁰

In California, as a matter of law, insurers are liable under CGL policies for their insureds' obligations to reimburse the government for environmental response costs and for costs of compliance with injunctions ordering environmental cleanup. Costs of purely prophy-

restore to the plaintiff that which was wrongfully acquired"). *Id.*

93. *AIU*, 51 Cal. 3d at 840, 799 P.2d at 1277, 274 Cal. Rptr. at 844.

94. *Id.* at 840, 799 P.2d at 1278, 274 Cal. Rptr. at 845. The court cited C.D. Spangler Constr. Co. v. Industrial Crankshaft & Eng'r Co., 326 N.C. 133, 149-50, 388 S.E.2d 557, 565 (1990); Aerojet-General Corp. v. Superior Court, 211 Cal. App. 3d 216, 228, 257 Cal. Rptr. 621, 628 (1989); Chesapeake Utils. Corp. v. American Home Assurance, 704 F. Supp. 551, 559-60 (D. Del. 1988).

95. *AIU*, 51 Cal. 3d at 840-41, 799 P.2d at 1278, 274 Cal. Rptr. at 845. The court cited *Spangler*, 326 N.C. at 150, 388 S.E.2d at 565; *Intel Corp. v. Hartford Accident & Indem. Co.*, 692 F. Supp. 1171, 1183, 1193 (N.D. Cal. 1988); *Chemical Applications Co. v. Home Indem. Co.*, 425 F. Supp. 777, 778-79 (D. Mass. 1977); *United States Aviox Co. v. Travelers Ins.*, 125 Mich. App. 579, 589-90, 336 N.W.2d 838, 843 (1983).

96. *AIU*, 51 Cal. 3d at 840, 799 P.2d at 1278, 274 Cal. Rptr. at 845.

97. *Id.* at 841, 799 P.2d at 1278, 274 Cal. Rptr. at 845.

98. *Id.* at 824, 799 P.2d at 1266, 274 Cal. Rptr. at 833.

99. *Id.* at 842, 799 P.2d at 1279, 274 Cal. Rptr. at 846.

100. *Id.* at 842-43, 799 P.2d at 1279, 274 Cal. Rptr. at 846.

lactic measures are not covered.¹⁰¹

IV. ANALYSIS

The California Supreme Court stopped insurance companies' first line of defense against million-dollar claims for environmental damage with a "plain meaning" interpretation of Comprehensive General Liability insurance policies. The court's methodical, tenacious adherence to well-established principles of contract interpretation bodes well for all standard-form insurance policy holders.

The question is whether the court truly read the policies neutrally or whether the court would expand its interpretation of liability insurance to include coverage even if policy language were changed to be unambiguous. The most obvious way to answer the question, by examining an interpretation by the court of policies worded to remove the ambiguities, is unlikely to be forthcoming. Coverage is virtually unavailable for all types of liability for pollution and cleanup.¹⁰² Thus, policy language now being interpreted by the courts was written long before liability for pollution was an issue.¹⁰³ Because liability under CERCLA is retroactive,¹⁰⁴ often the policies being interpreted were in effect at the time the alleged pollution occurred but may not be currently in effect.

This Note, therefore, will explore the court's holding based, first, on its own language, and, second, on the effect of its holding and the policy considerations the court *might* have had in mind.

A. Plain Meaning Interpretation

In the problematic area of toxic waste and defiled waterways, where feelings run high and fears and outrage are easily aroused, the court said it refused to address the question of who pays for cleanup from a public policy standpoint.¹⁰⁵ The issue before it, the court insisted, was not whether CGL policies were *permitted* to cover cleanup costs, but whether they *do* provide the coverage.¹⁰⁶ The relevant public policy determinations were made by Congress and the

101. *Id.* at 832, 799 P.2d at 1271, 274 Cal. Rptr. at 838.

102. Abraham, *Environmental Liability and the Limits of Insurance*, 88 COLUM. L. REV. 942, 944 & n.8 (1988) [hereinafter *Environmental Liability*].

103. F. Bardenwarper & D. Hirsch, *supra* note 4.

104. 42 U.S.C. § 9607(a) (1988).

105. *AIU*, 51 Cal. 3d at 818, 824 n.10, 799 P.2d at 1262, 1266 n.10, 274 Cal. Rptr. at 829, 833 n.10. *See supra* notes 65-67 and accompanying text.

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

Legislature when they enacted CERCLA and the Hazardous Substance Account Act allowing parties to insure against the relief those statutes afford.¹⁰⁷ The court rejected insurers' public policy argument, based on Insurance Code section 533.5, on the same basis.¹⁰⁸ The other five states whose highest courts have decided the issue¹⁰⁹ also have addressed it from the contract interpretation rather than public policy standpoint.¹¹⁰

In only one instance did the court waver in its resolve to leave public policy to the legislature. Because costs for responsible parties to do their own cleanup do not as easily fit a definition of damages as does reimbursement of government expenses for cleanup, the court considered the effect of a holding that insurance covers reimbursing government response costs but not injunctive relief.¹¹¹ The court couched its own finding that *both* are covered in policy interpretation, saying policy language is ambiguous, so it must be construed in favor of coverage.¹¹² However, the justices approved the rationale of some courts who "stated this conclusion in terms of public policy."¹¹³

By firmly grounding its decision in codified precepts of contract interpretation, the court left few, if any, doubts about interpretation of standard-form insurance policies. Future litigants will not have the "wiggle room" they might have had with a policy-based decision.

107. See *supra* note 66 and accompanying text.

108. See *supra* note 91.

109. See *supra* notes 30-31 and accompanying text.

110. The Washington court, for example, said:

It is important to note the absence of public policy in the construction of insurance contracts. While this case implicitly presents a grave question of policy, namely who should bear the cost of polluting our environment, the task presently before this court only requires us to construe the terms of the policies under Washington law. Washington courts rarely invoke public policy to override express terms of an insurance policy.

Boeing Co. v. Aetna Casualty and Sur. Co., 113 Wash. 2d 869, 876 n.1, 784 P.2d 507, 510 n.1 (1990) (citations omitted).

111. *AIU*, 51 Cal. 3d at 838, 799 P.2d at 1276, 274 Cal. Rptr. at 843.

112. *Id.* at 841, 799 P.2d at 1278, 274 Cal. Rptr. at 845.

113. *Id.* The referenced public policy is summarized by the court:

[C]osts of compliance must be interpreted as "damages" in the environmental context, because to hold otherwise would make insurance coverage hinge on the "mere fortuity" of the way in which government agencies seek to enforce cleanup requirements, would unreasonably constrain the agencies' choice of cleanup mechanisms, and would introduce substantial inefficiency into the cleanup process.

Id. at 840-41, 799 P.2d at 1278, 274 Cal. Rptr. at 845. See *supra* note 95 and accompanying text.

The Supreme Court of Minnesota, whose reasoning was based on policy language interpretation, strayed into public policy in the same area. "It is obviously the better public policy to encourage responsible parties to take immediate action themselves to mitigate and remedy groundwater contamination rather than await a state operated clean up effort at a later date." *Minnesota Mining & Mfg. v. Travelers Indem. Co.*, 457 N.W.2d 175, 182 (1990).

B. Policy Considerations

While the decision may not have been policy-based, its effect clearly is. Who pays for environmental cleanup is a tough, persistent question. It boils down to economics. The real question, perhaps, is who best can bear the inordinate cost of cleanup with the least impact on our society. The bills for environmental cleanup are paid by government agencies (with tax dollars), by "responsible parties" (usually corporate polluters) and by insurers.

For the short term, at least, the decision to place a large responsibility on insurance companies may be the least burdensome, for several reasons. First, by the very nature of their business, insurers are better able than either taxpayers or corporations to accept the risk without severe adverse effects. Certainly, both taxpayers and corporations will pay the price for increased risk to insurers, but instead of a lump sum, the cost will be spread over years of premium payments.

Second, insurers' liability is limited to the face value of the policy. There are no limits on a corporation's liability except exhaustion of its assets. Even if unlimited liability seems like just retribution for polluters, driving corporations out of business is not in society's best interest. Bankrupt companies cease to be employers, taxpayers and supporters of charitable concerns. They adversely affect creditors, other businesses and consumers. Society as a whole suffers a detriment from failing businesses, just as society suffers from the effects of widespread pollution.

However, several policy considerations argue against imposition of the pollution burden on insurers. One, alluded to above, is the deterrence notion, that polluters who pay for their own sins will be more careful next time. This is the moral hazard argument that those with insurance take fewer precautions.¹¹⁴ Indeed, during the insurance crisis of the mid-1980s, companies which became self-insured evidently became far more safety-conscious.¹¹⁵

114. Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CALIF. L. REV. 1, 39 (1985). Cooter observes:

The tension that sometimes arises between efficient risk bearing and efficient precaution can occur in insurance contracts as well. The insurer can more efficiently spread risk, but the insured party can more efficiently take precautions against that risk. Insurance thus undermines the incentives of the policyholder to take precaution against the insured event.

Id.

115. "Once self-insured, companies often become safety zealots. The incentive: fear of lawsuits they will have to absorb directly." Schmitz, Shapiro & Waldman, *The*

Insurers, however, combat moral hazard by building into policies several means of promoting loss avoidance. One method is use of deductibles. The insured, who must pay a portion of the loss, is thus aligned with the insurer by a common interest in loss avoidance. Another way insurers induce greater caution in insureds is by excluding coverage for particularly high risks.¹¹⁶

Another consideration for not holding insurers liable is that damages usually will be limited to the value of the insured property. Environmental cleanup, however, far exceeds the pre-contamination market value of property.¹¹⁷ Thus, in a normal insurance scheme, polluted property would be abandoned. The insurer would reimburse up to market value, not the unexpected (and uncharged for) cost of remediation exceeding value.¹¹⁸ Cleanup of our natural resources, however, is a valuable, indeed essential, goal itself. Society literally cannot survive unlimited toxic waste and contaminated water.¹¹⁹ Thus, "CERCLA liability is essentially a societally based liability, not a market one."¹²⁰

Finally, another reason to question placing the pollution burden on insurers is the profound uncertainty of environmental liability. Insurers are unable to predict and properly assess premiums for unknown and unknowable environmental risks. For example, retroactive strict liability imposed by CERCLA¹²¹ means hazardous waste site generators, transporters, owners and operators are liable, regardless of when waste was deposited or whether their actions were considered reasonable at the time.¹²²

Thus, the impact of *AIU* is not on *future* pollution liability coverage. Since insurers did not wait for the California Supreme Court's decision to exclude almost all pollution coverage in current liability policies,¹²³ the point is moot. However, *AIU* will affect California

Surge in Self-Insurance, 111 NEWSWEEK 74 (March 7, 1988).

116. *Environmental Liability*, *supra* note 102, at 951-52. Insurers' reaction to escalating losses evidently has had a desired effect on their insureds.

'The crisis in liability insurance has made risk management a main concern for top corporate decision-makers,' says Robert H. Malott, chairman of FMC Corp. [real party in interest in *AIU*] . . . Like other sophisticated corporations, FMC uses 'preventive law' programs to reduce the company's exposure to suits. Such programs can include a so-called legal audit of a corporation's businesses, identifying products, services, or manufacturing operations that could trigger lawsuits, and either cleaning them up or scrapping them.

Brody, *When Products Turn into Liabilities*, 113 FORTUNE 20, 23-24.

117. Mountainspring, *Insurance Coverage of CERCLA Response Costs: The Limits of "Damages" in Comprehensive General Liability Policies*, 16 ECOLOGY L.Q. 755, 796 (1989) [hereinafter *Insurance Coverage*].

118. *Id.*

119. *Federal Environmental Programs*, *supra* note 1.

120. *Insurance Coverage*, *supra* note 117, at 796.

121. 42 U.S.C. § 9607(a) (1988).

122. *Environmental Liability*, *supra* note 102, at 957-58.

123. *Environmental Liability*, *supra* note 102, at 944 n.8.

courts' decisions about coverage under *past* CGL policies for existing and yet-to-be-discovered pollution.

V. CONCLUSION

In a decision worth millions of dollars to comprehensive general liability insurance policyholders, the California Supreme Court held insurers are obligated to cover environmental response costs and costs of compliance with injunctions incurred pursuant to CERCLA and state and federal hazardous waste violations. *AIU Ins. Co. v. Superior Court* resolved a one-one split in California courts of appeal and left no doubt about interpretation of standard-form CGL policies.

The court grounded its decision in case law and statutes, particularly principles of contract interpretation. The justices refused to acknowledge public policy as a basis for their analysis. Yet, given the magnitude of this life-threatening problem and the phenomenal cost of cleanup, the court made an important policy-based decision by including insurers in the allocation of expenses for toxic waste cleanup. By emphasizing the reasonable expectations of an insured, even if the insured is a sophisticated conglomerate like FMC, the court did make policy-oriented judgments. Instead of excusing insurers from the bargain they unknowingly made to cover unthought-of property damage, the California Supreme Court chose to marshal *all* resources to combat pollution.

In its digression into the realm of policy, the court refused to let insurers off on the technicality of non-liability for the insured's own expenses to mitigate damages and decrease the cost of remediation. The court thus assured companies some resources and the incentive to *initiate* cleanup, thereby meeting the goal of efficient, timely response to this crucial problem. The court pointed out that Congress and the California Legislature had already made the public policy determinations by providing express statutory permission for insurance against government-required cleanup. Appropriately, the court supported legislative policy with its decision in *AIU*.

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