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CLASSIFYING RI/FS COSTS UNDER A POLICY OF COMPREHENSIVE GENERAL LIABILITY INSURANCE: INDEMNITY OR DEFENSE?

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INTRODUCTION

THE Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA)[1] created and imposes broad-based liability for parties that contaminate the environment. The United States Environmental Protection Agency (EPA) has been vested with the power to impose financial responsibility on potentially responsible parties (PRPs) for extensive and far-ranging costs associated with the investigation and remediation of environmental pollution.[2] Such liability can be stratospheric for a PRP who is responsible for the clean-up of a badly contaminated site or of multiple sites. The average cost to clean up a single waste site on EPA's National Priorities List is approximately $31 million.[3] It is thus no surprise that parties who are targeted as waste site PRPs often turn to their liability insurers and demand coverage for clean-up liabilities.

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1. 42 U.S.C. §§ 9601-9675 (1988).

2. Pursuant to 42 U.S.C. § 9607(a), any person who owns or operates a hazardous substance facility; or disposes of, or arranges for the disposal of, a hazardous substance; or who accepts hazardous substances for transport to a facility from which there is a release, or threat of release, into the environment, shall be liable for:

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

42 U.S.C. § 9607(a) (1988).

3. LLOYD S. DIXON ET AL., RAND CORP., PRIVATE-SECTOR CLEANUP EXPENDITURES AND TRANSACTION COSTS AT 18 SUPERFUND SITES (1993).

I. The Grant of Coverage Under a Comprehensive General Liability Policy

This article addresses an area of environmental insurance law which can profoundly influence the amount of coverage potentially available to PRPs who are insured under policies of comprehensive general liability (CGL) insurance. Coverage is provided under a typical CGL policy for potential liabilities to third parties who allege, among other things, property damage or bodily injury arising out of the unintentional acts or omissions of the policyholder. A CGL policy generally has two broad coverage components. These are the duties to defend and to indemnify the insured in legal proceedings instituted by third parties. A policy form adopted by many CGL insurers grants defense and indemnity coverage under the following insuring agreement:

> The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of
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> A. bodily injury or
>
> B. property damage to which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage, even if any of the allegations of the suit are groundless, false or fraudulent, and may make such investigation and settlement of any claim or suit as it deems expedient, but the company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgments or settlements.[4]

Pursuant to the foregoing policy language, the duty to indemnify requires the insurer to pay on behalf of the insured all sums, up to a specific amount, which the insured becomes legally obligated to pay as damages arising out of bodily injury or property damage caused by a covered "occurrence."[5] In the case of primary insurance, however, an insurer's coverage obligation is rarely restricted to the duty to indemnify A primary CGL policy will also impose upon the insurer the right and duty to defend any suit against the insured seeking damages. This entitles the insured, subject to the terms, conditions and exclusions of the policy, to a paid defense in lawsuits commenced by third parties who seek damages.

The duty to defend under a CGL policy obligates the insurer to pay the fees of attorneys, investigators and expert consultants who prepare and assist in the defense of lawsuits filed against the policyholder.

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4. Form No. GL 00 02 01 73, Insurance Servs. Office, Inc. (1982, 1986).

5. Pursuant to language found in many CGL policies, an " 'occurrence' means an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured." Form No. GL 00 00 01 73, Insurance Servs. Office, Inc. (1982, 1986).

Depending upon the policy language, defense costs will either count towards the stated coverage limit of the policy or they will be exclusive of the limit. Under a cost-exclusive policy, the insurer's coverage obligation has the potential to be far greater than the stated indemnity limit. This is because defense costs in a cost-exclusive policy will not serve to impair the liability limit; only payments for damages in the form of judgments or settlements impair or exhaust the limits of a cost-exclusive policy

Defense costs under a cost-exclusive CGL policy can eclipse the stated policy limit where no settlements or judgments equaling the limit are sustained. This is quite different from a policy where defense costs count towards the limit. Any combination of settlements, judgments and defense costs which equals the stated coverage limit will exhaust such a policy.

A CGL policy generally will contain a provision which broadly defines the kinds of covered costs associated with the defense of lawsuits. For instance, costs falling under the duty to defend may be defined in a supplementary payments clause which states, in pertinent part, as follows:

> The company will pay, in addition to the applicable limit of liability:
>
> (a) all expenses incurred by the company, all costs taxed against the insured in any suit defended by the company and all interest on the entire amount of any judgment therein which accrues after entry of the judgment and before the company has paid or tendered or deposited in court that part of the judgment which does not exceed the limit of the company's liability thereon;
>
> . . .
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> (d) reasonable expenses incurred by the insured at the company's request in assisting the company in the investigation or defense of any claim or suit . . [6]

As explained more fully below, under a policy where defense costs do not serve to impair the coverage limit, the insured will have great incentive to classify expenses incurred in legal actions as defense costs rather than indemnification.

II. Classification of Costs Under a Liability Policy

Pursuant to express policy language and interpretive case law, fees for attorneys, investigators and experts retained in connection with the defense of lawsuits filed against the policyholder are readily classified as defense costs.[7] In the environmental coverage arena, however,

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6. *Id.*

7. *See, e.g.*, New York v. Blank, 745 F Supp. 841, 852 (N.D.N.Y. 1990) (An insurer under a policy containing a duty to defend must reimburse the insured "for services rendered which are useful in defending against the first-party complaint."). *See also* Colonial Tanning Corp. v. Home Indem. Co., 780 F Supp. 906, 927 (N.D.N.Y. 1991).

a question concerning the appropriate characterization of certain costs has nevertheless arisen. At issue are costs associated with government-mandated remedial investigation/feasibility studies (RI/FS), or similar government-mandated investigative efforts. Pursuant to CERCLA, the EPA can force a waste site PRP to perform an investigation in order to determine the nature and extent of environmental problems posed by hazardous waste.[8] Similar statutes also create enforcement powers at the state environmental agency level.[9]

The RI/FS process may include the monitoring and sampling of air, water and soil and the compilation of sufficient data to determine the necessity for, and the proposed extent of, any action required to remedy existing contamination. Remedial investigations address whether environmental damage can be mitigated or minimized by controlling the source of the contamination, or whether additional action is necessary because of migration of contaminants from the site. Feasibility studies comprise plans for implementing the remediation alternative selected for the site.[10]

There is no secret as to why an insured under a cost-exclusive CGL policy would argue that RI/FS costs should be classified as part of the insurer's duty to defend. To the extent expenses associated with performing a waste site RI/FS can be attributed to the defense component of the policy, there would be more indemnity coverage potentially available to satisfy the policyholder's liability for the clean-up. There would also be more indemnity coverage potentially available to satisfy liability associated with other claims.

Another reason policyholders may argue that RI/FS costs are part of the insurer's defense obligation is because the duty to defend is often held to be broader than the duty to indemnify.[11] This means an insurer could be called upon to provide a defense in cases where the allegations against the insured conceivably could, if proven, be covered under the terms of the policy.[12] Based on this more generous

8. *See* 42 U.S.C. § 9604(a)(1) (1988).

9. *See, e.g.*, ILL. ANN. STAT. ch. 415, para. 5/22.18 (Smith-Hurd 1993); LA. REV STAT. ANN. § 30:2204(a)(2) (West 1989); N.J. STAT. ANN. § 58:10-23.11u(b)(2) (West 1992); N.Y. ENVTL. CONSERV LAW § 27-1313 (McKinney 1984 & Supp. 1994); PA. STAT. ANN. tit. 35, § 6020.1102(A) (1993); TEX. HEALTH & SAFETY CODE ANN. § 361.185 (West 1992); WASH. REV CODE ANN. § 70.105D.030(1)(b) (West 1992).

10. *See generally* 40 C.F.R. § 300.430 (1993).

11. *See* Federal Rice Drug Co. v. Queen Ins. Co., 463 F.2d 626, 631 (3d Cir. 1972); Tampa Elec. Co. v. Stone & Webster Eng'g Corp., 367 F Supp. 27, 30-31 (M.D. Fla. 1973); Steyer v. Westvaco Corp., 450 F Supp. 384, 389 (D. Md. 1978); John Mohr & Sons v. Hanover Ins. Co., 322 F. Supp. 184 (N.D. Ill. 1971).

12. *See* Colon v. Aetna Life & Casualty Ins. Co., 484 N.E.2d 1040, 1041-42 (N.Y. 1985); Seaboard Sur. Co. v. Gillette Co., 476 N.E.2d 272, 274-75 (N.Y. 1984); International Paper Co. v. Continental Casualty Co., 320 N.E.2d 619, 621-22 (N.Y. 1974). *See also* 14 GEORGE J. COUCH, CYCLOPEDIA OF INSURANCE LAW § 51:42 (2d ed. rev. 1982 & Supp. 1993); 7C JOHN A. APPLEMAN, INSURANCE LAW AND PRACTICE § 4683.01 (Berdal ed. 1979 & Supp. 1993).

standard for triggering the duty to defend, policyholders often will move for summary judgment on the duty to defend soon after a lawsuit seeking coverage is filed. The policyholder will argue that the court merely has to facially examine the underlying allegations in order to determine whether a duty to defend exists while fact-sensitive indemnity issues are being litigated in the coverage case.[13]

III. The Insurer's Duty to Defend

Policyholders and insurers often disagree on whether a governmental directive to remediate environmental contamination (a "PRP letter")[14] is a "suit against the insured seeking damages" within the meaning of this phrase in a CGL policy. A suit seeking damages for "bodily injury or property damage" is the threshold requirement for triggering an insurer's duty to defend. Insurers routinely argue that a PRP letter issued by EPA or another environmental authority seeks injunctive relief rather than actual damages for bodily injury or property damage. A CGL policy does not cover costs associated with claims for injunctive relief.[15] Coverage is instead provided for the policyholder's liability for "damages" which, it is argued by insurers, are limited to sums payable by reason of liability sustained in a formal lawsuit or legal proceeding.[16]

Many courts have addressed this issue, arriving at different conclusions. For instance, in the case of *Ray Industries, Inc. v. Liberty Mutual Insurance Co.*,[17] the United States Court of Appeals for the Sixth Circuit concluded that a PRP letter directing an insured to participate at its own expense in the remediation of a hazardous waste site did not constitute a suit seeking damages for injury to property. The court thus held that no duty to defend arises where the claim against the policyholder is in the form of a governmental clean-up directive.[18]

13. *But see* United States Fidelity & Guar. Co. v. Baugh, 257 N.E.2d 699, 710 (Ind. Ct. App. 1970) (The insurer, in determining whether a duty to defend exists, is not limited solely to the allegations against the policyholder. The insurer is permitted to examine the underlying facts before deciding whether it must provide a defense.). *Accord* Charles H. Eichelkraut & Sons, Inc. v. Bituminous Casualty Co., 519 N.E.2d 1180, 1185 (Ill. App. Ct. 1988); Fischer & Porter Co. v. Liberty Mutual Ins. Co., 656 F Supp. 132, 135 (E.D. Pa. 1986); Appleman, *supra* note 12, § 4683 ("where the insurer is aware of facts, not in the pleadings, which clearly disclose an absence of coverage, it can refuse to defend ").

14. 42 U.S.C. § 9613(k)(2)(D) (1988).

15. *See, e.g.*, Aetna Casualty & Sur. Co. v. Hanna, 224 F.2d 499, 503 (5th Cir. 1955) (damages relating to insured party's refusal to comply with injunction). *But see* Intel Corp. v. Hartford Accident & Indem. Co., 692 F Supp. 1171, 1186-93 (N.D. Cal. 1988).

16. *See, e.g.*, Continental Ins. Cos. v. NEPACCO, 842 F.2d 977, 987 (8th Cir.) (en banc), *cert. denied*, 488 U.S. 821 (1988).

17 974 F.2d 754 (6th Cir. 1992).

18. *See also* Aetna Casualty & Sur. Co. v. General Dynamics Corp., 968 F.2d 707 (8th Cir. 1992); Ryan v. Royal Ins. Co. of Am., 916 F.2d 731 (1st Cir. 1990); Hecla Mining Co. v. Continental Ins., No. 92-87608, slip op. (D. Idaho Aug. 19, 1992);

A different result was reached in *Broadwell Realty Services, Inc. v. Fidelity & Casualty Co. of New York.*[19] In this case, the insured instituted a lawsuit seeking coverage for the cost of complying with a New Jersey Department of Environmental Protection clean-up directive. On appeal, the New Jersey Appellate Division held that government-mandated clean-up costs are recoverable under a CGL policy, even where no formal lawsuit seeking to compel payment of such costs is filed.[20]

This article does not assume that a PRP letter triggers an insurer's duty to defend, or that costs associated with performing an RI/FS are recoverable under a CGL policy. The focus is instead on the appropriate classification — defense or indemnity — which should be ascribed to such costs in the event coverage is ultimately found to exist.

IV THE MANDATORY NATURE OF AN RI/FS CONDUCTED PURSUANT TO CERCLA

Whenever it is determined that a release or substantial threat of release of a hazardous substance into the environment has occurred, EPA has been authorized pursuant to CERCLA to undertake measures necessary to remove or contain the substance and remediate any contamination to the environment caused thereby.[21] Authority has also been vested with EPA to require PRPs to undertake necessary response actions designed to remediate a waste site or prevent the

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Becker Metals Corp. v. Transp. Ins. Co., 802 F Supp. 235 (E.D. Mo. 1992); Upjohn Co. v. Aetna Casualty & Sur. Co., 768 F Supp. 1186 (W.D. Mich. 1990); Detrex Chem. Indus. v. Employers Ins. of Wausau, 681 F Supp. 438 (N.D. Ohio 1988); Ulrich Chem. Inc. v. American States Ins. Co., 1990 WL 484974 (Ind. Ct. App. July 26, 1990); Patrons Oxford Mut. Ins. Co. v. Marois, 573 A.2d 16 (Me. 1990); City of Evart v. Home Ins. Co., No. 103621, slip op. (Mich. Ct. App. Apr. 10, 1989); Borg-Warner Corp. v. Ins. Co. of North Am., 577 N.Y.S.2d 953 (N.Y. 1992); Technicon Elec. Corp. v. American Home Assurance Co., 533 N.Y.S.2d 91 (N.Y. App. Div. 1988), *aff'd on other grounds*, 542 N.E.2d 1048 (N.Y. 1989); Professional Rental Inc. v. Shelby Ins. Co., 599 N.E.2d 423 (Ohio 1991).

19. 528 A.2d 76 (N.J. Super. Ct. App. Div. 1987). *But see* Morton Int'l v. General Accident Ins. Co. of Am., 629 A.2d 831, 847 (N.J. 1993).

20. 528 A.2d at 76. *See also* Aetna Casualty & Sur. Co. v. Pintlar Corp., 948 F.2d 1507 (9th Cir. 1991); Avondale Indus. v. Travelers Indem. Co., 887 F.2d 1200 (2d Cir. 1989); Village of Morrisville Water & Light Dep't v. U.S. Fidelity & Guar. Co., 775 F Supp. 718 (D. Vt. 1991); City of Corvallis v. Hartford Accident & Indem. Co., 1991 WL 523876 (D. Or. May 30, 1991); Teledyne v. Continental Casualty Co., No. 908363, slip op. (Cal. App. Dep't Super. Ct. Jan. 8, 1992); U.S. Fidelity & Guar. Co. v. Specialty Coatings Co., 535 N.E.2d 1071 (Ill. 1989); Hazen Paper Co. v. U.S. Fidelity & Guar. Co., 555 N.E.2d 576 (Mass. 1990); Polkow v. Citizens Ins. Co. of Am., 447 N.W.2d 853 (Mich. Ct. App. 1989), *rev'd on other grounds*, 476 N.W.2d 382 (Mich. 1991); C.D. Spangler Constr. Co. v. Indus. Crankshaft & Eng'g Co., 388 S.E.2d 557 (N.C. 1990); Cascade Pole Co. v. Reliance Ins. Co., No. 88-2-2316-3, slip op. (Wash. Super. Ct. June 12, 1992); Boeing Co. v. Aetna Casualty & Sur. Co., 784 P.2d 607 (Wash. 1990).

21. 42 U.S.C. § 9604 (a)(1) (1988).

release of hazardous substances into the environment. This response includes performing an RI/FS at a National Priorities List (NPL) site targeted by EPA for clean-up.[22]

Pursuant to CERCLA, the clean-up of environmental contamination at an NPL site is conducted pursuant to the strictures of the National Oil and Hazardous Substances Pollution Contingency Plan (NCP).[23] The NCP is administered by EPA.[24] The NCP implements standards and procedures for responding to the release or threat of release of hazardous substances in the environment.[25] Pursuant to CERCLA, these standards and procedures must comprise at least the following:

> (1) methods for discovering and investigating facilities at which hazardous substances have been disposed of or otherwise come to be located;
> (2) methods for evaluating, including analyses of relative cost, and remedying any releases or threats of releases from facilities which pose substantial danger to the public health or the environment;
> (3) methods and criteria for determining the appropriate extent of removal, remedy, and other measures authorized by this chapter . . . .[26]

The procedures established by the NCP for evaluating and remediating environmental contamination are compulsory in nature.[27] A PRP can be compelled by EPA to undertake all remedial measures consistent with the NCP.[28] This includes performing an RI/FS to determine the extent of pollution and the most cost efficient clean-up alternative.[29]

The enforcement provisions of CERCLA are critical to the analysis of whether costs associated with an RI/FS should be classified as defense or indemnity under a policy of CGL insurance. Waste site PRPs retain investigators and experts to assist in developing a remediation plan that will be acceptable to EPA. In this regard, a private party PRP will only be allowed to perform an RI/FS if EPA determines

> [t]hat the party is qualified to conduct the RI/FS and only if the President [EPA] contracts with or arranges for a qualified person to assist the President [EPA] in overseeing and reviewing the conduct of such RI/FS and if the responsible party agrees to reimburse the

22. *Id.*
23. 40 C.F.R. § 300.1 (1993).
24. 42 U.S.C. § 9605 (1988).
25. Pursuant to 40 C.F.R. § 300.1, "[t]he purpose of the National Oil and Hazardous Substances Pollution Contingency Plan (NCP) is to provide the organizational structure and procedures for preparing for and responding to discharges of oil and releases of hazardous substances, pollutants and contaminants."
26. 42 U.S.C. § 9605(a) (1988).
27. *See generally* 40 C.F.R. §§ 300.400-300.440 (1990).
28. 40 C.F.R. § 300.68(c) (1990).
29. 40 C.F.R. § 300.430(a)(i)-(iii) (1990).

> Fund for any cost incurred by the President [EPA] under, or in connection with, the oversight contract or arrangement.[30]

Unlike the defense of a lawsuit, where a party makes largely tactical decisions in its retention of investigators and expert consultants, CERCLA's criteria for allowing a private party to perform an RI/FS mandate that only those qualified professionals who are acceptable to the government may be retained to assist in the remediation process.[31] This requirement militates in favor of classifying costs associated with performing an RI/FS as indemnification rather than as defense expenditures.

V. Classifying RI/FS Costs Under a CGL Policy

A limited number of cases have addressed the issue of how to classify RI/FS costs under a policy of CGL insurance. The courts which have examined the issue, however, have generally held that such amounts are to be considered indemnification rather than defense costs. In one such case, *Aerojet-General Corp. v. Transport Indemnity Insurance Co.*,[32] at issue was coverage for, *inter alia*, approximately $30 million in site investigation costs incurred by the rocket manufacturer Aerojet-General Corporation.[33] The costs were incurred in connection with the remediation of environmental pollution at a manufacturing facility located near Rancho Cordova, California.[34] Aerojet sought coverage for these investigative costs under various CGL policies issued by the defendant insurers.[35]

In an effort to satisfy government clean-up requirements under CERCLA, Aerojet performed an RI/FS which included the drilling of 1,400 groundwater monitoring wells.[36] An issue arose as to how costs associated with the RI/FS were to be classified under Aerojet's liability policies.[37] Aerojet took the position that the insurers' duty to defend contemplated an obligation to pay costs incurred in connection with performing site investigative procedures.[38] Aerojet claimed its attorneys used information gathered during the RI/FS process to defend private party lawsuits filed by landowners who lived near the contaminated manufacturing facility.[39] Aerojet argued that government mandated RI/FS costs fell under the duty to defend component

30. 42 U.S.C. § 9604(a)(1) (1988).
31. *Id.*
32. No. 262425, slip op. (Cal. App. Dep't Super. Ct. Mar. 30, 1992).
33. *Aerojet Jury Denies Coverage for Investigation Costs*, Mealey's Litig. Rep. (Ins.), Feb. 18, 1992, at 8.
34. *Id.*
35. *Id.*
36. *Id. See also* Transcript of Jan. 24, 1992 at 13,751, *Aerojet* (No. 262425).
37. *Aerojet*, slip op. at 6.
38. Transcript, *supra* note 36, at 13,748.
39. *Aerojet Jury Denies Coverage for Investigations Costs*, *supra* note 33, at 8.

of the defendant insurers' respective CGL policies.[40] Aerojet took the position that the duty to defend entitles the policyholder to a reasonable investigation as part of its defense.[41] Since Aerojet's lawyers allegedly used the information developed during the RI/FS to assist in negotiating and defending Aerojet in litigation, Aerojet claimed costs associated with the investigation were defense costs.[42]

The insurers in the *Aerojet* case prevailed upon the court to instruct the jury that RI/FS costs should be classified as indemnification rather than defense costs.[43] The insurers argued that under CERCLA, site remediation includes a mandatory RI/FS performed by the site PRPs.[44] The RI/FS performed by Aerojet, the insurers claimed, was an integral part of the overall site clean-up for which Aerojet sought indemnification under the insurers' policies.[45] It was thus the insurers' position that the expenses attendant to performing the RI/FS, including negotiating with the government, were not included as part of the duty to defend under the CGL policies.[46]

The court in the *Aerojet* case relied on the California Supreme Court decision in *AIU Insurance Co. v. Superior Court of Santa Clara County*.[47] In the *AIU* case, it was held that the cost of contracting for and implementing site clean-up measures constituted "damages" within the meaning of that term in a CGL policy. The *AIU* court stated,

> [B]ecause the compensable loss is all remedial out-of-pocket expenditures incurred by the agencies, the "compensation" sought . . includes reimbursement for costs of cleaning up existing contamination on and off the disposal site itself, investigating the extent of contamination or the viability of cleanup options and monitoring the spread of waste from the site as long as some "property damage" . . . has already taken place, the agencies' expenses for responding constitute loss or detriment, whether or not the expenses are attributable to actual cleanup, mitigation of damage, or investigation and monitoring. When the agencies seek reimbursement of such expenses from the insured under CERCLA, their claim is for compensation for all their expenses, not merely those resulting from actual cleanup efforts on government property. Any other conclu-

40. Transcript, *supra* note 36, at 13,747.

41. *Id.* at 13,757-58.

42. *Id.*

43. *Id.* at 13,783. *See* Aerojet General Corp. v. Transport Indem. Ins. Co., No. 262,425, Slip Op., (Cal. App. Dep't Super. Ct. Feb. 11, 1992) (order finding Aerojet's site investigation costs are *not* defense costs).

44. Transcript, *supra* note 36, at 13,748.

45. *Id.* at 13,748.

46. *Id.* at 13,747.

47. 799 P.2d 1253 (Cal. 1990) (referred to at Transcript, *supra* note 36, at 13,783). *See also Aerojet Loses Defense Costs Ruling After Coverage Trial Loss*, MEALEY'S LITIG. REP. (INS.), Jan. 28, 1992, at 5 [hereinafter *Aerojet Loses Defense Costs*].

> sion would be illogical as a matter of the reasonable expectations of the insured.[48]

The trial judge in the *Aerojet* case was persuaded by the mandatory nature of the Aerojet's site investigative activity.[49] The court thus instructed the jury that RI/FS costs are to be classified as indemnity rather than defense.[50] One of the instructions read:

> All sums which Aerojet paid (1) because of government orders or requests to investigate, cleanup or remediate, or (2) because of Aerojet's agreement or commitment to perform the investigation, clean up [sic] or remediation are indemnity expenses, and therefore not recoverable as defense costs.
> Investigation costs, such as investigating the extent of contamination or the viability of cleanup options and monitoring the spread of waste from the site, which were incurred as part of Aerojet's effort to cleanup or remediate the site are not considered defense costs.
> If the costs involved here were necessary to or part of Aerojet's effort to cleanup and remediate the site, such costs are not defense costs, even if Aerojet's lawyers used information developed during the investigation to assist them in negotiating with the government to limit Aerojet's obligation to cleanup and remediate.[51]

A case which addressed coverage for fees of expert consultants retained to assist in the defense of a lawsuit filed by state environmental authorities, as well as in the clean-up of the site at issue in the lawsuit, is *New York v. Blank*.[52] In this case, the State of New York brought an action pursuant to CERCLA and various New York State environmental laws against Walter Blank alleging he had been the owner of a pest exterminating company which had contaminated the site with hazardous materials.[53] The State sought, among other things, to compel Blank to take steps necessary to investigate and remediate the site, as well as to reimburse the State for costs incurred in responding to the pollution emanating from the site.[54] Blank filed a third-party action against his insurers seeking coverage for the defense of the main action and for any site clean-up liabilities.[55]

The trial court granted partial summary judgment on a motion filed by Blank in the third-party action against his insurers.[56] The court held that the insurer, Capital Mutual, was obligated to defend Blank in connection with the first-party action filed by the State.[57] The court

48. *AIU*, 799 P.2d at 1270 (citations omitted).
49. *Aerojet Loses Defense Costs*, *supra* note 47, at 5.
50. Phase III Jury Instructions, Jury Instruction No. 4: Site Investigation Costs, *Aerojet* (No. 262425).
51. *Id.*
52. 745 F Supp. 841 (N.D.N.Y. 1990).
53. *Id.* at 842.
54. *Id.* at 847.
55. *Id.* at 843.
56. *Id.*
57 *Id.*

also instructed the parties to attempt to resolve between themselves the amount of fees due as defense costs.[58] When no agreement could be reached, the insurers filed a motion pursuant to Rule 60(b) of the Federal Rules of Civil Procedure to be relieved from the court's judgment. One of the bases for the motion was that certain of the costs sought by Blank were not covered as defense costs.[59]

Among the amounts which Blank sought to recover as defense costs were $159,372.25 in fees charged by a firm of environmental consultants.[60] Blank retained the consulting firm to assist both in the defense of the clean-up action filed by the State of New York and in performing the clean-up itself.[61] The court distinguished these tasks in rendering its award on the insurers' motion.[62] The court held that fees for services performed by the consultants in connection with the defense of the State's lawsuit were recoverable as defense costs.[63] The court noted, however, that much of the work done by the consultants was "aimed at the remediation of the site, as opposed to developing an expert defense."[64] The court thus held that, under the circumstances of the *Blank* case, the expert consultant's fees attributable to the "planning and execution of the site cleanup are more in the nature of indemnification costs and, therefore, are not recoverable, if at all, until after a determination on the merits."[65]

The United States District Court for the Eastern District of Washington addressed the issue of how to classify RI/FS costs in *Spokane County v. American Re-Insurance Co.*[66] In *Spokane*, the insured alleged that its insurers were liable for defense and indemnity with respect to the clean-up of the Colbert Landfill located in Spokane County, Washington. The insured filed a motion for summary judgment seeking, *inter alia*, recovery of an unspecified amount of RI/FS costs. The insured argued that such costs fell within the insurers' duty to defend.[67] The insurers argued that the RI/FS costs should be classified as indemnification rather than defense costs because they were an inextricable part of the overall site clean-up remedy.[68]

In ruling that RI/FS costs were not related to the defense of the insured, the United States District Court in *Spokane* case employed reasoning similar to that used by the California Supreme Court in the *Aerojet-General* case. The District Court looked to the Washington

58. *Id.*
59. *Id.* at 852.
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.*
65. *Id.*
66. No. CS-90-256-WFN, slip op. (E.D. Wash. May 10, 1993).
67. *Id.* at 4.
68. *Id.*

Supreme Court decision in the case of *Boeing Co. v. Aetna Casualty & Surety Co.*,[69] wherein it was held that response costs incurred pursuant to a CERCLA clean-up directive constitute "damages" within the meaning of that term in a CGL policy.[70] The court in *Spokane* reasoned that all costs related to a CERCLA clean-up, whether they concern performance of an RI/FS or implementation of the clean-up remedy, are mandatory.[71] The court distinguished mandatory investigative efforts under CERCLA from an investigation conducted as part of the defense of a lawsuit against the policyholder.[72]

An analogous case decided by a Michigan appellate court is *Gelman Sciences, Inc. v Fireman's Fund Insurance Cos.*[73] At issue in this case was coverage for costs incurred by the policyholder, Gelman Sciences, to remedy contamination caused by its manufacturing operations.[74] Gelman had been notified by Michigan's Washtenaw County Health Department that 1,4 dioxane used by Gelman had contaminated area water supplies.[75] Gelman thereafter incurred substantial costs in connection with mitigating the effects of the groundwater contamination.[76] This included connecting private parties to the city water system, installing sewers, and paying for the assistance of attorneys and expert consultants to assist in the process.[77]

Gelman tendered the claim to Fireman's Fund, seeking coverage for reimbursal of more than $800,000 associated with installing water line hookups for residents and businesses whose water supplies had become contaminated.[78] Gelman also demanded that Fireman's Fund pay $110,000 related to installation of a sewer system.[79] Fireman's Fund denied coverage for the claim. This prompted Gelman to file suit against Fireman's Fund seeking recovery of all amounts incurred in connection with remedying groundwater contamination.[80]

The trial court ordered Gelman and Fireman's Fund each to pay one half of the remediation costs while a final ruling on the classification of the amounts as either defense or indemnity was pending.[81] Fireman's Fund appealed this ruling claiming that the costs associated with the water line hookup and sewer installation were in the form of indemnification rather than defense.[82] Fireman's Fund argued that

69. 784 P.2d 507, 516 (Wash. 1990).
70. *Spokane*, slip op. at 4.
71. *Id.* at 5.
72. *Id.* at 4-5.
73. 455 N.W.2d 328 (Mich. Ct. App. 1990).
74. *Id.* at 328.
75. *Id.* at 329.
76. *Id.* at 329-30.
77. *Id.* at 330.
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*

Gelman characterized such amounts as defense costs in order to exceed the policy's indemnification limit.[83]

In deciding the appropriate classification of the sums incurred by Gelman, the Michigan appeals court relied on the definitions of defense costs and indemnification found in a legal dictionary.[84] The court noted that defense costs are defined to include "monies expended to develop and put forth a theory that the defendant is not liable," while "indemnification costs, being damages, are monies paid to compensate for injury suffered by the plaintiff through the unlawful act or omission or negligence of another."[85] The court reasoned that costs associated with the water hookups and sewer installation were not necessary to defend Gelman in the underlying matter.[86] These costs were more akin to indemnification because they were incurred in an effort to mitigate potential future injury that could have resulted from the contaminated groundwater.[87] The court thus held that the amounts, if covered, were to be classified as indemnification rather than defense costs.[88]

A case from the United States District Court in Michigan that used the reasoning employed in *Gelman Sciences* is *Higgins Industries, Inc. v. Fireman's Fund Insurance Co.*[89] This was a declaratory judgment action wherein the policyholder, Higgins, sought coverage from the defendant insurers for costs associated with a groundwater investigation.[90] A groundwater consultant was retained to perform the investigation after the Michigan Department of Natural Resources (MDNR) detected groundwater contamination at premises located adjacent to the insured's property.[91] Following this discovery, MDNR issued a notice of noncompliance with the wastewater discharge permit under which Higgins had been conducting its business.[92] Higgins asked its insurers to pay the costs associated with responding to the MDNR investigation.[93] The insurers refused to pay the costs on the ground that no duty to defend existed unless and until formal legal proceedings involving Higgins were filed.[94]

The court granted Higgins' motion for summary judgment on the duty to defend.[95] The court held that the insurer's duty to defend arose upon the "actual or threatened use of legal process to coerce

83. *Id.*
84. *Id.*
85. *Id.* (quoting BLACK'S LAW DICTIONARY 351-52 (5th Ed. 1979)).
86. *Id.*
87. *Id.*
88. *Id.*
89. 730 F Supp. 774 (E.D. Mich. 1989).
90. *Id.* at 774.
91. *Id.* at 775.
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.* at 778.

payment" on environmental clean-up by the policyholder.[96] The court ordered the parties to identify the costs associated with the defense of the MDNR clean-up matter.[97] The parties agreed that fees incurred prior to July 1, 1987, when the consultant's report identified Higgins as the source of groundwater contamination, would be classified as defense costs.[98] However, the parties could not agree on how to classify approximately $800,000 of the consultant's fees incurred after July 1, 1987.[99] The policyholder argued that the fees were defense costs. The insurers said the fees were incurred as part of the overall site remediation.[100] The court noted that "[t]he hazy line between what costs may be attributed to the defense of a claim and what costs are attributable to indemnification form[ed] the basis of the dispute."[101]

The matter was submitted to a federal magistrate for resolution. After an evidentiary hearing, the court divided the disputed fees into defense and indemnification based on the nature of the consultant's work:

> I am convinced that the consultative work performed after July 1, 1987 must be characterized as falling into the indemnification category and that these costs are not now reimbursable to Higgins. Up through July 1, 1987, the date of the initial report, the investigation and its attendant costs were focused on determining what substances were in the soil and groundwater, how far it had travelled, and most significantly, where it had originated. This work was therefore designed to assist Higgins in determining whether or not it was liable for the cleanup as claimed by the MDNR. As the focus of this portion of the investigation was the issue of liability, the portion of the work clearly fell within the definition of defense costs . . .[102]

Two principal factors appear to have influenced the court's decision to classify some of the consultant's fees as defense costs in the *Higgins* case.[103] First, the court's analysis was partially shaped by the agreement between Higgins and the insurers to classify as defense costs consultant's fees incurred prior to July 1, 1987.[104] The second factor was that the fees incurred prior to July 1, 1987 were not associated with a mandatory undertaking such as an RI/FS. According to the opinion, the pre-July 1, 1987 fees primarily concerned Higgins' attempt to determine whether or not it was the cause of groundwater

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96. *Id.*
97 *Id.* at 779.
98. No. 87-CV-10406, slip op. at 3 (E.D. Mich. Oct. 23, 1990), *reprinted in* MEALEY'S LITIG. REP. (INS.), Nov. 20, 1990, at B1.
99. *Id.* at 4.
100. *Id.*
101. *Id.* at 5.
102. *Id.* at 11.
103. *Id.* at 11-12.
104. *Id.* at 3.

contamination and, therefore, whether it was liable for the clean-up.[105] This is what distinguishes *Higgins* from the other cases which have addressed the classification issue.

Had the pre-July 1, 1987, consultative work in *Higgins* been a compulsory component of a statutorily scripted site clean-up, it is questionable whether the parties or the court would have divided the fees into defense and indemnity.[106] It was only when Higgins had been identified as the contaminant source that attention turned to planning for and implementing the clean-up.[107] The circumstances underlying *Higgins* thus can be contrasted from an RI/FS performed under CERCLA. Investigative efforts that are part of an RI/FS are an inseparable part of the site remediation process.[108] Had all investigative work in *Higgins* been part of a specific statutory clean-up plan, the better reasoned approach would have been to classify attendant costs as indemnity rather than defense.

The few environmental coverage cases which have addressed the issue of how to classify RI/FS costs under a CGL policy have sensibly distinguished between the mandatory nature of the RI/FS process and the more permissive or tactical decisions governing the retention of experts in connection with the defense of a lawsuit. As outlined below, cases addressing the nature of a PRP's liability for clean-up costs under CERCLA provide further justification for classifying RI/FS expenses under an insurance policy as indemnification rather than defense costs.

VI. Authority From Outside the Coverage Arena

Guidance on the issue of how to classify RI/FS costs can be found in cases that do not involve insurance coverage issues. For instance, in *Wickland Oil Terminals v Asarco, Inc.*,[109] the purchaser of contami-

105. *Id.* at 11.

106. The decision is unclear as to whether Higgins' investigation into the identity of the party responsible for groundwater contamination was a compulsory component of the overall clean-up. No environmental statute is cited in the opinion, although it is revealed that the MDNR inspected the site and informed Higgins of the results and Higgins "employed Keck Consulting Services to investigate and test the groundwater." *Id.* at 2.

107. *Id.* at 8, 11.

108. The scope of an RI/FS is defined in the NCP as follows:

> *Remedial investigation/feasibility study.* The purpose of the remedial investigation/feasibility study (RI/FS) is to assess site conditions and evaluate alternatives to the extent necessary to select a remedy. Developing and conducting an RI/FS generally includes the following activities: project scoping, data collection, risk assessment, treatability studies, and analysis of alternatives. The scope and timing of these activities should be tailored to the nature and complexity of the problem and the response alternatives being considered.

40 C.F.R. § 300.430(a)(2) (1993).

109. 792 F.2d 887 (9th Cir. 1986).

nated property, Wickland, filed an action for damages and declaratory judgment against Asarco, the prior owner of the site.[110] At issue were costs incurred by Wickland to remediate contamination caused by Asarco's use of the site for smelting operations.[111] The California Department of Health Services (CDHS) identified environmentally-hazardous slag deposits at the site (up to one million metric tons above the surface and an unknown amount below) as the source of groundwater contamination.[112] The CDHS directed Wickland as owner of the site to undertake an appropriate clean-up.[113]

In response to the CDHS directive, Wickland performed certain tests designed to evaluate the ongoing threat to the environment posed by the slag deposits.[114] This activity was conducted under the guidance and direction of the CDHS and cost Wickland approximately $150,000.[115] Pursuant to CERCLA section 107(a),[116] Wickland sued Asarco to recoup these costs, and for a judicial declaration that Asarco was solely liable under CERCLA for any additional costs that would be required to remediate the site.[117] The United States District Court for the Northern District of California dismissed Wickland's complaint for failure to state a claim under CERCLA.[118] One of the bases for the dismissal was that the investigative costs were not recoverable pursuant to CERCLA because they were not "response" costs as defined in the statute.[119] Wickland appealed the trial court's dismissal of the complaint.

On appeal, the United States Court of Appeals for the Ninth Circuit reversed the lower court's dismissal of Wickland's claims against Asarco and remanded the case.[120] The Court of Appeals held that there is no difference between investigative costs and actual clean-up costs for purposes of recovery under CERCLA.[121] The court noted that CERCLA allows recovery of response costs incurred in connection with "such actions as may be necessary to monitor, assess, and evaluate the release or threat of release of hazardous substances."[122] The court thus concluded that the costs associated with Wickland's

110. *Id.* at 889.
111. *Id.*
112. *Id.*
113. *Id.* at 889.
114. *Id.*
115. *Id.*
116. 42 U.S.C. § 9607(a) (1988).
117 *Wickland Oil Terminals*, 792 F.2d at 889.
118. Wickland Oil Terminals v. Asarco, Inc., 590 F Supp. 72, 78 (N.D. Cal. 1984).
119. *Id.* at 76-78.
120. *Wickland Oil Terminals*, 792 F.2d at 888.
121. *Id.* at 892.
122. *Id.* (quoting 42 U.S.C. § 9601(23) (1988)).

investigation of site contamination were recoverable from Asarco because they were mandatory under CERCLA.[123]

Conclusion

The integral role of an RI/FS in a waste facility clean-up pursuant to CERCLA, or similar compulsory activities under state statutes, militates heavily in favor of classifying related costs as indemnification rather than defense under a policy of CGL insurance. This is an especially important consideration in cases where defense costs do not serve to deplete the policy limits. To define RI/FS costs as part of the duty to defend in such instances could result in insurers being exposed to exponentially more coverage liability than they bargained for when issuing their policies.

123. *Id.* at 892. *See also* Ascon Properties, Inc. v. Mobil Oil Co., 866 F.2d 1149, 1153 (9th Cir. 1989) (" 'response costs' under CERCLA can include the costs of investigation or testing for the presence of hazardous wastes"); Artesian Water Co. v. New Castle County, 851 F.2d 643, 651 (3d Cir. 1988) (costs of monitoring and evaluating aquifer to ensure that neighboring landfill did not contaminate water supply were recoverable under CERCLA); Tanglewood East Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568, 1575 (5th Cir. 1988) (investigatory costs are included within response costs recoverable under CERCLA); New York v. Shore Realty Corp., 759 F.2d 1032, 1042-43 (2d Cir. 1985) (state's costs in assessing the conditions of the site fall squarely within CERCLA's definition of response costs); Gache v. Town of Harrison, 813 F Supp. 1037, 1046 (S.D.N.Y. 1993) (preliminary investigatory and monitoring costs are recoverable under CERCLA regardless of the recoverability of other response costs).